



Chorus Full Year Result, FY14

For 12 months ending 30 June 2014



25 August 2014, Wellington

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Mark Ratcliffe

Chorus CEO



Agenda

Mark Ratcliffe, CEO

- > Business performance overview
- > Connections trends
- > UFB and RBI programmes

Andrew Carroll, CFO

- > Financial results
- > Capex, CPPP and CPPC
- > Guidance update

Reshaping Chorus – Mark Ratcliffe, CEO

- > Workstreams
- > Regulatory processes
- > Q and A

Solid financial performance

- > Net Profit After Tax of \$148 million
- > EBITDA of \$649 million
- > Revenue of \$1,058 million
- > Total fixed line connections largely stable at 1,781,000
- > UFB and RBI rollouts ahead of schedule; 425,000 end-users within reach of better broadband
- > NZ 15th in OECD for fixed broadband penetration, ahead of USA and Japan
- > Structural separation continues with delivery of significant IT projects
- > Aon Hewitt best employer for 3rd year running

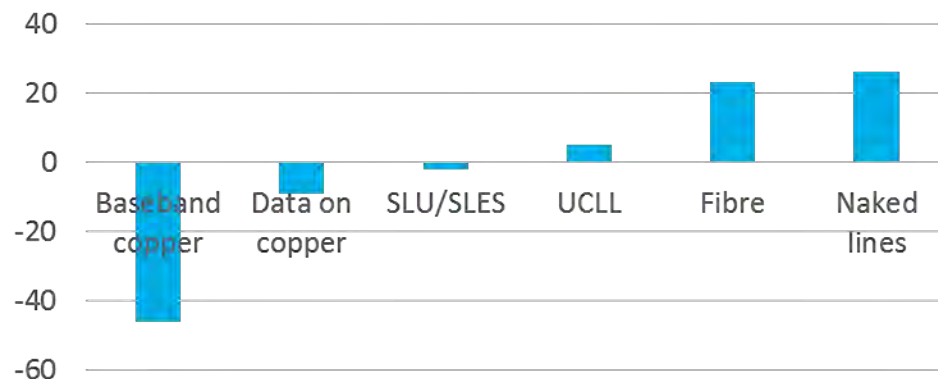
Fixed line connections

Fixed line connections	30 June 2014	30 June 2013
Baseband copper	1,475,000	1,521,000
UCLL	127,000	122,000
SLU/SLES	4,000	6,000
Naked Basic/Enhanced UBA and Naked VDSL	117,000	91,000
Data services over copper	16,000	25,000
Fibre	42,000	19,000
Total fixed line connections	1,781,000	1,784,000

> Total connections decreased by 3,000 lines

- **naked lines** now account for ~7% of connections and **fibre** ~2%
- baseband copper shift to fibre and naked lines continues
- **baseband demand 'inflated'** where fibre lines still need copper voice
- some RSP clean-up of legacy lines
- UCLL/SLU ~7% of connections

Change in connections

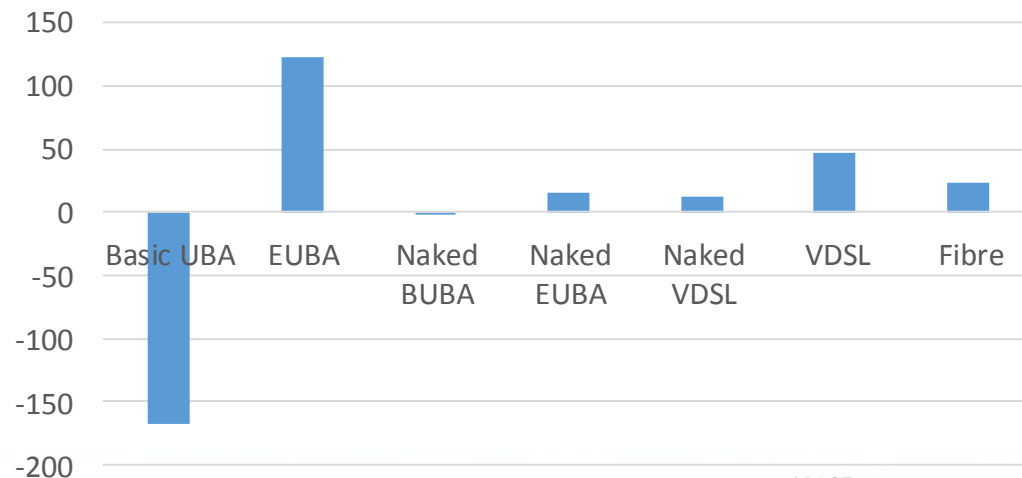


Continuing broadband growth

Broadband connections	30 June 2014	30 June 2013
Basic UBA	164,000	331,000
Naked Basic UBA	9,000	11,000
Enhanced UBA	802,000	680,000
Naked Enhanced UBA	93,000	78,000
VDSL	49,000	2,000
Naked VDSL	15,000	2,000
Fibre (Bitstream 2, 3 and fibre subdivisions)	31,000	8,000
Total broadband connections	1,163,000	1,112,000

- > 51,000 broadband connections added
 - high speed services (VDSL and fibre) increased from ~1% to ~8% of broadband connections

