

Chorus Half Year Result, FY15

**For six months ending
31 December 2014**



23 February 2015, 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
- > FPP update

Mark Ratcliffe, CEO

- > Regulatory framework
- > Outlook
- > Q and A

Solid business performance

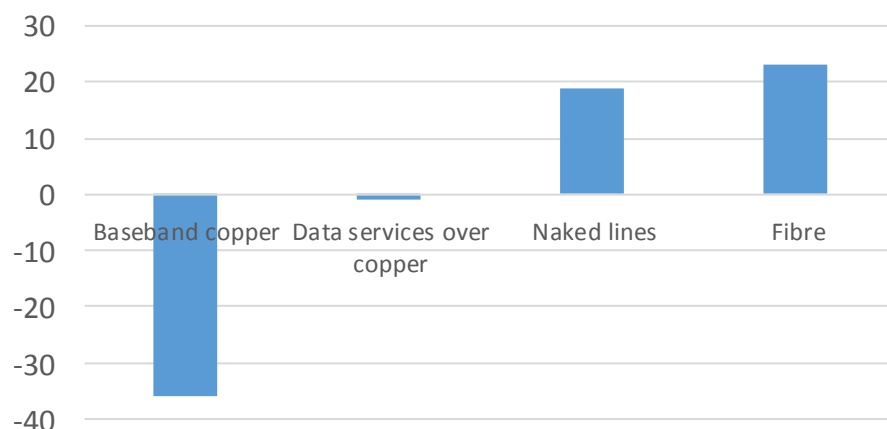
- > Net Profit After Tax of **\$64 million**
- > EBITDA of **\$321 million**
- > Revenue of **\$527 million**
- > Total fixed line connections increased to **1,782,000**
- > Broadband connections increased to **1,186,000**
- > UFB and RBI rollouts progressing well
 - **500,000** end-users within reach of better broadband
 - **\$1.75bn - \$1.80bn** new UFB communal capex range

Fixed line connections

Fixed line connections	31 Dec 2014	30 June 2014
Baseband copper	1,435,000	1,471,000
UCLL	127,000	127,000
SLU/SLES	4,000	4,000
Naked Basic/Enhanced UBA and Naked VDSL	136,000	117,000
Data services over copper	15,000	16,000
Fibre	65,000	42,000
Total fixed line connections	1,782,000	1,777,000*

- > Total connections up by **5,000** lines
(note: H1 subject to seasonal variation; e.g. university summer holidays)
- > Shift from baseband copper to other connection types continues
- > **55%** increase in fibre lines
- > **16%** growth in 'Naked' lines

Change in connections



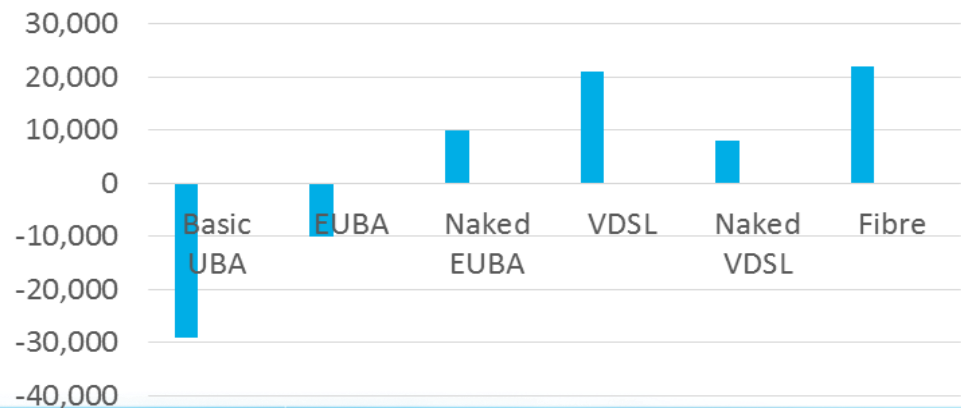
* Adjusted, as advised in 7 October presentation, to reflect 4,000 connections previously counted as intact but non-revenue generating.

Continuing broadband growth

Broadband connections	31 Dec 2014	30 June 2014
Basic UBA	135,000	164,000
Naked Basic UBA	10,000	9,000
Enhanced UBA	792,000	802,000
Naked Enhanced UBA	103,000	93,000
VDSL	70,000	49,000
Naked VDSL	23,000	15,000
Fibre (mass market)	53,000	31,000
Total broadband connections	1,186,000	1,163,000

- > Increase of 23,000 broadband connections
 - Strong growth in VDSL and fibre as end-users transition from UBA connections
 - 12% of connections now high-speed VDSL or fibre

Change in broadband connections



Chorus connections drivers

Maintaining connections

Building consents at highest level since 2007: ~25,000 new dwellings consented in 2014 and net gain of ~51,000 migrants in December 2014 year

Temporary retention of ~20,000 copper voice lines for some fibre end-users

1 Dec billing changes identified ~20,000 baseband copper lines not currently billed. Reviewing with customers

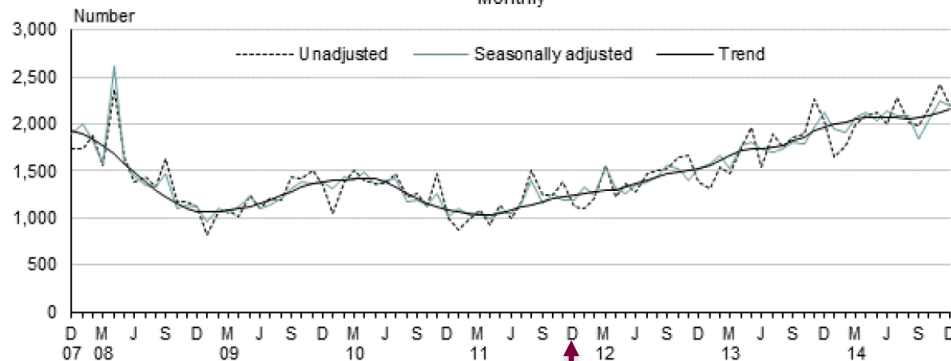
Reducing connections

Fixed to mobile substitution: households with landline access decreased from 92% (2006 census) to 86% (2013 census)

Local fibre companies expanding footprint: estimate ~200,000 end-users passed (target ~360,000) and uptake of ~23,000 lines

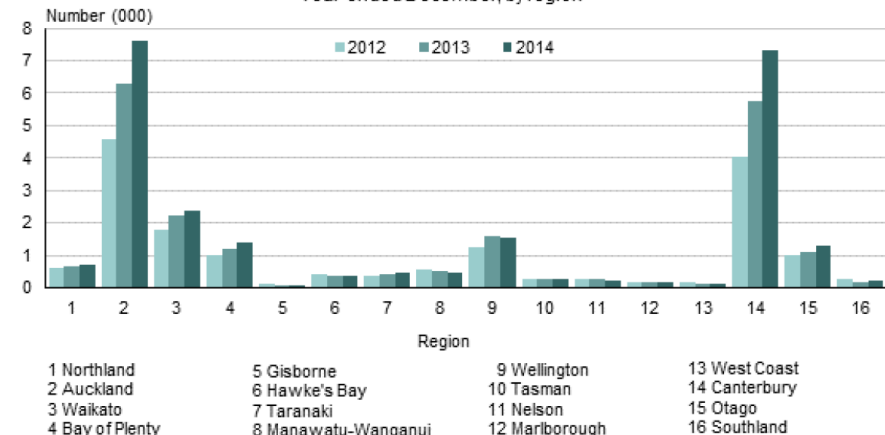
RSPs continuing to rationalise input costs

