

# 2013 Chorus Annual Report

## HIGHLIGHTS

NPAT

**\$171m**

Net profit after tax

EBITDA

**\$663m**

Earnings before interest, income tax, depreciation and amortisation

ANNUAL DIVIDEND

**25.5**

Cents per share (see page 7 for details)

FIXED LINE CONNECTIONS

**1,784,000**

UFB PROGRAMME

**18%**

UFB completion



P2 A good operating result  
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Chorus accepted in FTSE4Good Index  
(Corporate Sustainability, page 4)  
For a second year, Chorus received  
Aon Hewitt Employers Accreditation



# A good operating result

Ultra-fast broadband build on track but regulatory headwinds and capital expenditure demands remain

Report from chairman Sue Sheldon and CEO Mark Ratcliffe



Dear shareholder

The financial year ended 30 June 2013 was Chorus' first full year of operation as New Zealand's largest wholesale only fixed line communications infrastructure company.

Revenue was \$1,057m for the full financial year, and our operational costs have continued to increase as expected to \$394m. This resulted in earnings before interest, depreciation, tax and amortisation (EBITDA) of \$663m and net profit after tax (NPAT) of \$171m for the period. Prior period comparisons are challenging as this was the first full year of operation for Chorus and a normalised comparison is included to assist shareholders.

Chorus has declared dividends totalling 25.5 cents per share for the financial year.

This has been a good operating result, with both the Ultra-Fast Broadband (UFB) and Rural Broadband Initiative (RBI) programmes slightly ahead of target, a small increase in the number of access lines and a 6% increase in copper broadband connections.

On the downside, capital expenditure demands continue to be significant and regulatory headwinds remain. We are pleased with the principled approach the Crown is taking to the regulatory review. However, we note that while the outcome of the Government's regulatory review is uncertain, all potential options contained within the discussion paper imply reduced future earnings for Chorus. The discussion

paper suggests a potential decrease of Chorus' pricing within a range of \$2.48 to \$7.48 per broadband connection per month. Based on 30 June 2013 connection volumes, Chorus anticipates this could imply a reduction in annual EBITDA in the range of \$20 million to \$100 million.

Overall fixed line connections remained stable for the period, at about 1.8 million lines, and the number of those copper connections that provide broadband services grew by more than 64,000 to a total of 1.112 million lines.

By the end of June we had built fibre past 153,000 premises, surpassing the 149,000 targeted. This means we are now 18% of the way through the UFB rollout and, through UFB and other initiatives, have added more than 3,000km of new fibre infrastructure during the year.

Alongside Crown funding, Chorus is investing a significant amount of its own capital. In February we provided updated guidance to the market that the total estimated cost to build the communal infrastructure for the network has increased from \$1.4 - \$1.6 billion to \$1.7 - \$1.9 billion.

At this stage we are around 18% of the way through the communal build programme but have incurred over 25% of the estimated cost of the programme for build completed. To achieve a total programme cost within this guidance range, we have put in place a range of initiatives to drive cost savings and efficiencies. We also expect less challenging build in the second half of the programme.

While Chorus is undertaking one of the largest infrastructure upgrades in New Zealand's history, it has been an ongoing concern that the telecommunications industry faces significant regulatory uncertainty.

In a move to address this uncertainty, a wide ranging review of the regulation that applies to the telecommunications sector was announced in February and a consultation document was released in early August.

When announcing the review, Minister Amy Adams said "The options we are canvassing give us an opportunity to provide clarity and certainty during a period when large investments are being made in a once-in-a-many-generation upgrade of our telecommunications infrastructure that will deliver significant benefits for New Zealanders well into the future."

We welcome the review and the opportunity now exists for the industry to engage in the establishment of a forward looking, coherent and stable policy environment that ensures a sustainable and efficient transition to fibre for the years ahead.

Despite the twin challenges of regulatory uncertainty and increased capital demands, we are pleased with the progress Chorus has made over the last 12 months.

New Zealand now has one of the fastest growing rates of broadband penetration in the OECD.

In May we announced new pricing and specifications for very high speed copper

plans, using a technology known as VDSL. This delivers higher quality broadband to retail service providers at the same regulated price as the standard copper broadband product. Retail service providers then take this product and develop their own plans and pricing for end-users.