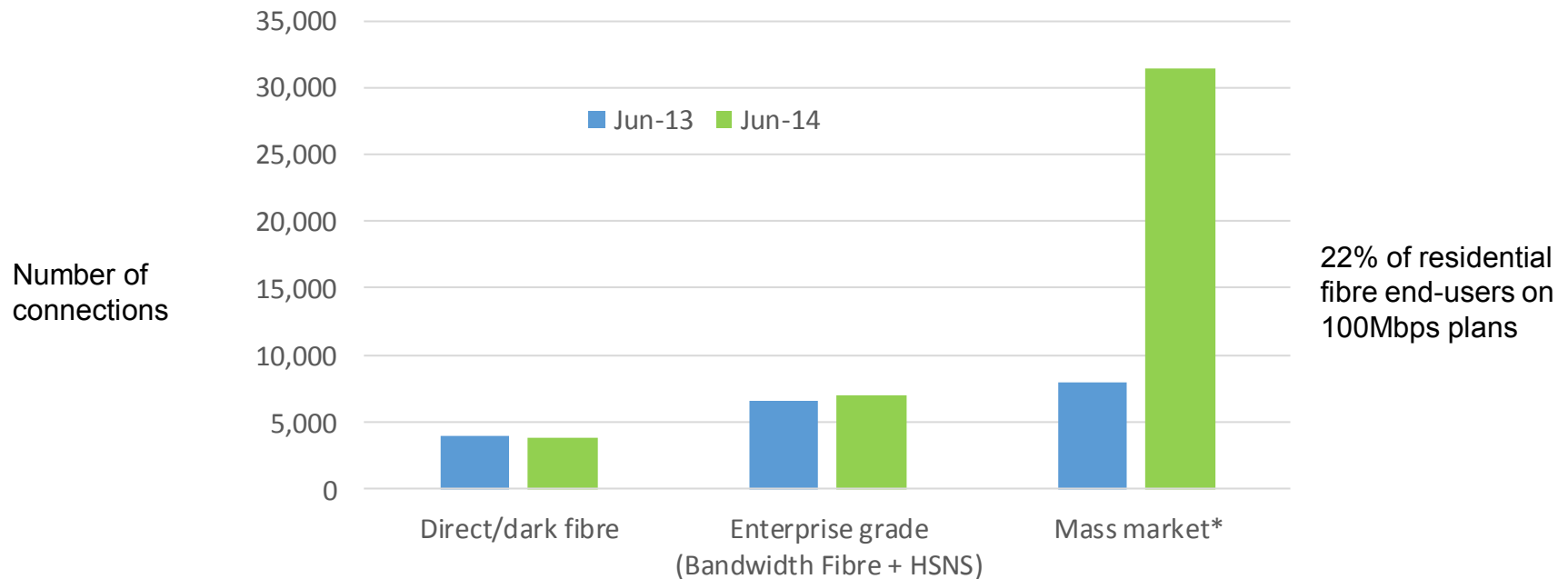
Change in broadband connections



Fibre connection types

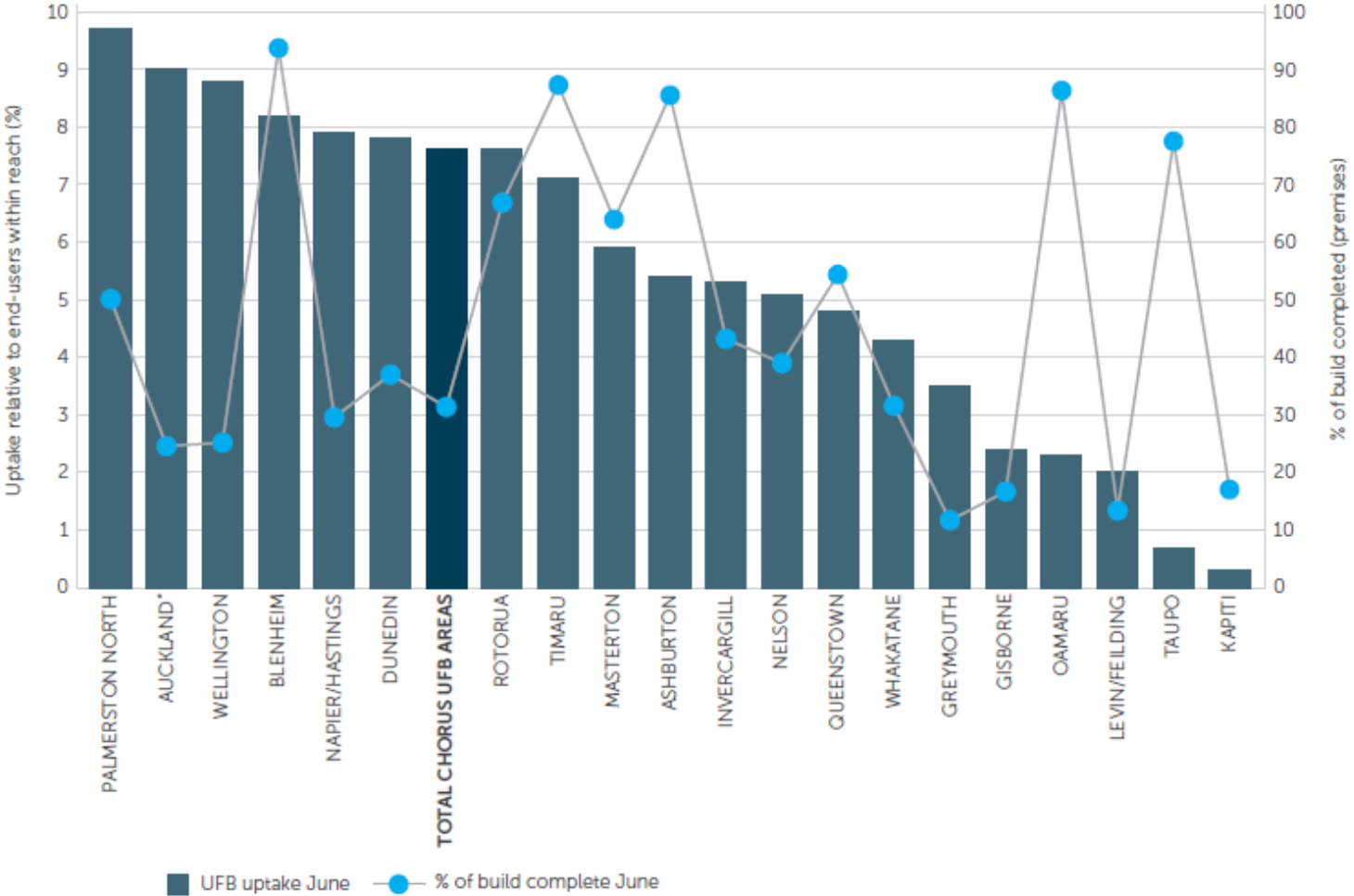
- > 27,000 fibre connections within UFB deployed footprint
- > 42,000 fibre connections nationwide

Fibre uptake by category



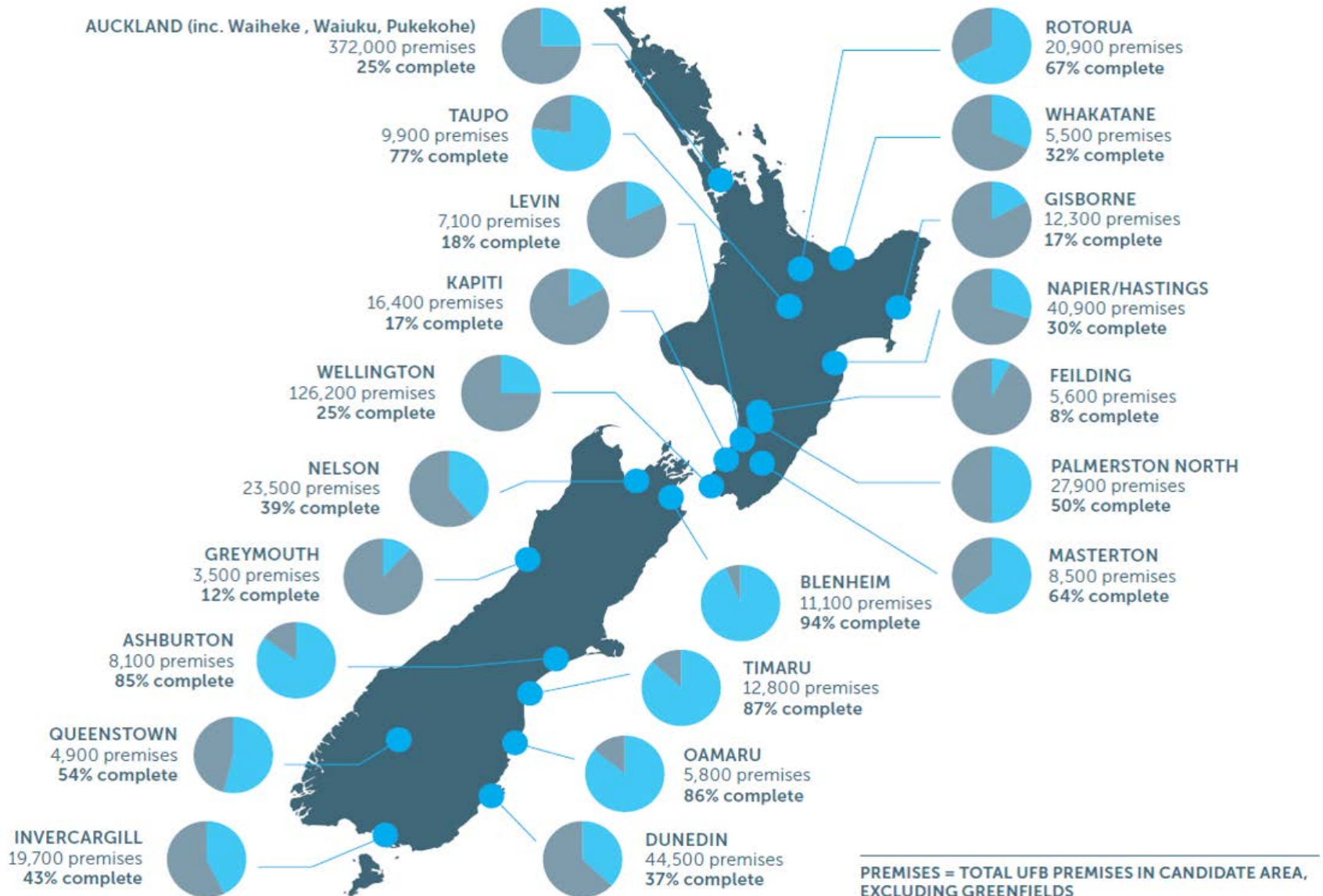
* Includes UFB Bitstream 2 and 3 and education connections and non-UFB greenfields end-users

UFB uptake varies widely



* Includes Auckland North, Auckland South, Pukekohe, Waiuku & Waiheke Island.