New dwellings consented
Including apartments
Monthly

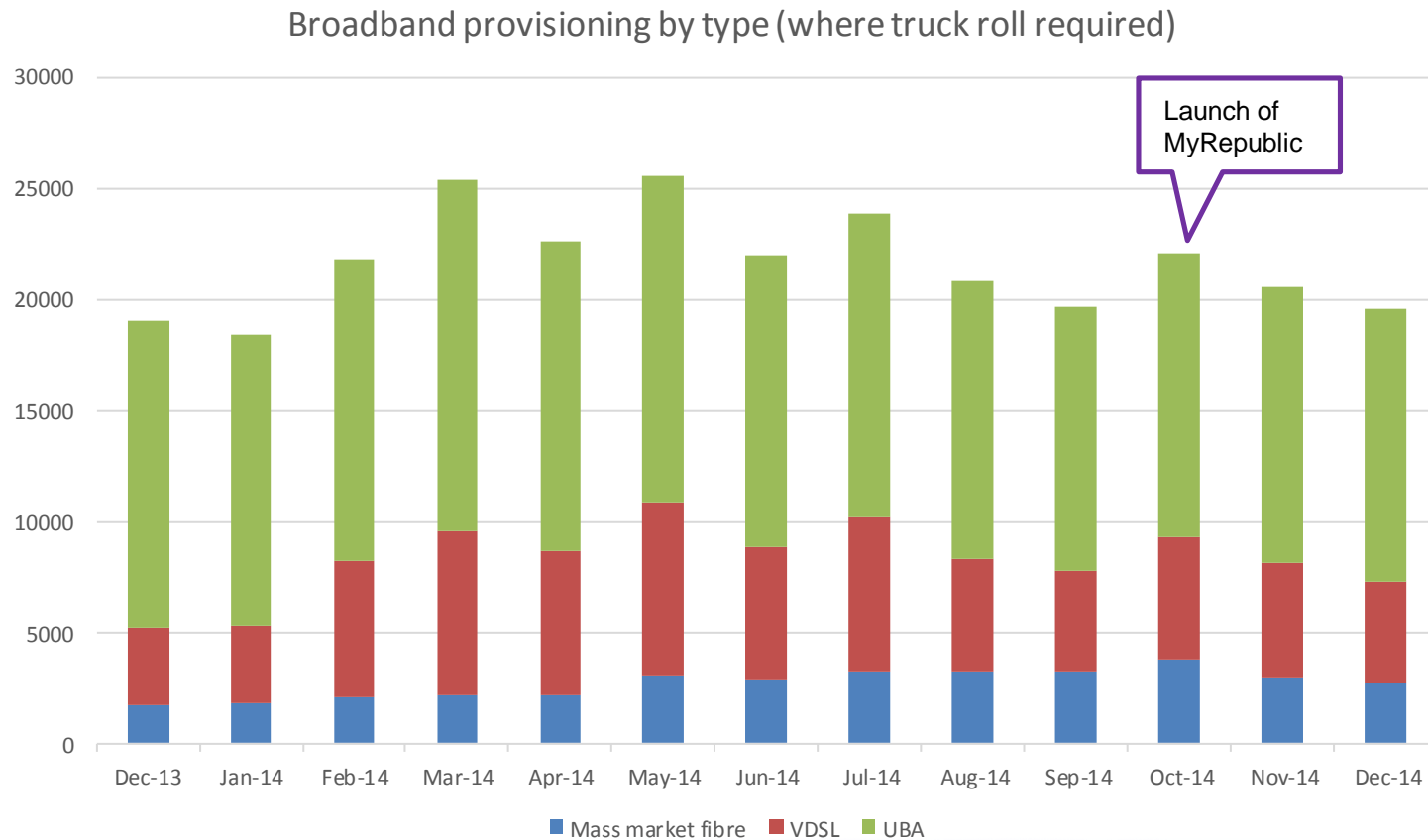


CNU
demerger

New dwellings consented
Including apartments
Year ended December, by region



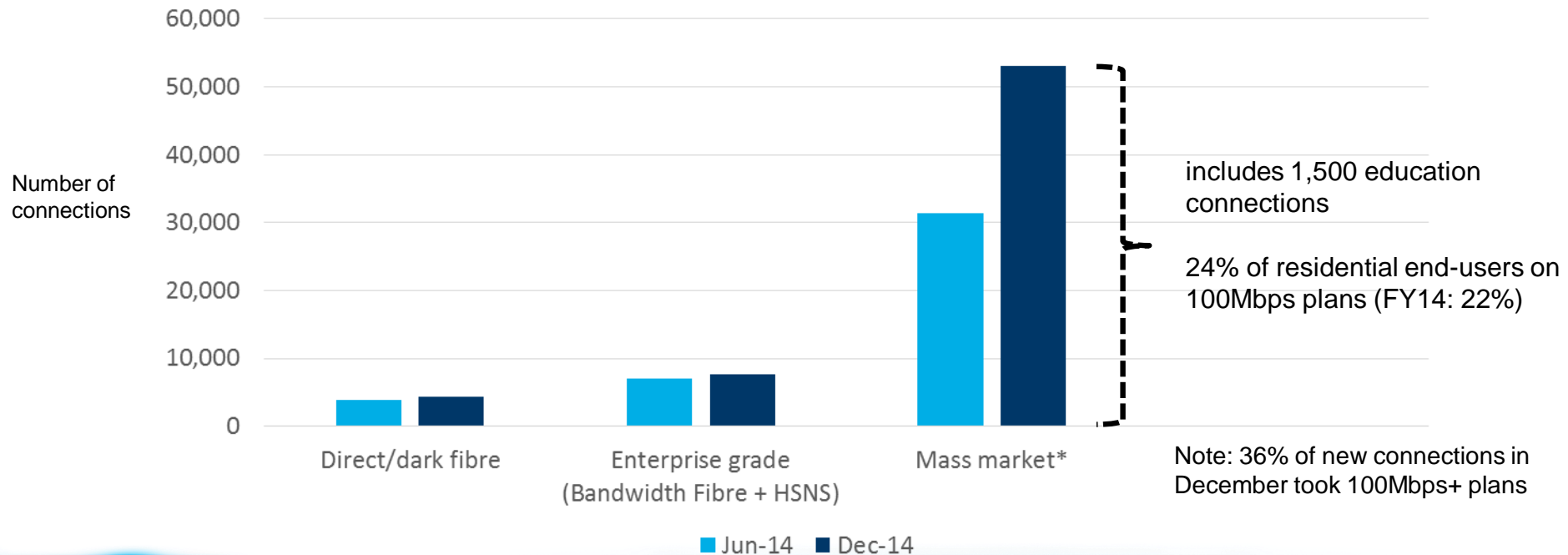
Broadband provisioning mix



Fibre connections

- > 65,000 fibre connections nationwide (FY14: 42,000)
- > 47,000 fibre connections within UFB deployed footprint (FY14: 27,000)

Fibre uptake by product category – all NZ



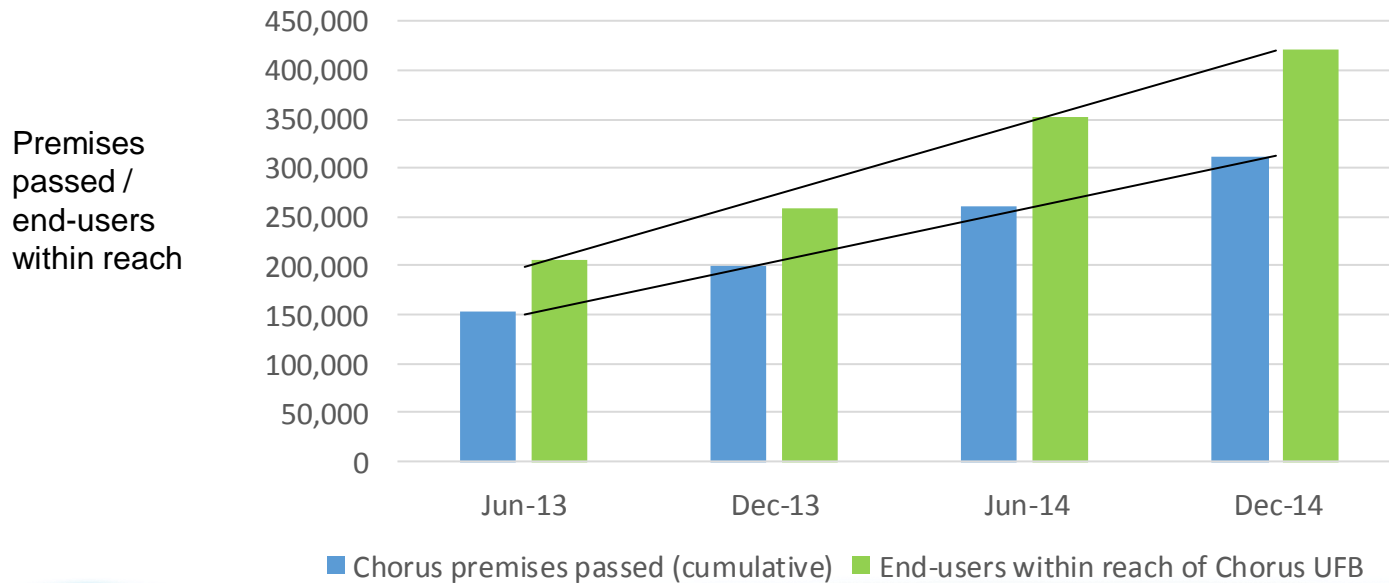
* Includes UFB Bitstream 2 and 3, non-UFB greenfields end-users and education connections