Faster copper-based technology forms an important stepping stone to fibre. Like any technology upgrade, the move to fibre will be a long term transition, and VDSL has an important role in the interim and in areas where UFB is not being rolled out.

Chorus now employs 763 permanent and fixed term employees directly, along with a further 4,434 people who are either employed directly by our service company partners or are sub-contracted by the service companies. This means the overall workforce has doubled since Chorus' demerger from Telecom.

We have been recognised for a second year as one of the best employers in Australasia, our people have retained a high level of engagement with our business and our culture promotes diversity and inclusiveness. Health and safety will continue to be a key focus for the company.

We have this year been accepted into a globally recognised corporate sustainability index and, in partnership with Downer, won a Ministry for the Environment green award.

Chorus' operational performance is good and we will continue to work hard on your behalf to address the challenges in the year ahead.

This report is dated 29 August 2013 and is signed on behalf of the Board of Chorus Limited:

*Sue Sheldon*

Sue Sheldon, Chairman

*Mark Ratcliffe*

Mark Ratcliffe, Director and CEO

## A simple business

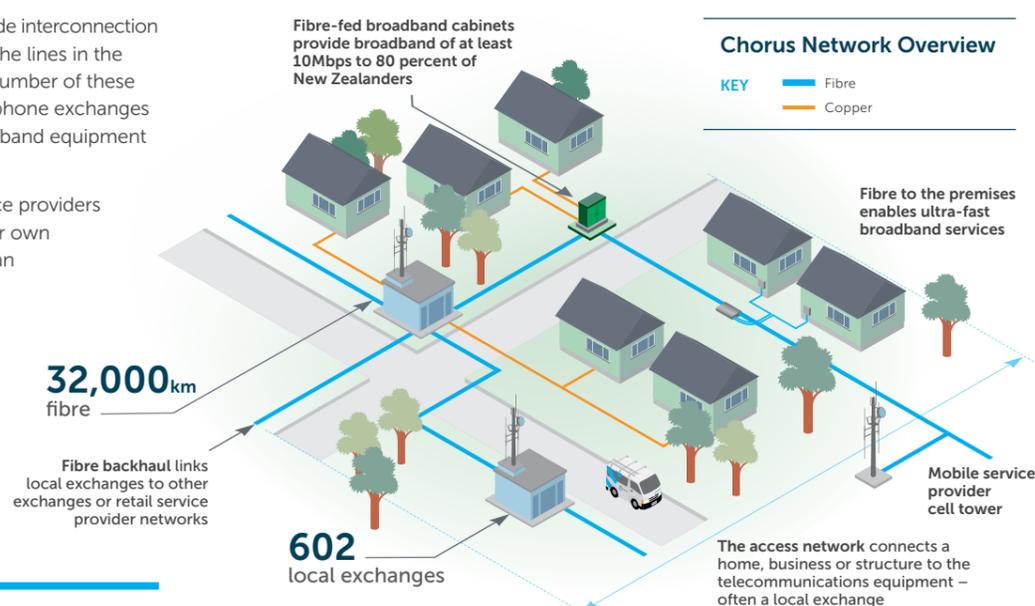
Fundamentally, Chorus is a simple business. The core of the business is the New Zealand wide network of fibre optic and copper cables that connect homes and businesses to each other.

The fibre network continues to grow rapidly and Chorus now has about 32,000km of fibre and 130,000km of copper cabling. These cables typically connect back to local telephone exchanges, of which Chorus has about 600 nationwide. Chorus fibre also connects many mobile phone towers owned by mobile service providers, so even mobile phone calls generally connect via the Chorus network at some point.

Chorus has about 1.8 million connections on the fixed line network, with about 1.1 million of these using a broadband service provided by Chorus' broadband equipment.

About 7,000 cabinets provide interconnection points for around 50% of the lines in the Chorus network. A large number of these cabinets are like mini telephone exchanges and have electronic broadband equipment installed in them.

In some cases, retail service providers have chosen to install their own broadband equipment in an exchange and pay Chorus just for the rental of the access line. This is called 'unbundling' and about 7% of Chorus' lines have been unbundled.