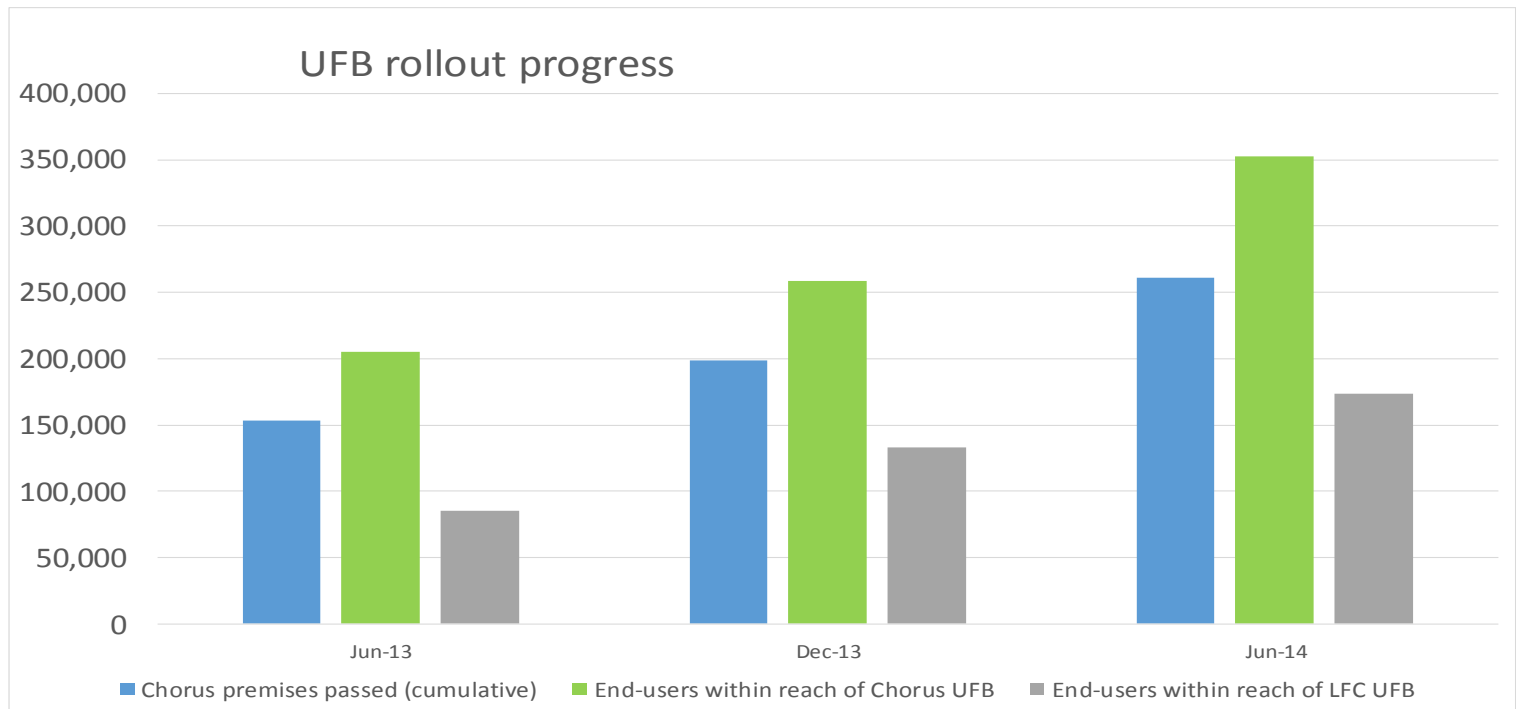
UFB rollout progress by area



UFB build ahead of schedule

- > UFB rollout **31%** complete
 - **353,000** end users now within reach of Chorus UFB
 - Build complete for **261,000 premises**; includes **57,000** (73%) priority premises
 - FY15 target: 106,000 premises to be completed

Premises passed / end-users within reach



Rural Broadband rollout

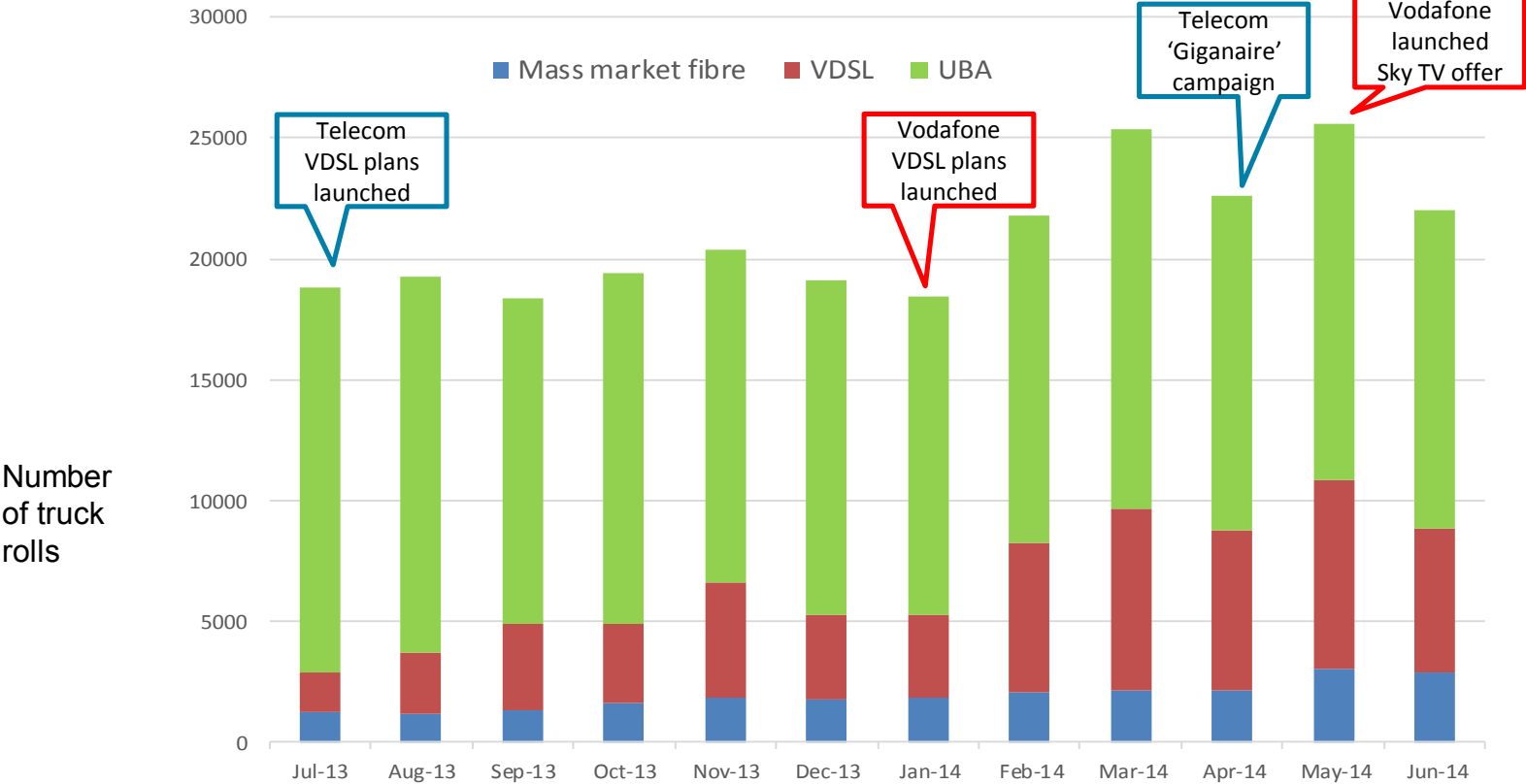
- > About 3,100 km fibre laid; 951 schools complete
- > 72,100 lines within reach of better broadband; 80% uptake

	Complete			% complete	To be completed	
	FY12	FY13	FY14		FY15	FY16
Schools	473	306	172	94	64	-
Hospitals	4	17	9	100	-	-
Fibre to RBI tower sites	13	40	37	58	51	13
FTTN cabinets	192	320	289	66	236	178
Fixed lines served	20,400	30,800	20,900	70	19,800	11,200
Total \$m	\$59m	\$106m	\$53m			

Broadband provisioning mix

- > High speed plans (VDSL + mass market fibre) up from 15% to 40% of provisioning activity during FY14

Broadband provisioning by type (where truck roll required)