UFB build on track

> **38%** of way through rollout

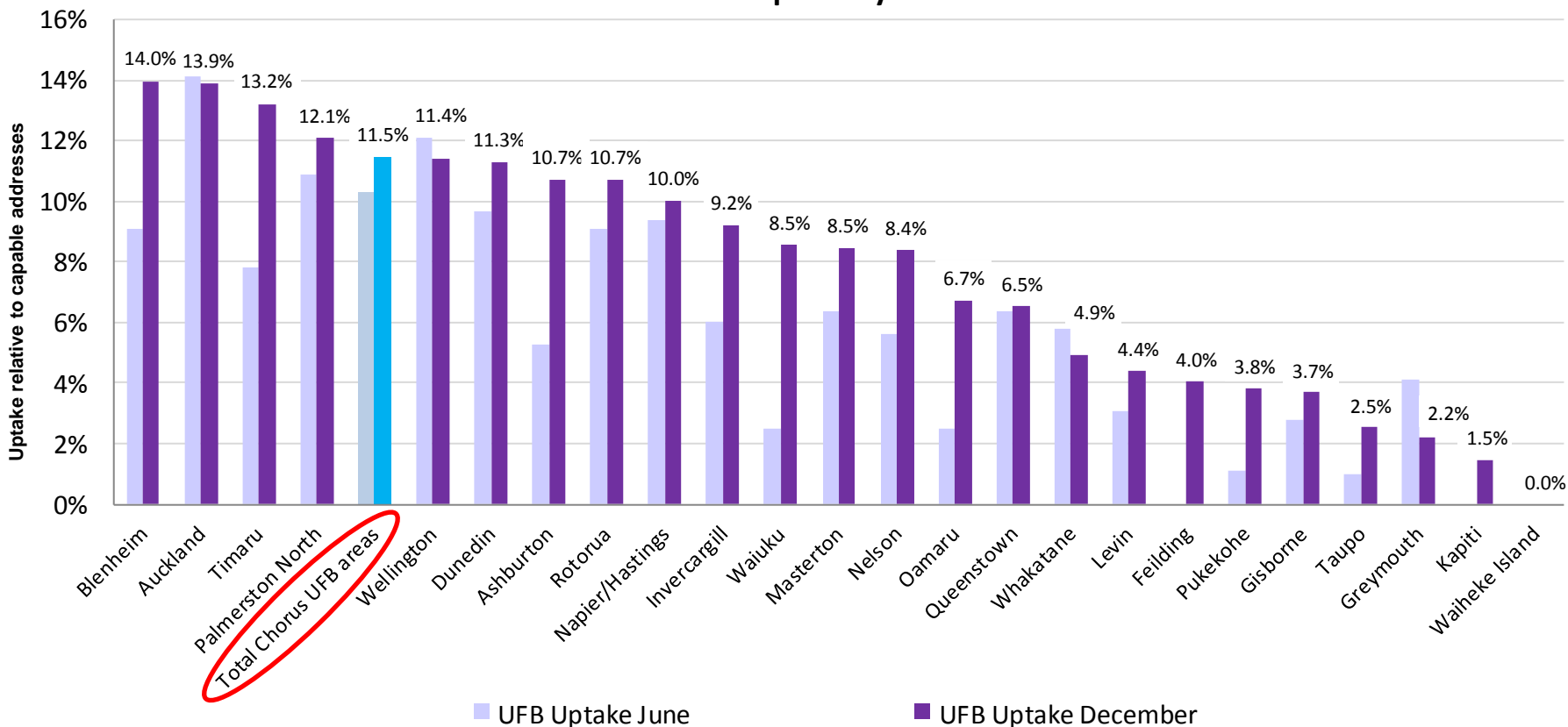
- **421,000** end users now within reach of Chorus UFB
- build complete for **312,000 premises**; includes **62,000 (79%)** priority premises
- **263,000** premises tested and paid at 31 December
- **FY15 target:** Build complete for **51,000** of 106,000 premises

UFB rollout progress



Regional fibre uptake June – Dec 14

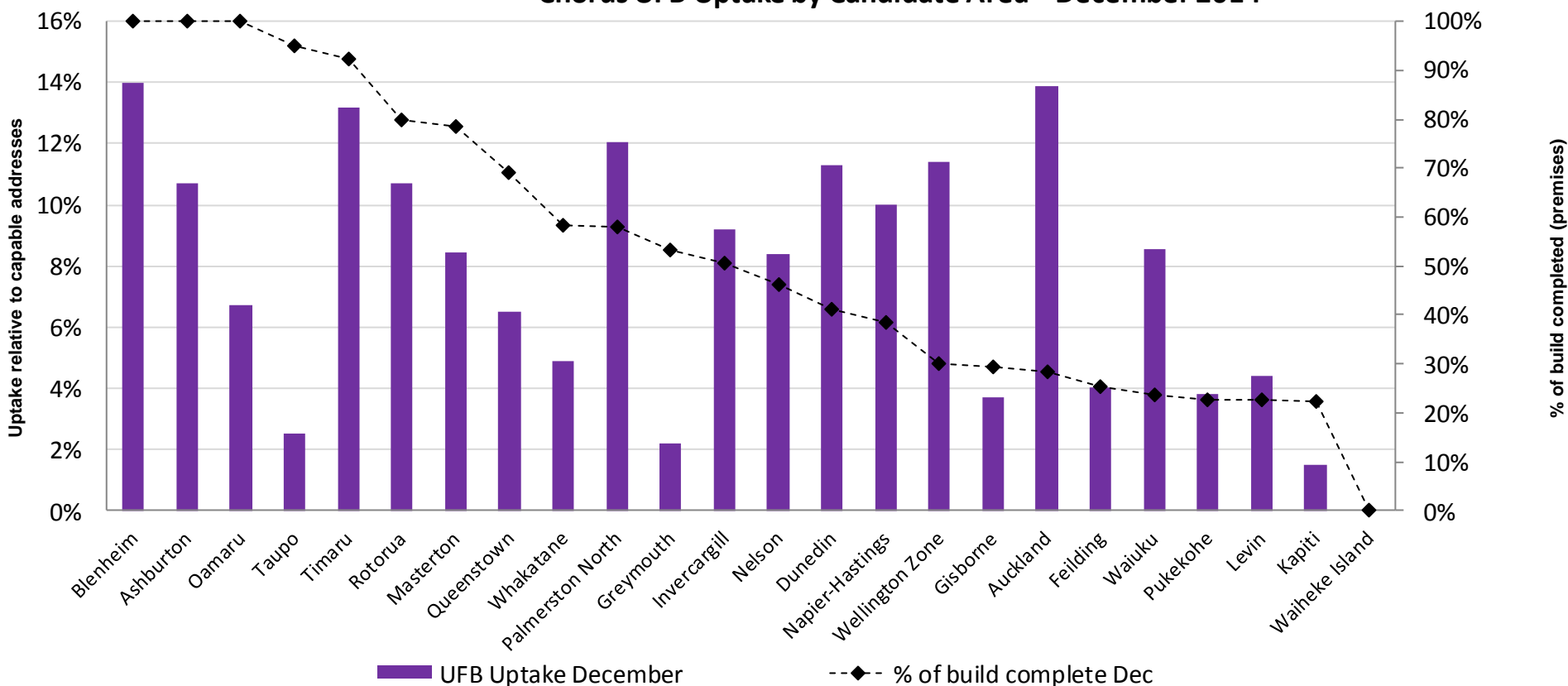
Chorus UFB Uptake by Candidate Area – December 2014