Andrew Carroll

Chorus CFO



Income statement

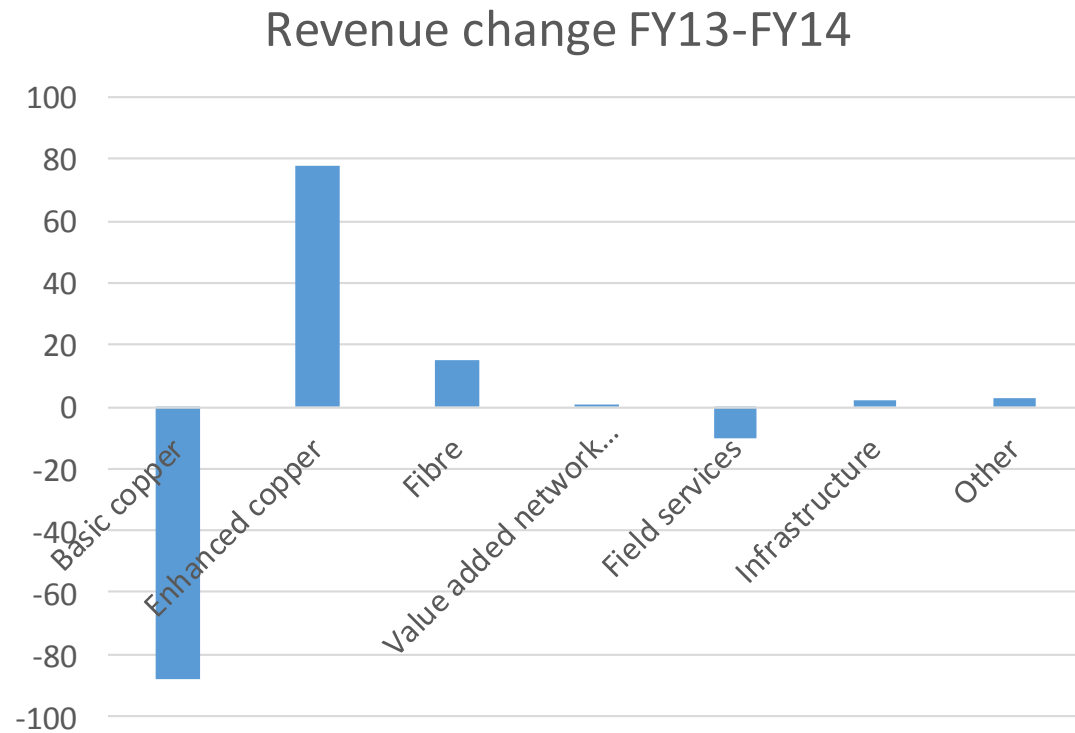
	FY14 \$m	FY13 \$m
Operating revenue	1,058	1,057
Operating expenses	(409)	(394)
Earnings before interest, tax, depreciation and amortisation (EBITDA)	649	663
Depreciation and amortisation	(322)	(319)
Earnings before interest and income tax	327	344
Net interest expense	(121)	(108)
Net earnings before income tax	206	236
Income tax expense	(58)	(65)
Net earnings for the year	148	171

- > Non-statutory measure: **FY14 underlying EBITDA \$656m***
 - +\$9m UCLFS connection charge backdating
 - -\$2m insurance proceeds

* See *Appendix Two* in Management Commentary for further detail

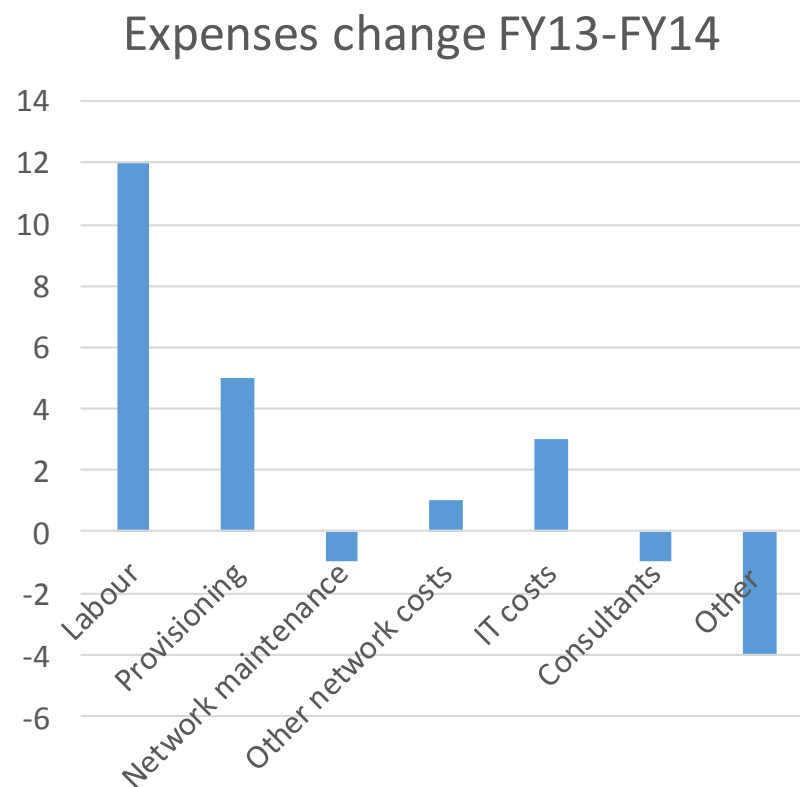
Revenue

	FY14 \$m	FY13 \$m
Basic copper	543	631
Enhanced copper	293	215
Fibre	75	60
Value Added Network Services	38	37
Field Services	75	85
Infrastructure	19	17
Other	15	12
Total revenue	1,058	1,057



Operating expenses

	FY14 \$m	FY13 \$m
Labour costs	79	67
Provisioning	56	51
Network maintenance	99	100
Other network costs	38	37
IT costs	55	52
Electricity	13	13
Rents, rates and property maintenance	24	24
Consultants	5	6
Insurance	4	4
Other	36	40
Total operating expenses	409	394



FY14 gross capex summary

- > Total FY14 capex of **\$679m**
- > Fibre-related spend \$566m (83% of total capex)

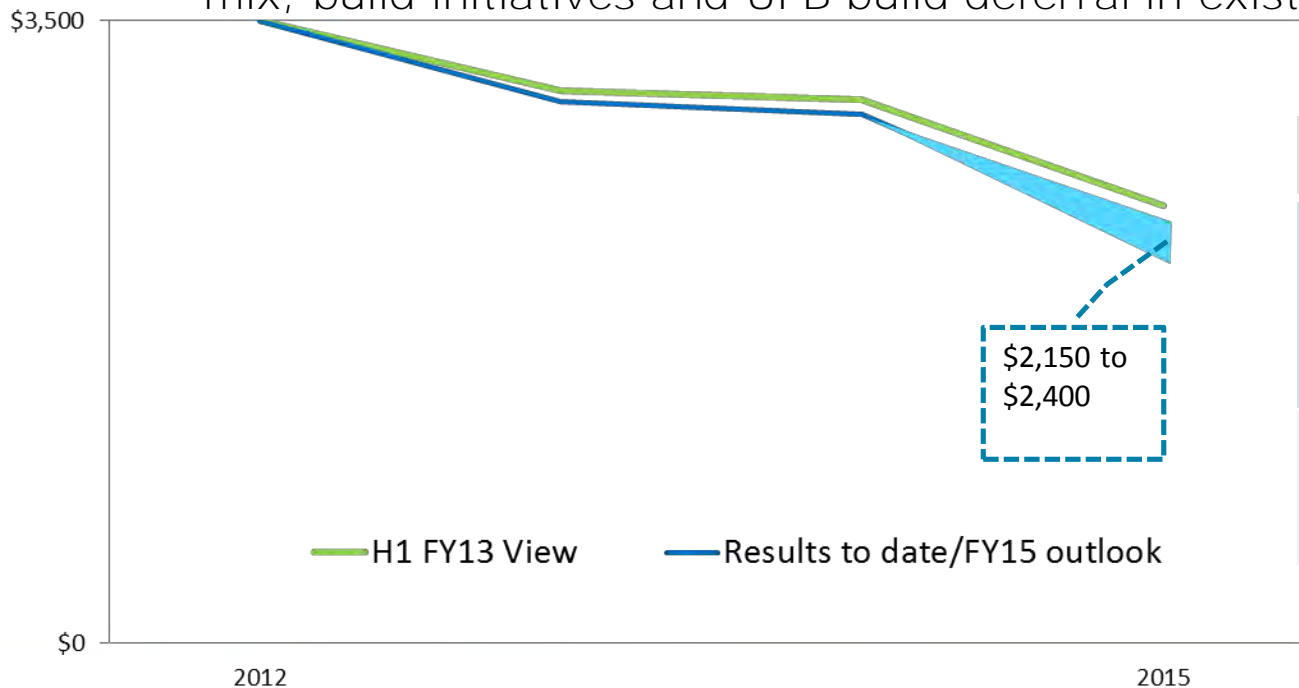
Fibre capex	FY14 \$m	FY13 \$m
UFB communal	338	362
UFB connections & fibre layer 2	74	31
Fibre products & systems	38	27
Other fibre connections & growth	63	53
RBI	53	106
Total	566	579

Copper capex	FY14 \$m	FY13 \$m
Network sustain	35	33
Copper connections	15	21
Copper layer 2	10	8
Product	1	7
Total	61	69

Common capex	FY14 \$m	FY13 \$m
Information technology	35	16
Building & engineering services	12	16
Other	5	1
Total	52	33

Cost per premises passed: tracking well

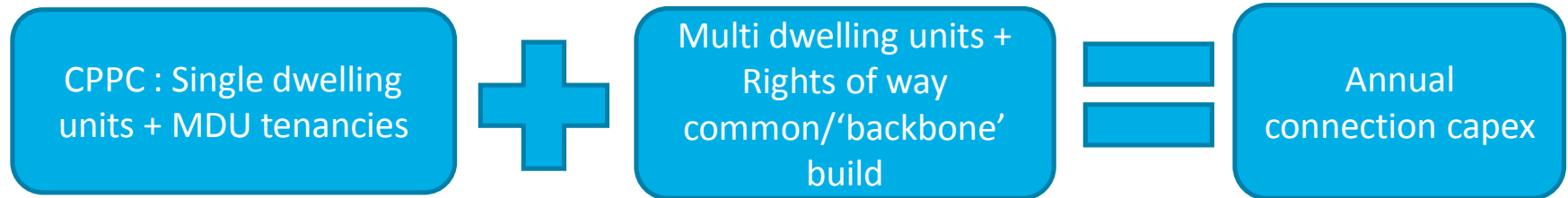
- > FY14 UFB communal spend of \$338m included:
 - \$42m work in progress (FY13: \$30m)
 - \$4m 'synergy' build ahead of planned rollout
- > **FY14 CPPP:** achieved lower end of guidance range (\$2,900 to \$3,200) with \$2,973 for brownfields premises and **\$2,948 'blended' CPPP**
- > **FY15 CPPP guidance: \$2,150 to \$2,400** reflects change in build mix, build initiatives and UFB build deferral in existing fibred zones



FY12	CPPP: \$3,567
FY13	CPPP: \$3,048 for UFB 'new build' premises Blended CPPP: \$2,935 when include existing Broadband Over Fibre premises and greenfields premises.
FY14	CPPP: \$2,973 for brownfields premises Blended CPPP: \$2,948 when include greenfields premises.

UFB connection capex

- > **Total programme view** at demerger in 2011: \$900 to \$1,100 real (circa \$1,000 to \$1,200 in FY14 dollars) average cost to connect **standard** residential premises. **No change.**
- > **In any one year, UFB connection capex** reflects cost per premises connected (CPPC) **plus** upfront common build required for MDUs and RoWs.
- > 2% of potential end-users now connected (27,000), growing in materiality while emerging backbone build impacting capex timing.



- Average standard CPPC reflects lead-in type (trenched, ducted, aerial, internal)
- Cost of non-standard lead-in additional and ~14% of mix to date
- Average standard CPPC trending to programme view as volumes build

- Reflects non-standard capex and/or brought forward standard capex to be averaged across future connections in same MDU/RoW
- Contributions for non-standard backbone from NSI fund, RSP or building owner

FY14 UFB connection capex

- > 21,000 end-users added in FY14
- > FY13 connection capex almost exclusively single dwelling units (SDUs)
- > **FY14 included 'backbone' spend on multi dwelling units (MDUs) + rights of ways (RoWs)**
- > **'backbone' capex in MDUs and RoWs = 28% of FY14 spend**

FY14: UFB connections & layer 2 capex	\$74m
Layer 2 (long run programme average of \$100 per connection)	\$9m
Schools wiring (Crown funded)	\$4m
Connections: single dwelling units, apartments	\$40m*
Backbone build: multi-dwelling units (1,600) and rights of ways (1,600)	\$21m*

*Non-standard install fund allocation for FY14 to be determined with CFH. Chorus has contributed \$28m to fund. \$100k used as of March 2013.

CPPC: SDUs and apartments

- > FY14: **\$1,680** average for standard connections (mix of existing/new duct and aerial) paid during year, excluding layer 2

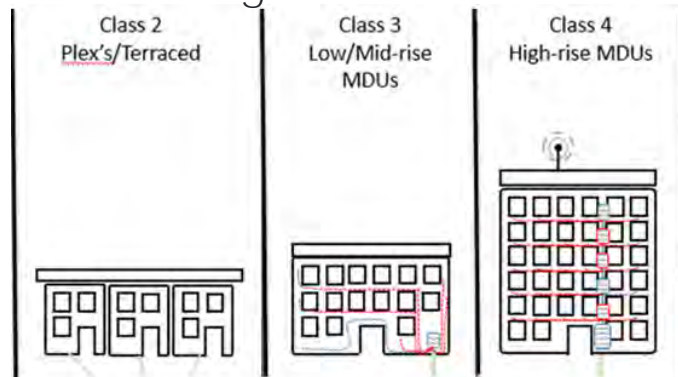
	% of installs: Standard	% of installs: Non-standard
Lead-in	86%	14%
Average cost	\$1,680 (includes all non-standard in-home wiring and excludes Layer 2)	\$620 (incremental cost of external lead-in)

- > FY15 focus on refining CPPC production line
 - coded rates in place with service companies
 - 3-stage install process (A-B-C) implemented
 - 'fit for purpose' install practices
 - Porirua trial supports longer term CPPC objective

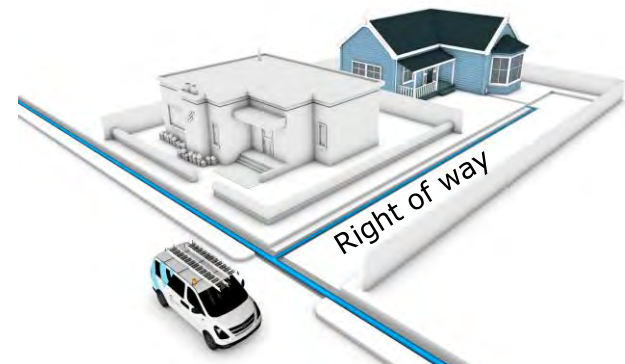


Connection capex: MDUs and RoWs

- > FY14: **\$6,500** average for MDU/RoW **'backbone'** + **street entry**
 - **'backbone'** or **common build** reflects **non-standard capex** and/or brought forward standard capex to be averaged across future connections
 - costs highly variable depending on MDU and RoW type
 - specialist MDU provider, UCG, for Auckland and Wellington
 - consent requirements driving time and cost
 - building owner contribution process implemented



- > MDU connection funding varies depending on height of building and number of tenancies
- > general principle that Chorus funds up to \$1,000 per end-user from the entry point to the apartment



- > general principle that RoW end-users **receive 'free' 15m connection** from Chorus

FY15 UFB connection capex

- > FY15 **CPPC guidance: \$1,300 to \$1,500** (excluding layer 2)
- > **Materially more 'backbone' capex** relative to prior years as MDU and RoW build progresses
- > Current estimate is FY15 **'UFB connections & layer 2' capex \$105m - \$115m** based on:
 - ~36,000 connections
 - corresponding uplift in layer 2 capex
 - ~5,000 backbone build (MDUs and RoWs)
 - FY15 backbone build mix anticipated to be more expensive than FY14
- > Demand forecasting is challenging
 - difficult to forecast annual volumes and mix
 - completed 2,900 mass market fibre installs in June 14 vs 1,300 in July 13
 - influenced by RSP initiatives and pre-existing demand in newly built UFB areas



FY15 EBITDA and capex guidance

	FY15 guidance \$m	FY14 actuals \$m
EBITDA	590-605	649
Copper capex	55 – 85	61
Common capex	45 – 50	52
Fibre capex	490 – 510	566
Gross capex	590 – 640	679

Note: The individual ranges presented above are not necessarily additive

- > FY15 EBITDA guidance reflects \$34.44 UBA pricing and installation charges that apply from 1 December, UCLFS pricing changes implemented in FY14, and Chorus UBA initiatives outlined at H1 FY14 results, including proposed **Boost** products
- > Copper capex range provides for incremental investment for proposed Boost products
- > Fibre capex reflects earlier assumptions around CPPP and CPPC, UFB uptake and connection mix and additional 'growth fibre' connection capex in CBD areas

Net Debt / EBITDA

- > Average indebtedness increased through FY14 but closing leverage ratio reduced, reflecting timing of customer payments FY14 vs FY13
 - Note: underlying EBITDA is used for covenant reporting

	As at 30 June 2014 \$m
Borrowings	1,817
+ PV of CFH debt securities (senior)	36
+ Net Finance leases	<u>123</u>
Sub total	1,976
- Cash	(176)
Total net debt	1,800
Net debt/EBITDA	2.7 times

Note: Standard & Poor's treatment includes Operating leases

Capital management

- > In February, Chorus noted its broader capital management objectives were to:
 - maintain an investment grade rating with headroom. In the longer **term, the Board continues to consider a “BBB” rating appropriate** for a business like Chorus; and
 - setting a financially sustainable dividend policy once sufficient certainty is achieved around the outcome of Chorus initiatives, CFH discussions, and regulatory reviews.
- > Consistent with this, as part of the 25 July bank agreements Chorus has agreed that no dividends will be paid until the later of the conclusion of the FPP review processes or 30 June 2015, so Chorus will not pay a final FY14 dividend.
- > If Chorus uses the option to bring forward part of CFH’s existing investment funding, Chorus would be unable to pay a dividend before December 2019 without CFH approval, unless Chorus normalises the CFH funding profile.