- Chart shows end-user uptake as a proportion of UFB capable addresses (i.e. network is commissioned for service)
- Uptake may decrease from period to period as more network is commissioned in an area

Regional fibre uptake vs build

Chorus UFB Uptake by Candidate Area – December 2014



- Chart shows end-user uptake as a proportion of UFB capable addresses (i.e. network is commissioned for service) ranked according to proportion of build complete premises in each area

Rural Broadband rollout

	Complete				To be completed	
	FY12	FY13	FY14	FY15 H1	FY15 H2	FY16
Schools	473	306	172	14	56	0
Hospitals	4	17	9	3	6	0
Fibre to RBI tower sites	13	40	37	16	31	17
FTTN cabinets	192	320	289	111	142	163
Fixed lines served	20,400	30,800	20,900	9,000	12,800	9,700
Chorus investment \$m	\$59m	\$106m	\$53m	\$18m		

> 965 schools complete

> 81,000 lines within reach of better broadband; ~84% uptake

Build performance summary

- > More than **\$1.7 billion** spent on fibre networks and capability since demerger
 - **500,000 end-users** able to benefit from UFB/RBI
 - fibre available at **~2,000 schools** across New Zealand
 - Build complete for **3 UFB towns**: Oamaru, Ashburton, Blenheim
 - H1 uptake volumes ahead of FY15 budget
 - NZ up from 18th to **15th among OECD countries for fibre coverage** at 30 June 2014, but **29th for uptake** (iDate data)
 - Gigatown Dunedin: gig services launch 25 February



Andrew Carroll

Chorus CFO



Income statement

	H1 FY15 \$m	H2 FY14 \$m
Operating revenue	527	523
Operating expenses	206	203
Earnings before interest, tax, depreciation and amortisation (EBITDA)	321	320
Depreciation and amortisation	159	160
Earnings before interest and income tax	162	160
Net interest expense	73	62
Net earnings before income tax	89	98
Income tax expense	25	28
Net earnings for the period	64	70

- > H2 FY14 has been used as the prior comparable period, rather than H1 FY14, because of the significant changes that regulatory uncertainty created in Chorus' underlying business during H2 FY14.

Revenue

	H1 FY15 \$m	H2 FY14 \$m
Basic copper	252*	264
Enhanced copper	156*	150
Fibre	45	41
Value Added Network Services	19	19
Field Services	40	32
Infrastructure	11	9
Other	4	8
Total	527	523

* reflects one month impact of the final benchmarked price for UBA

Expenses

	H1 FY15 \$m	H2 FY14 \$m
Labour costs	38	35
Provisioning	28	29
Network maintenance	48	50
Other network costs	15	18
Electricity	7	7
Rents, rates and property maintenance	12	12
IT costs	31	30
Consultants	2	2
Insurance	2	2
Other	23	18
Total	206	203

H1 FY15 gross capex summary

- > Total capex of **\$338m** for six month period
- > Fibre-related spend **\$297m** (88% of total capex)

Fibre capex	H1 FY15	H2 FY14
UFB communal	152	159
UFB connections & fibre layer 2	78	48
Fibre products & systems	18	15
Other fibre connections & growth	31	36
RBI	18	21
Total	297	279

Copper capex	H1 FY15	H2 FY14
Network sustain	15	21
Copper connections	6	7
Copper layer 2	4	4
Product	3	1
Total	28	33

Common capex	H1 FY15	H2 FY14
Information technology	8	22
Building & engineering services	5	9
Other	-	4
Total	13	35

UFB communal capex

- > Rollout in steady state; transition in build mix as move from CBDs into more suburban areas
 - \$152m in H1 FY15 with build complete for 51,000 premises
 - no change to FY15 cost per premises passed (CPPP) range of \$2,150 - \$2,400
 - transition from targeted to fixed cost contracts: Visionstream and Downer agreements effective 1 July 2014.
- > New contracts provide additional certainty on deployment costs to 2020
 - subject to reasonable build variations and aerial access costs
 - **UFB communal guidance narrowed from \$1.7 - \$1.9bn range to \$1.75 - \$1.80bn.** The bottom of the range reflects fixed price plus a limited number of variations; the top of the range allows for a greater range of build variations (mix of aerial, replacement of poles, access to Chorus infrastructure etc).






UFB connection capex

- > H1 FY15: average CPPC of **\$1,350** (FY14: \$1,680) excluding layer 2; includes standard installations **and** some non-standard single dwelling unit installations
- > FY15 standard connections cost guidance of \$1,300 to \$1,500 reduced on 25 November to **\$1,150 to \$1,350** (excluding layer 2)
 - reflects new agreements with service companies with fixed prices, varying according to agreed deployment types
 - costs range from ~\$900 for re-use of existing duct and aerial to ~\$1,700 for limited instances needing civil work
- > New service company agreements:
 - start dates vary: Downer (1 July 2014), Visionstream (1 Dec 2014), Transfield (1 Feb 2015)
 - imply average cost to connect approximately 10-20% lower than current FY15 guidance on an annualised basis
 - reduce non-standard install costs; implications for NSI fund under discussion with CFH
- > No change to 2011 total programme view of \$900 to \$1,100 real (circa \$1,000 to \$1,200 in FY15 dollars) average cost to connect standard residential premises

Connections capex drivers

- > **UFB connection capex** reflects cost per premises connected (CPPC) for single dwelling units and MDU tenancies **plus** upfront common 'backbone' build required for MDUs and RoWs
 - difficult to forecast annual volumes
 - costs highly variable depending on mix of build/building types

Single dwelling units - standalone	Multiple dwelling units	Rights of way
 <p>Estimated 772,000 premises and 916,000 end users.</p>	 <p>Estimated 15,000 premises and 134,000 end users. General principle: Chorus funds up to \$1,000 per end-user from entry point to apartment (see Appendix D - E for more detail).</p>	 <p>May occur in any premises type category. General principle: end-users receive 'free' 15m connection from Chorus (see Appendix D - E for more detail).</p>

H1 FY15 volume and mix	Prior FY15 guidance assumptions
22,000 end users connected (FY14:21,000)	~36,000 end users connected by 30 June 2015
1,500 MDU backbone complete/accrued (FY14:1,600) 1,900 RoW backbone complete/accrued (FY14:1,600)	~5,000 backbone build (MDU + RoW)
Backbone mix weighted to large MDUs and work commenced prior to coded serco rates = higher average cost of about \$10,000 for work completed and paid for	Backbone mix anticipated to be more expensive than FY14 average of \$6,500 for backbone + street entry

UFB connection capex

- > \$78m UFB connections and layer 2 capex in H1 FY15
 - build mix weighted to upfront 'backbone' build (MDUs + RoWs) at 46% of spend to date (FY14: 28%)
- > UFB connections growing ahead of budget; still only 4% of ultimate market

UFB connections & layer 2 capex	H1 FY15 \$78m	FY14 \$74m
Layer 2 (long run programme average of \$100 per connection)	\$8m	\$9m
Schools wiring (Crown funded)	-	\$4m
Connections: single dwelling units, apartments	\$34m*	\$40m
Backbone build: multi-dwelling units and rights of ways	\$36m*	\$21m

- > FY15 UFB connections and layer 2 capex now estimated to be **\$145m - \$155m** (based on **50,000 connections** and **6,400 backbone builds**)
- > New coded rates and specialist MDU builder (UCG) in Auckland and Wellington expected to reduce average costs in H2.