Reshaping Chorus



Addressing the funding gap*

CFH discussions

Chorus initiatives

Regulatory

*Funding gap refers to the \$1 billion funding shortfall identified by Chorus following the UBA decision of 5 November 2013, as confirmed by the EY report of 14 December 2013

CFH discussions

UFB improvements

- First package of contractual amendments agreed 11 March 2014, providing Chorus with greater deployment flexibility and better matching of CFH funding to Chorus cost of build until June 2015.
- Changes to Chorus' marketing commitments and charging regime for UFB subdivisions, offset in part by an additional contribution to the non-standard installation fund of \$8m.

'backstop' facility

- 'Backstop' facility agreed with CFH 18 July 2014, provides option of bringing forward the present value of CFH funding of up to \$178 million budgeted to be spent on Chorus' UFB programme in FY18 and FY19.

Chorus initiatives

Revenues

- Changed pricing for a range of commercial activities.
- Boost product proposals launched for consultation to RSPs 14 May. Discussions ongoing. Commission investigation into regulated UBA opened on 22 July.

Operating model

- Reduction in support staff; FY15 short term incentives reduced.
- Discretionary capex tightly managed.
- Reduced proactive maintenance.
- Service company review under way.

Capital management

- Interest rate swaps reset to realise \$30m cash.
- Dividend guidance withdrawn November 13 and no interim dividend paid. Capital management update to market 25 February indicating no dividend policy until financially sustainable and sufficient certainty.
- Agreed amendments to committed bank facilities 25 July, confirming no dividend until earlier of FPP or 31 July 2015.

Regulatory

Court process

- Seeking clarification of application of Telco Act. Appeal dismissed in High Court.
- Court of Appeal decision pending.

FPP reviews

- UCLL review requested February 2013; UBA review requested December 2013.
- Commission's preliminary modelling views on a number of parameters received 9 July.
- WACC submissions (FPP and input methodologies) ongoing.
- Draft decisions for UCLL and UBA due 1 December. Final decisions due April 2015.

Boost/UBA review

- Parallel Commission investigation/clarification of regulated UBA and Chorus' proposed *Boost* products. Decision timings unclear.

2013 TSO review and wider regulatory review

- Timings unclear.
- General election 20 September 2014.



Chorus' network reality

End-users value functionality

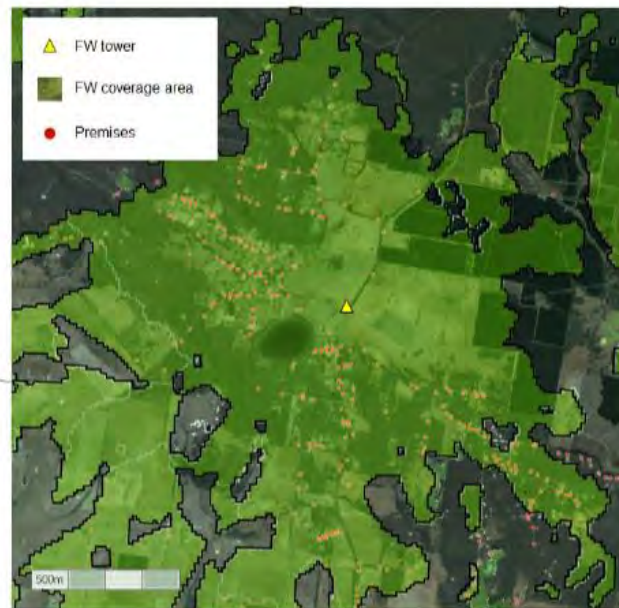
- > modelling should cost-in services end-users use and expect on the existing network
 - e.g. burglar alarms, medical alarms, Sky TV, eftpos



Fixed wireless limitations

- > Fixed wireless can't be unbundled. Australia modelled just 1% for TSLRIC
 - NBN target ~3%, but with satellite as backstop
- > Capacity and coverage challenges
 - Kordia 20% failure rate; NBN modelling 7%
 - NBN review suggests ~\$1.1bn extra capex to double base stations

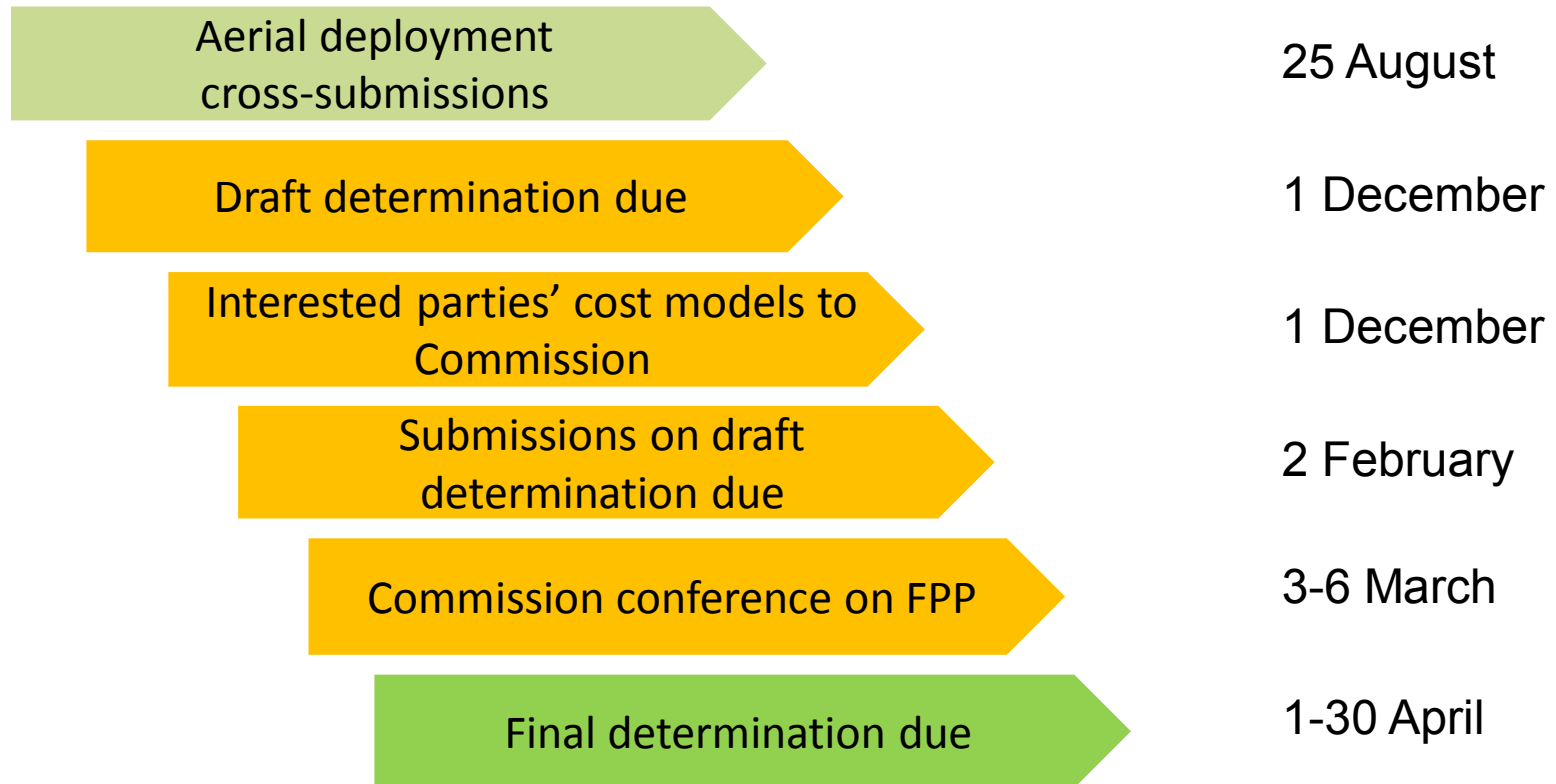
Exhibit 2-2: Example fixed wireless coverage area



Due to line of sight requirements and local topography, range of NBN Co fixed wireless towers is often as little as 2-3km, even though theoretical range can extend to 14km

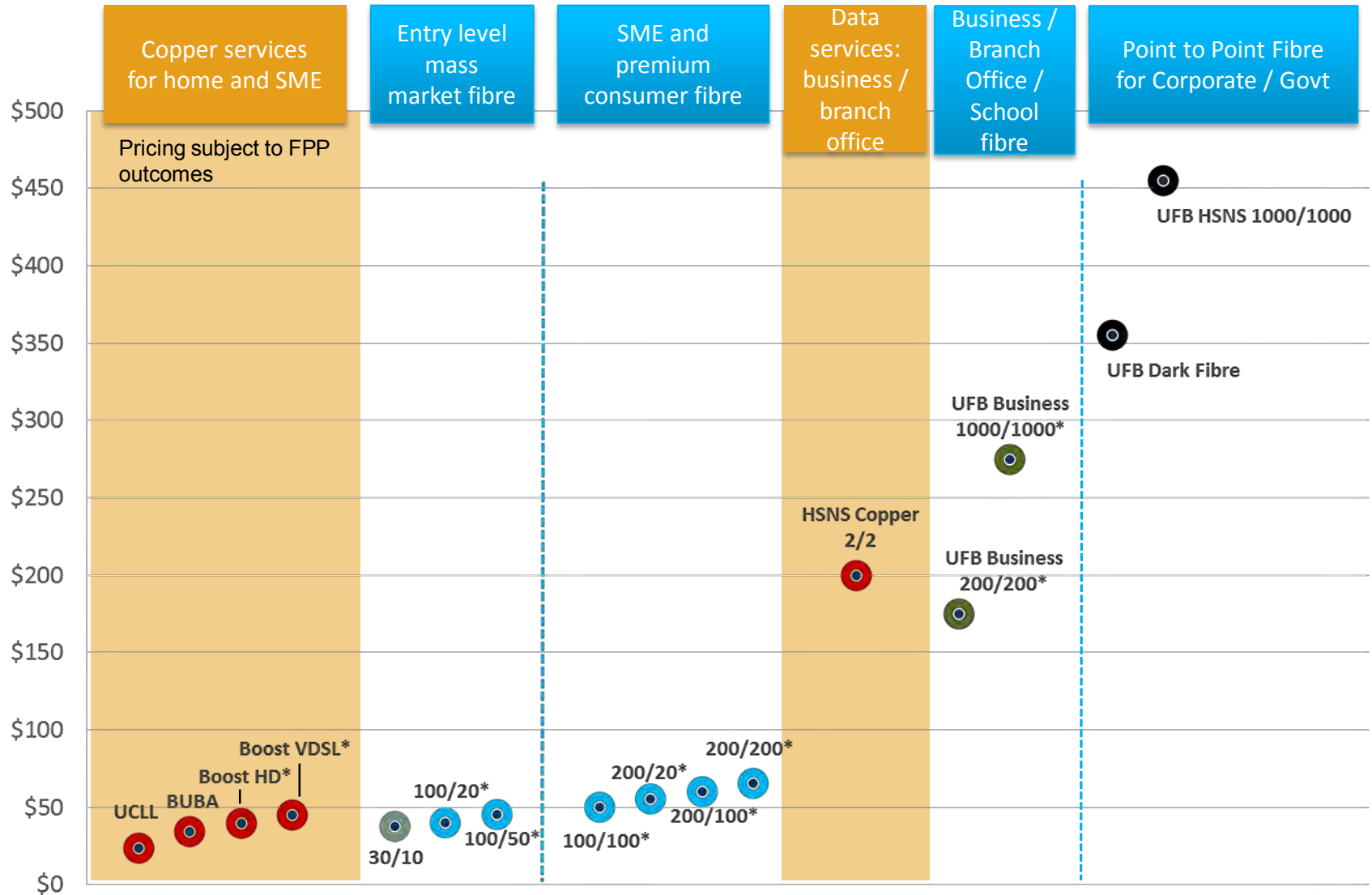
On average, actual geographic coverage for any individual NBN Co tower is ~20 percent of the area defined by a 14km radius