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

Guidance summary

	Prior guidance \$	As at 23 Feb 2015 \$
FY15 Cost Per Premises Connected (CPPC)	\$1,150 - \$1,350 (excluding layer 2 and including standard installations and some non-standard single dwelling unit installations)	no change
FY15 Cost Per Premises Passed (CPPP)	\$2,150 - \$2,400	no change
UFB communal guidance	\$1.7 - \$1.9bn	\$1.75 - \$1.80bn The bottom of the range reflects fixed price plus a limited number of variations; the top of the range allows for a greater range of build variations (mix of aerial, replacement of poles, access to Chorus infrastructure etc).
FY15 UFB connections & layer 2 capex	\$105 - 115m (based on 36,000 connections and 5,000 backbone builds; FY15 backbone build mix anticipated to be more expensive than FY14)	\$145 - \$155m (based on 50,000 connections and 6,400 backbone builds; FY15 backbone build mix anticipated to be more expensive than FY14)
FY15 Copper capex	\$55 - 85m	\$60 - 75m
FY15 Common capex	\$45 - 50m	\$30 - 40m
FY15 Fibre capex	\$490 - 510m	\$530 - 550m
FY15 Gross capex	\$590 - 640m	\$625 - \$650m based on updated connection capex estimates
FY15 EBITDA	\$590-605m	no change

Note: The individual capex ranges presented above are not necessarily additive

Net Debt / EBITDA

- > Key financial covenants require senior debt ratio to be no greater than the applicable senior debt ratio, which is currently 3.75 times

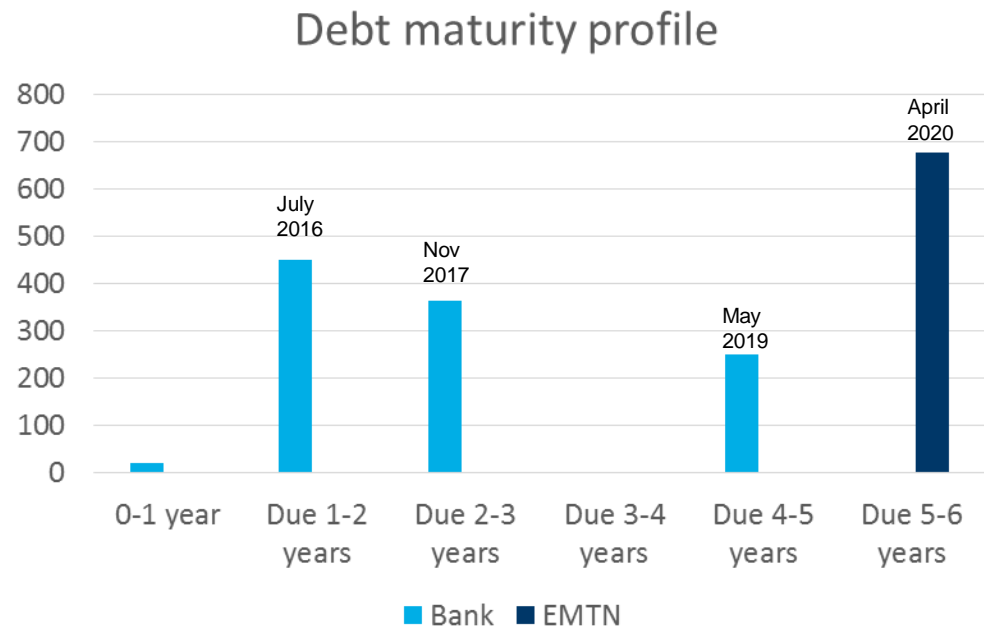
	As at 31 Dec 2014 \$m
Borrowings	1,762
+ PV of CFH debt securities (senior)	40
+ Net Finance leases	<u>128</u>
Sub total	1,930
- Cash	(103)
Total net debt	1,827
Net debt/EBITDA	2.85 times

Note: Standard & Poor's treatment includes Operating leases

Capital management

- > As part of the 25 July 2014 bank agreements, Chorus agreed that no dividends will be paid until the later of the conclusion of the FPP review processes or 30 June 2015.
 - Commerce Commission has indicated 30 September as due date for FPP final determination

- > At 31 December, debt of \$1,762m comprised:
 - \$20m short term facility
 - \$1,065m long term bank facilities
 - \$677m (NZ\$ equivalent at hedged rates) Euro Medium Term Note



Reshaping business update

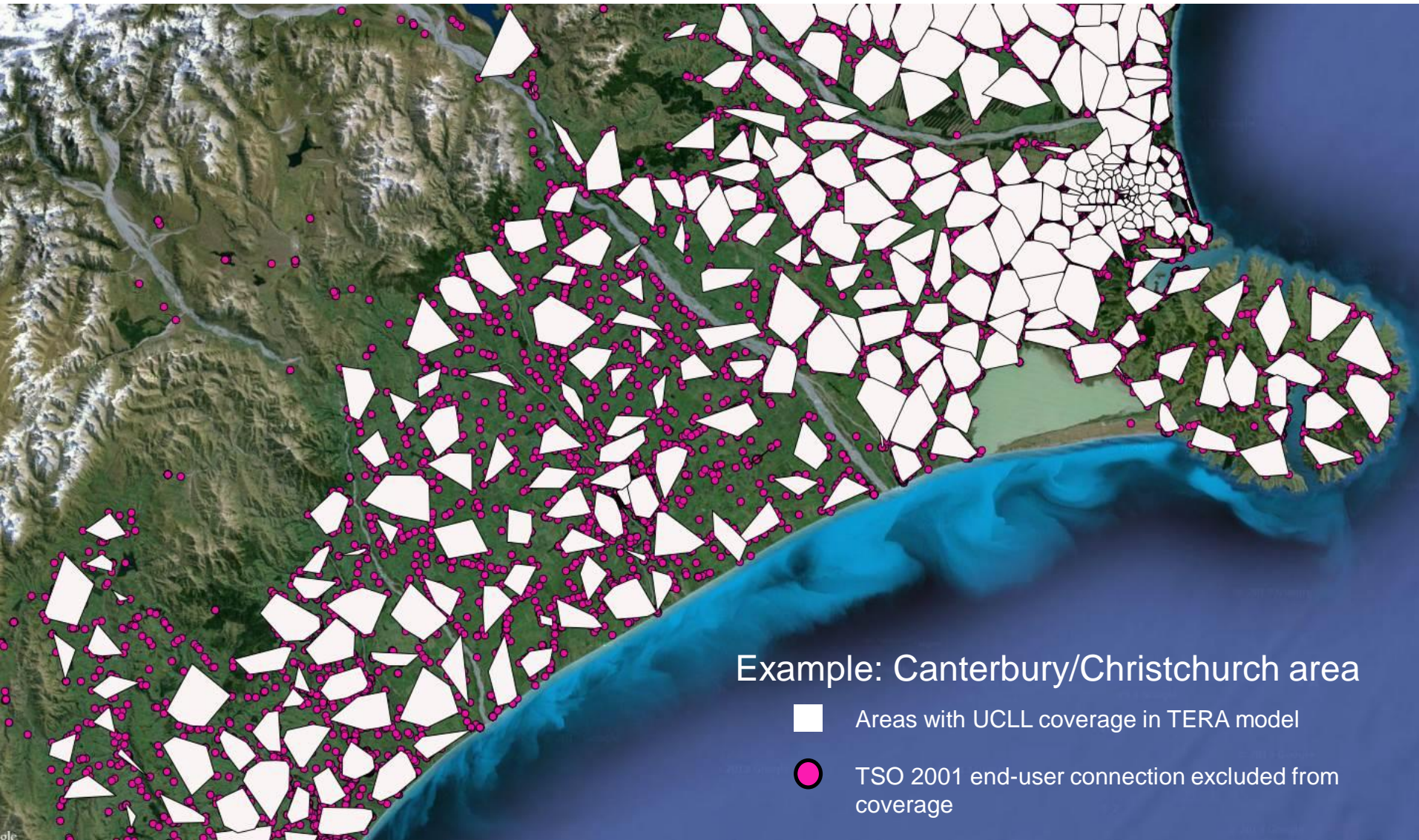
- > Range of financial, capital management and other initiatives implemented to date
- > Operational initiatives to reduce funding gap created by benchmarked pricing are **on track** to achieve \$400m target
 - must continue to assume \$34.44 until final FPP determination
 - some initiatives would be reviewed once FPP price confirmed

	Objective – FY15	FY15 update
Revenue	Indicative range \$10m to \$15m p.a. excluding any new commercial broadband revenues.	Range of initiatives implemented including: <ul style="list-style-type: none"> ▪ subsidies removed for extension of network (e.g. new fibre/copper subdivision connections and non-UFB business fibre) ▪ re-pricing of commercial products and some field service activities
Opex	Circa \$5m to \$10m savings in FY15.	Range of initiatives implemented include: <ul style="list-style-type: none"> ▪ reduction in non-operational staff (although provisioning demands have partially offset this) ▪ proactive maintenance spend deferred Review of service company operational model continuing.
Capex	Indicative gross range \$300m to \$350m up to and including FY20. Trade-off of ~\$100m to \$150m foregone growth revenues.	Discretionary investment restricted: <ul style="list-style-type: none"> ▪ proactive maintenance and network expansion programmes deferred ▪ IT spend for further transition from Spark systems deferred Full cost recovery reducing end-user demand for network extension.

Final Pricing Principle (FPP) update

- > Chorus continues to agree with the Commerce Commission on significant aspects of the FPP review
- > Chorus' submission on draft determinations includes:
 - extensive Analysys Mason review of TERA model
 - identification of various omissions and oversights
- > If these issues alone were corrected, Chorus' view is that the TSLRIC price will be at or above 2011 levels.
- > There are still a number of steps to complete in the FPP process and the Commission has a degree of discretion

10,000km+ of network omitted

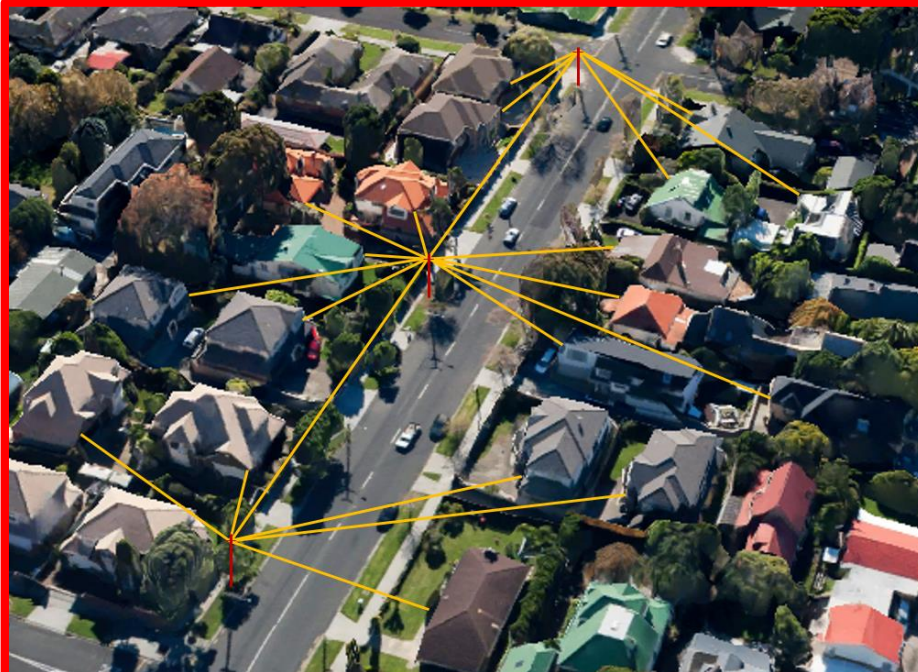


Architecture matters

Illustrative aerial deployment: Epsom



- > Chorus: standard NZ aerial architecture
 - recognise local consent requirements
 - reflects property boundaries
 - allow for road clearance requirements (5.5m+)



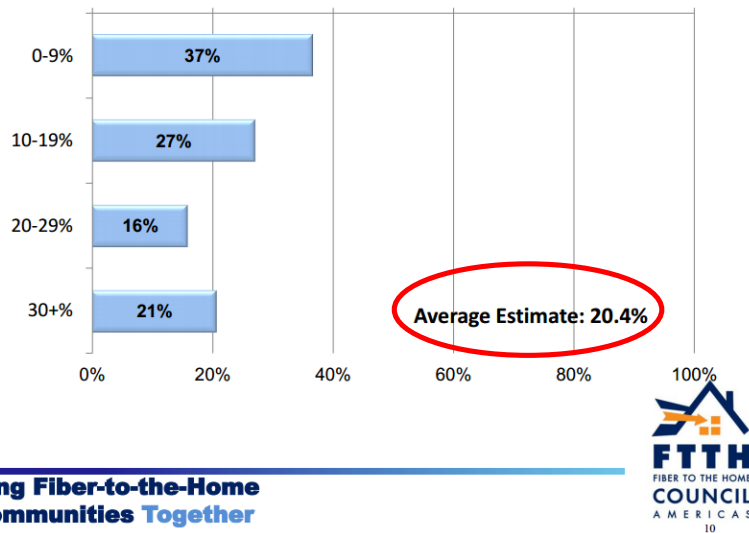
- > TERA: modelled aerial architecture
 - single sided pole deployment
 - based on maximum 65m span distance, not property boundaries
 - pole height below road clearance
 - omits footpaths/berms

Model should reflect real world

- > 50% opex fibre efficiency adjustment not reflected in previous TERA modelling and network operator data

FTTH Reduces Operations Costs

Estimated Opex Savings among Those with Active FTTH Customers



**Building Fiber-to-the-Home
Communities Together**

Source: FTTH Council Americas survey of 350 telecommunications operators, April 2013

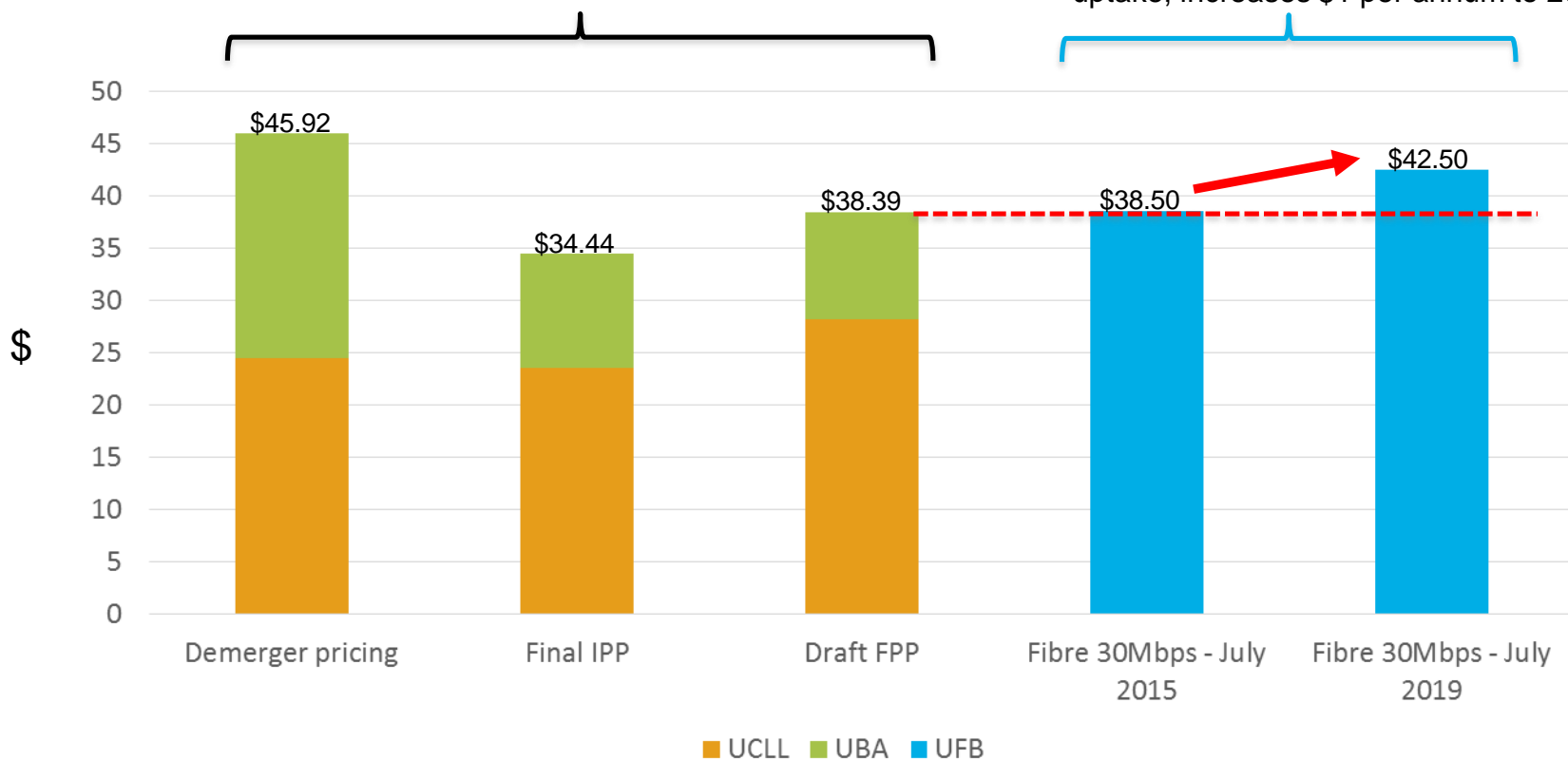
- > Horowhenua-Kapiti not representative of costlier urban build