Final pricing principle calendar



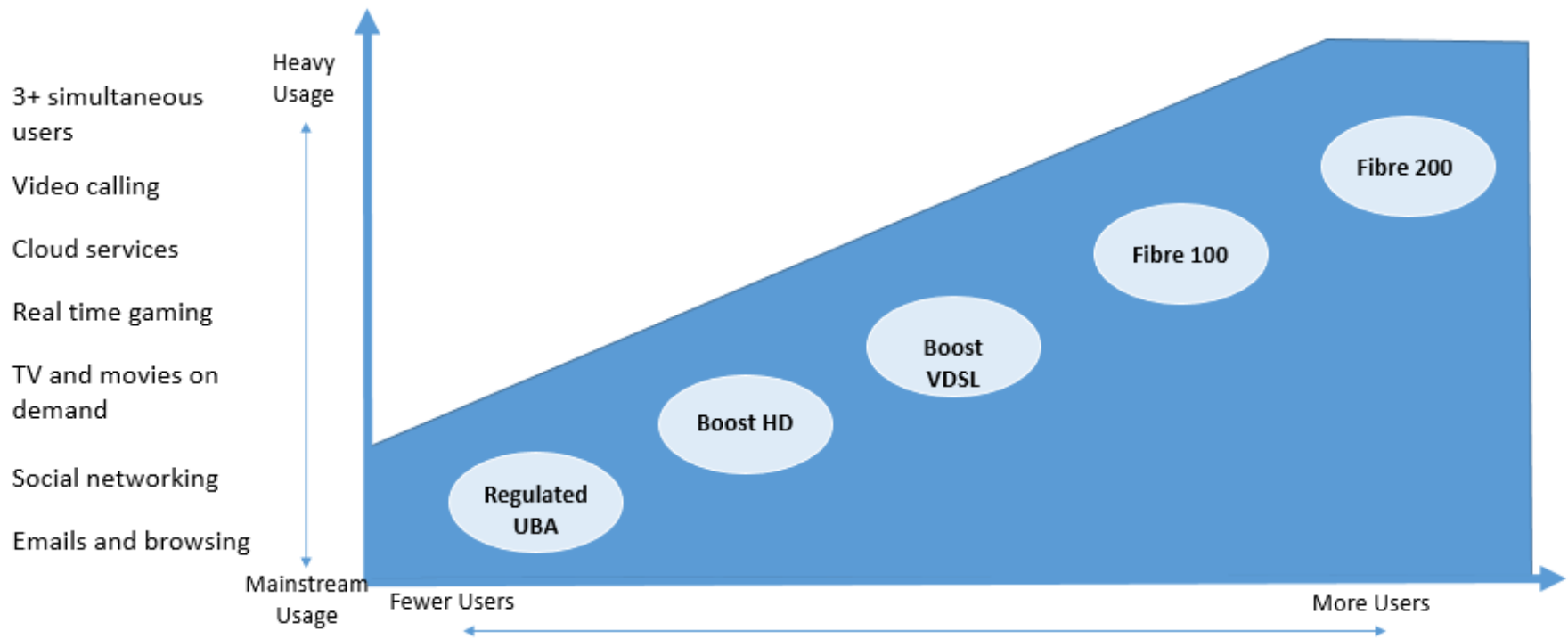
Innovation focus

Chorus wholesale product overview – from 1 December 2014

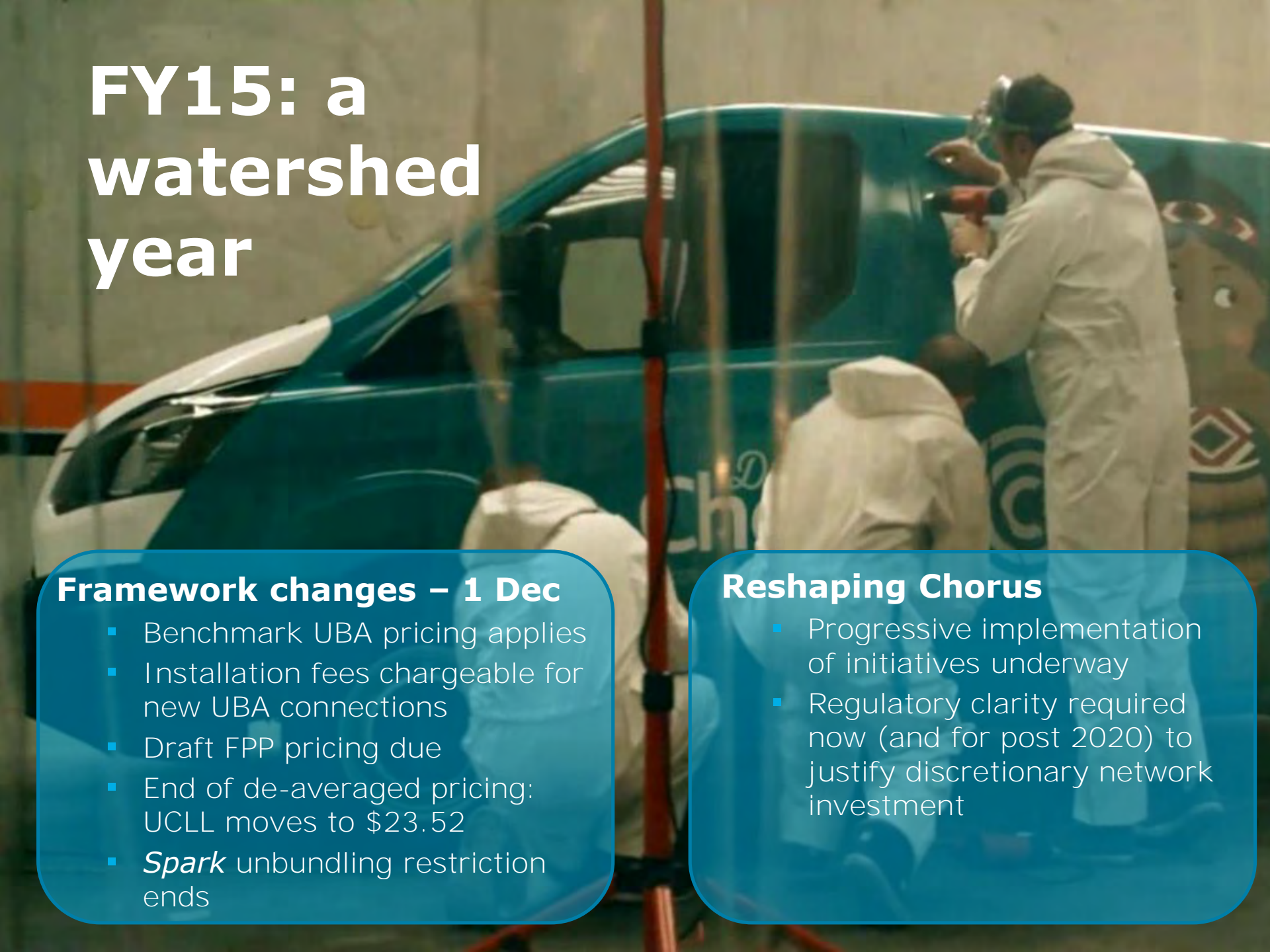


* Chorus Accelerate range of improved services announced in May

Enabling service differentiation



FY15: a watershed year



Framework changes – 1 Dec

- Benchmark UBA pricing applies
- Installation fees chargeable for new UBA connections
- Draft FPP pricing due
- End of de-averaged pricing: UCLL moves to \$23.52
- *Spark* unbundling restriction ends

Reshaping Chorus

- Progressive implementation of initiatives underway
- Regulatory clarity required now (and for post 2020) to justify discretionary network investment

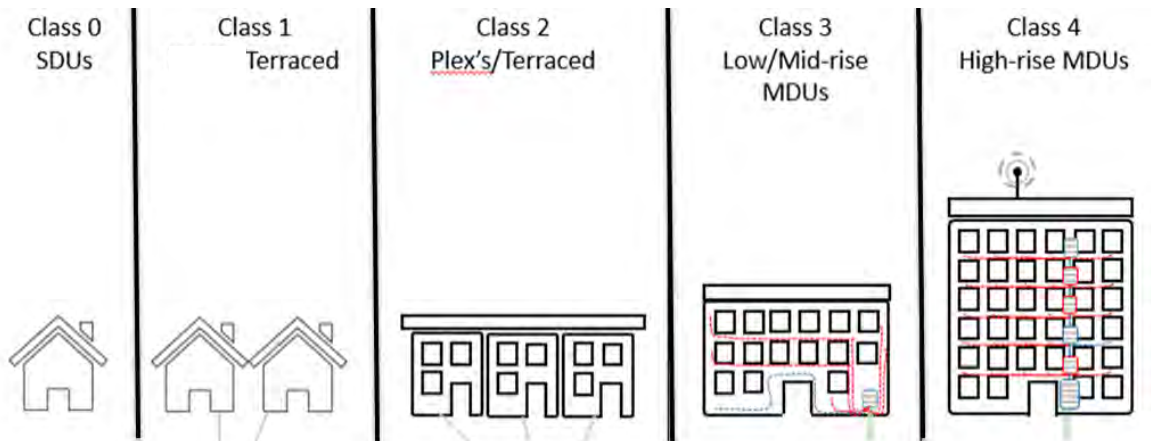


Any questions?



Appendix A: UFB premises types

Premises type estimates from UFB deployment premises count methodology







Premises	649,000	123,000	10,000	4,000	1,000	787,000*
End user connections	649,000	267,000	43,000	34,000	57,000	1,050,000

*Total UFB premises in Candidate Area, excluding greenfields

Note: Rights of way may occur in any of the above premises type categories

Appendix B: UFB installation types and funding

	Rights of way 	Single dwelling units 	Simple Multi-dwelling units (up to 3 stories) 	Complex Multi-dwelling units (>3 stories) 
Chorus funded Note: funding policy will change at end of UFB build contract in 2020	Residential/business standard lead-in from street to building entry point at time of connection: <ol style="list-style-type: none"> 1. New underground – up to 15m 2. Existing conduit or open trench – up to 100m 3. Aerial – 1 span 4. In-home wiring to the ONT* *Internal cabling limited to 5m once NSI fund ends.			
				Entry point to Apartment ('backbone riser'): Chorus funds up to \$1k per residential/business tenancy
Non-standard install Fund Note: capped at \$28m funding from Chorus	Residential non-standard RoW installation: <ol style="list-style-type: none"> 1. New underground 15m to 200m 2. Existing Conduit open trench >100m to 200m 3. Aerial > 1 span 	Residential non-standard installation: NSI fund available for: <ol style="list-style-type: none"> 1. New underground 15m to 200m 2. Existing conduit or open trench up to 200m 3. Aerial >1 span 		
			Entry point to residential apartment ('backbone riser'): NSI fund for >\$1k cost	
Other funding required	Residential >200m charged via RSP			Building owner to pay for lead-in and backbone riser costs if exceeds Chorus funding
	Business non-standard RoW installation: charged via RSP <ol style="list-style-type: none"> 1. New underground >15m 2. Existing conduit or open trench >200m 3. Aerial > 1 span 	Business non-standard install lead-in: charged via RSP	Simple business install: charged via RSP (or building owner) to fund lead-in and backbone riser costs if exceeds Chorus funding.	

Note: Installation is different from connection, which may be charged for business plans.

Appendix C: Revenue categories

Basic Copper

- core regulated products that are earlier technology or products with limited scope for further development e.g Baseband copper (UCLFS), Basic UBA, Naked UBA, UCLL, SLU, SLES

Enhanced Copper

- products enhanced to deliver higher speed capability and better customer experience e.g. Enhanced UBA, VDSL2, Baseband IP, HSNS Lite Copper

Fibre

- existing business fibre and new UFB services. Also includes UFB **backhaul and direct, or 'dark', fibre**

Value Added Network Services

- products and expertise for higher value or specialist services. Includes carrier network services which provide connectivity across backhaul links

Field Services

- field force in provisioning, maintaining and installing copper or fibre products

Infrastructure

- **services that provide access to Chorus' network assets,** principally exchange co-location space.

Appendix D: Capex categories

Fibre capex categories

UFB communal

- cost of building UFB network along street to pass premises

UFB connections & fibre layer 2

- UFB connections are subject to demand via RSPs
- Layer 2 electronics

Fibre products & systems

- Fibre- related product and system development

Other fibre connections & growth

- Demand driven by greenfield & business fibre growth.
- Regional backhaul to enable RSP traffic
- Fibre lifecycle investment

RBI

- Layers 0, 1 - network duct and fibre; Layer 2 cabinet electronics
- Expect total 5 year programme to cost around \$280 - 295 million. Spend weighted to front end of programme

Copper capex categories

Network sustain

- Upgrading or replacing plant (e.g. poles, cabinets, cables) where risk of failure or degraded service
- Proactive network replacement more cost effective than reactive maintenance

Copper connections

- Demand for copper connections for residential / business customers (e.g. infill housing, new buildings)

Copper layer 2

- Demand driven layer 2 investment in broadband capacity and growth. Expected to reduce slowly as customers migrate to fibre

Product fixed

- Largely RSP driven investment in copper-related products

Common capex categories

Information technology

- Investment in future Chorus IT platforms, in part to meet June 2014 deadline to move from Telecom enterprise systems

Building and engineering services

- Spend for growth and plant replacement (e.g. power, air conditioning) at Chorus exchange, building and remote sites

Other

- Items such as office accommodation and equipment

Appendix E: Contributions to capex

UFB

- CFH funds up to \$929 million over course of programme, at a rate of \$1,118 per premises

RBI

- Government grant funding of ~\$236 million over 5 years to cover most layer 0 and 1 capex spend
- Layer 2 is not covered by the grant
- Grant is payable on completion of build work
- Annual grant around 80 - 85% of annual RBI capex spend

Other

- Central & local government contribute to cost (often 100%) when requesting Chorus to relocate or rebuild existing network.