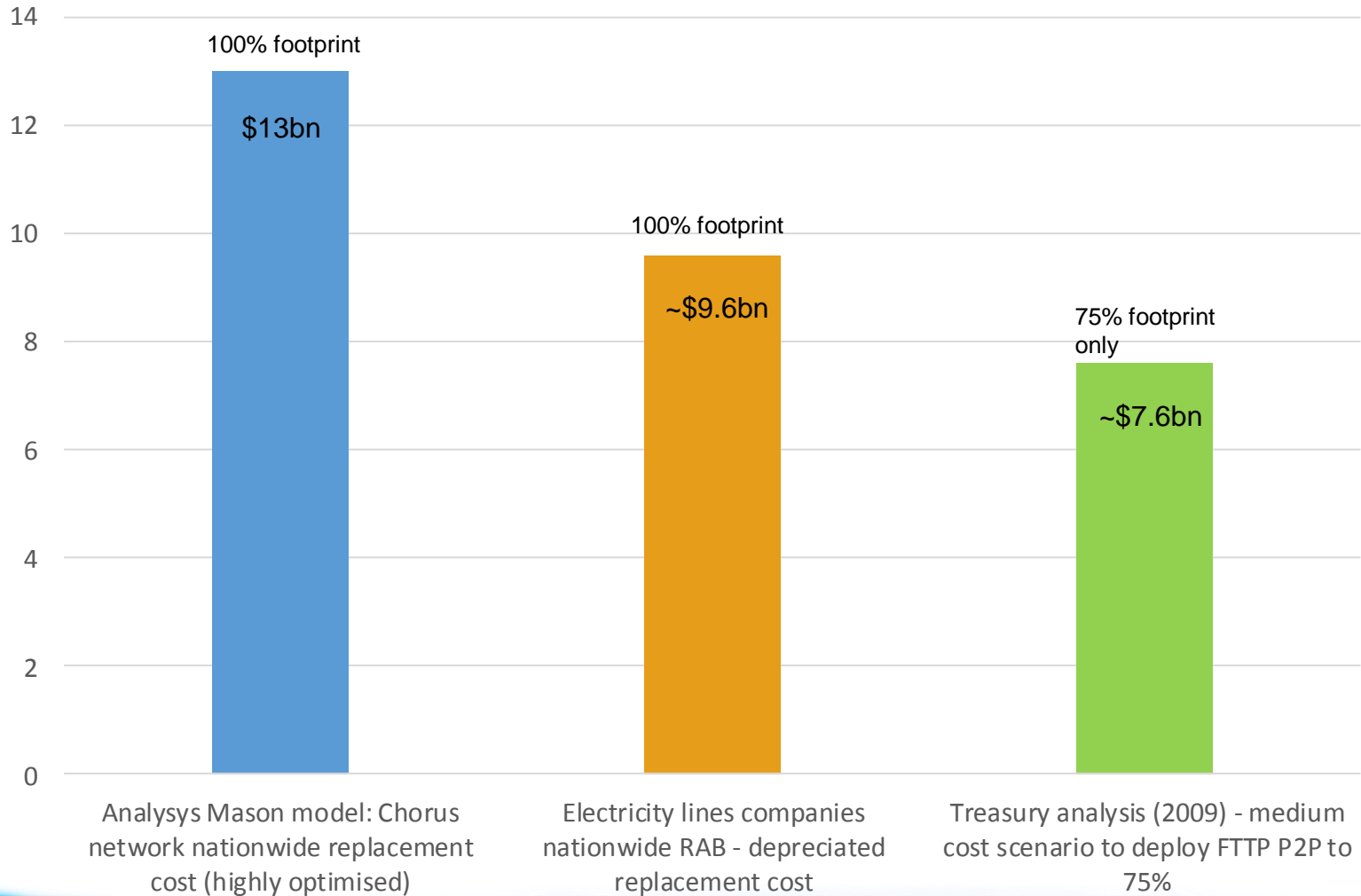
Copper vs fibre pricing

- Pricing to reflect nationwide service (i.e. urban + rural)

- Contracted pricing for urban areas only
- 30Mbps price set to encourage initial uptake, increases \$1 per annum to 2020



Sense check: Comparative network values



Mark Ratcliffe

Chorus CEO



Final pricing principle calendar



Seeking clarity: beyond 2020

Government to commence Telco Act review early 2015 with legislation expected to be in place during current term of government. Ministry of Business, Innovation and Employment briefing document to Minister (Nov 2014) states:

- *"Ongoing private sector investment will be required and the settings have to be right to encourage investment and innovation. Private sector participants need to be clear about whether, when, and why, government is likely to intervene in the sector, and confident that the regulatory systems are stable and supportive of investment."*
- *"The next phase of the Review start from first principles, and that it be a wide ranging exercise that tests fundamental features of the regime...A likely focus of the review will be the importance of creating an efficient and predictable regulatory price setting process."*



Outlook

- > FPP process an ongoing distraction and handbrake on discretionary activity and investment.
- > Initial details of Government framework review and new UFB and RBI programmes expected.
- > Gigatown and online video to assist fibre demand.
- > Step up in provisioning pipeline requirements.
- > Focus on refining MDU and RoW consenting processes.
- > VDSL capability and coverage enhanced through band plan changes.
- > RSPs continue to focus on cost out.

Any questions?



Appendix A: Non statutory measure - underlying reconciliation

- > This appendix provides a high level trend analysis of the underlying EBITDA (excluding those items which are non-recurring and not part of business as usual operations). This appendix has not been audited.

	H1 FY15 \$m	H2 FY14 \$m	% change	H1 FY14 \$m	% change
Operating revenue	527	530	-0.6%	535	-1.5%
Operating expenses	206	203	1.5%	206	0%
Underlying EBITDA	321	327	-1.8%	329	-2.4%
	H2 FY14 \$m	Less: insurance proceeds \$m	Add: UCLFS \$m	Underlying H2 FY14 \$m	
Operating revenue	523	-2	9	530	

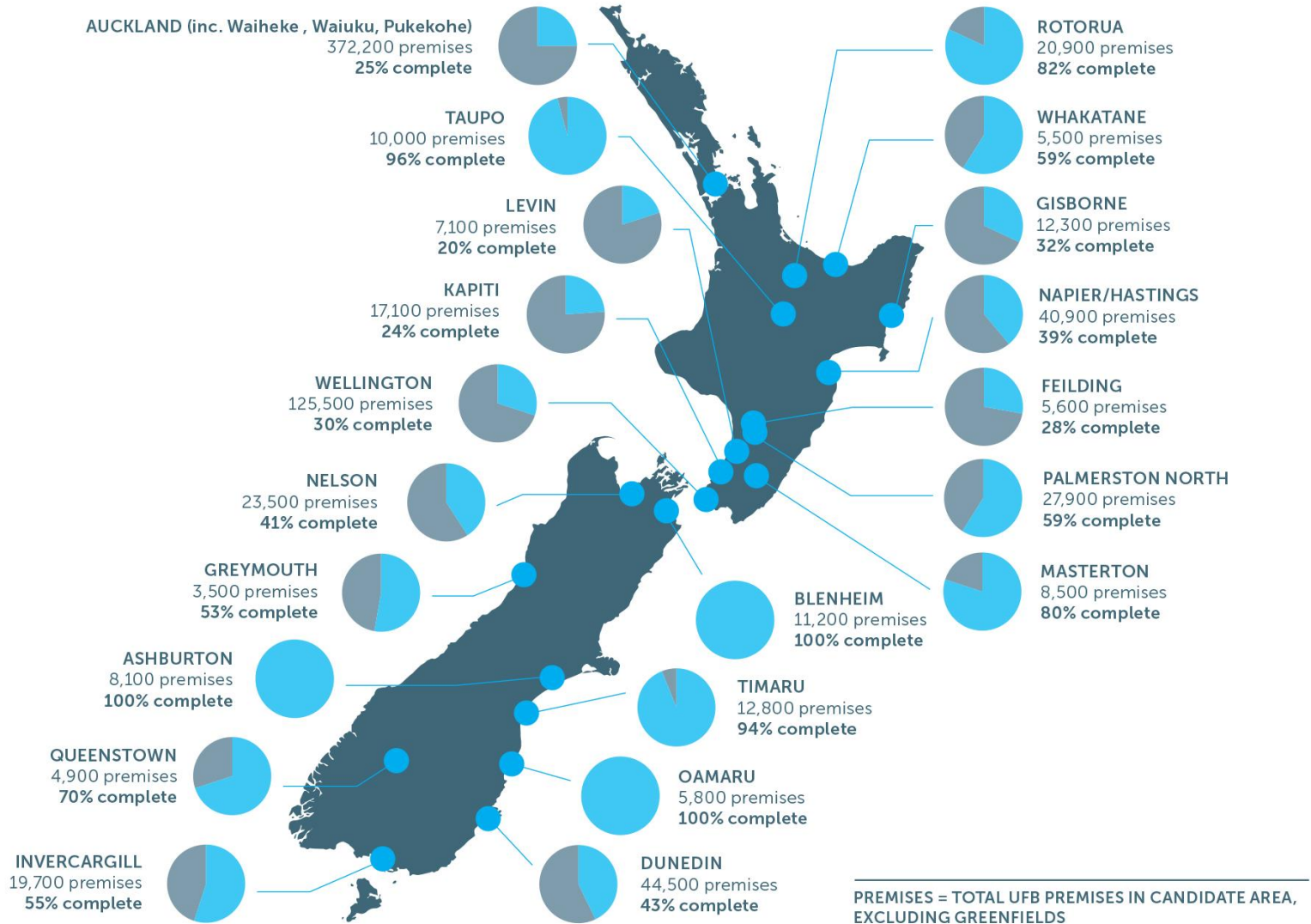
* Details of the adjustments to the H214 numbers can be found in Appendix Two to the 30 June 2014 management commentary

Appendix B: Prior period restatements

- On 1 July 2014 Chorus migrated its general ledger from Spark's SAP to our own independent version of SAP. As part of this migration the general ledger hierarchy was reviewed and the following expenditure items and assets have been re-presented. Specifically, labour recoveries have moved from 'other' expenses to 'labour costs' and network software has moved from 'network assets' to 'software and other intangibles'.

Operating expenses	Original H2 FY14 classification \$m	Adjustment \$m	Revised H2 FY14 classification \$m	Original H1 FY14 classification \$m	Adjustment \$m	Revised H1 FY14 classification \$m
Labour costs	38	-3	35	41	-4	37
Other	15	3	18	21	4	25
Network assets	Original H2 FY14 classification \$m	Adjustment \$m	Revised H2 FY14 classification \$m	Original H1 FY14 classification \$m	Adjustment \$m	Revised H1 FY14 classification \$m
Cost	7289	-22	7267	7066	-22	7044
Accumulated depreciation	-4153	14	-4139	-4106	14	-4092
Net carrying amount	3136	-8	3128	2960	-8	2952
Software and other intangibles	Original H2 FY14 classification \$m	Adjustment \$m	Revised H2 FY14 classification \$m	Original H1 FY14 classification \$m	Adjustment \$m	Revised H1 FY14 classification \$m
Cost	497	22	519	482	22	504
Accumulated depreciation	-331	-14	-345	-321	-14	-335
Net carrying amount	166	8	174	161	8	169

Appendix C: UFB rollout progress by area



Appendix D: 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

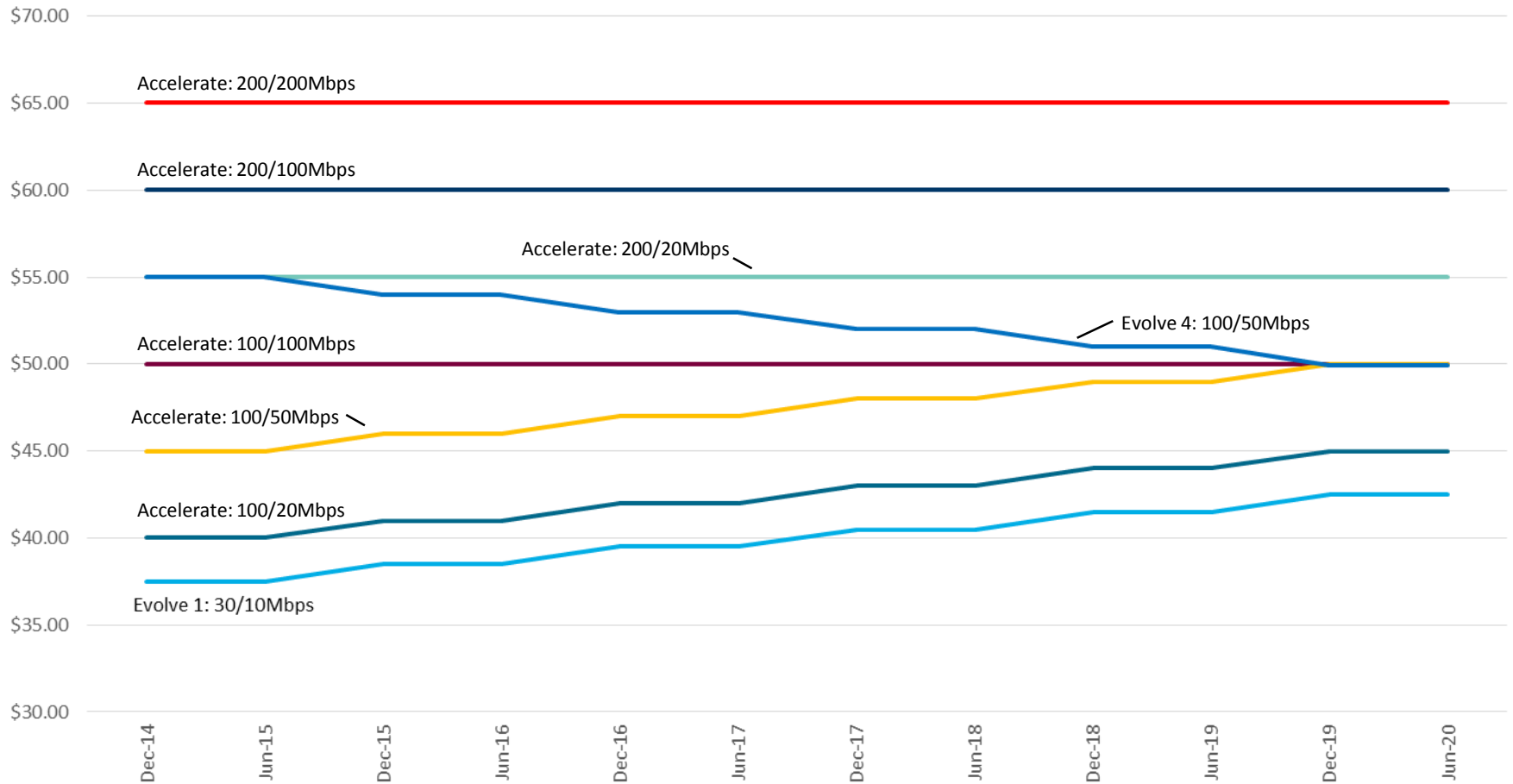
Appendix E: UFB installation types and funding

	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 F: Chorus mass market fibre product and pricing

Mass market fibre product pricing at 23 February 2015



Note: *Evolve* products shown are the core UFB contracted products introduced in 2012. *Accelerate* products are commercial products introduced by Chorus in mid 2014.

Appendix G: 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 H: 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 I: 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.