## DIRECTORS

### Sue Sheldon CNZM, BCom, FCA

Chairman; director since 1 July 2011; independent

Sue is a professional company director. She is chairman of Freightways and Paymark, deputy chairman of the Reserve Bank of New Zealand and a director of FibreTech Holdings and Contact Energy. Sue is a former director of Telecom, Smiths City Group and Meridian Energy, among others. She has extensive experience as both a chairman and member of audit and risk committees and is a former president of the New Zealand Institute of Chartered Accountants. Sue was made a Companion of the New Zealand Order of Merit for services to business in 2007.



### Anne Urlwin, BCom, CA, F InstD, FNZIM, ACIS

Director since 1 December 2011; independent

Anne has more than 20 years' directorship experience across many sectors, including energy, health, construction, regulatory services, internet infrastructure, research, banking, forestry and the primary sector, as well as education, sports administration and the arts. She is a director of Southern Response Earthquake Services Ltd, Steel & Tube Holdings Ltd and OnePath Life (NZ) Ltd. She is chairman of Naylor Love Enterprises Ltd and an independent chairman of Ngai Tahu Te Runanga Audit & Risk Committee. Anne is a former chairman of Lakes Environmental Ltd, the New Zealand Blood Service and New Zealand Domain Name Registry, and a former director of Meridian Energy.



### Clayton Wakefield, BSc (Computer Science), GradDip Mgmt

Director since 1 December 2011; independent

Clayton has over 30 years' experience in the banking, financial services, telecommunications and technology industries. He is an executive director and owner of Techspace, a leading New Zealand independent IT advisory company working with New Zealand's major corporates. From 2001 to 2007 he was Head of Technology and Operations at ASB Bank. He was previously a director and chairman of Electronic Transaction Services and of Visa New Zealand and also previously an independent director of Endace Ltd.



### Jon Hartley, BA Econ Accounting (Hons), Fellow ICA (England & Wales), Associate ICA (Australia), Fellow AICD

Director since 1 December 2011; independent

Jon is a Chartered Accountant and Fellow of the Australian Institute of Company Directors. He has held senior roles across a diverse range of commercial and not for profit organisations in several countries, including chairman of SkyCity, director of Mighty River Power, CEO of Brierley New Zealand and Solid Energy, and CFO of Lend Lease in Australia. Jon is currently deputy chairman of ASB Bank, Sovereign Assurance Company and vice chairman of VisionFund International. He is a director of VisionFund Cambodia and a trustee of World Vision New Zealand and of the Wellington City Mission.



### Keith Turner, BE (Hons), ME, PhD

Director since 1 December 2011; independent

Dr Keith Turner was CEO of New Zealand electricity generator and retailer Meridian Energy for nine years from its establishment in 1999. He is now chairman of Fisher and Paykel Appliances, deputy chairman of Auckland International Airport and a director of Spark Infrastructure, an Australian listed company. He is also chairman of Solar City New Zealand. Keith has had an extensive career in electricity, taking part in much of its reform, including separation of Transpower from Electricity Corporation of New Zealand Ltd (ECNZ) in 1992, the separation of Contact Energy from ECNZ in 1996 and the eventual break up of ECNZ into three companies in 1999.



### Mark Ratcliffe, BA Accounting

Director since 9 December 2011; non-independent

Mark has been CEO of Chorus since it was established in 2007 as an operationally separate business unit within Telecom and was then appointed as the first CEO of the listed entity in 2011. In a 20 year career with Telecom, Mark held finance, marketing, product development, product management and IT roles and was promoted to the executive team in 1999 where he was CIO (including a period as joint CEO of AAPT in Australia) and then COO Technology and Wholesale before becoming CEO of Chorus. From May 2010, he led the team that secured Chorus' participation in the Government's UFB initiative and the demerger of Chorus and Telecom.

### Prue Flacks, LLB, LLM

Director since 1 December 2011; independent

Prue is a director of Bank of New Zealand and Mighty River Power, and a trustee of the Victoria University Foundation. She is a barrister and solicitor with extensive experience in commercial law and, in particular, banking, finance and securities law. Her areas of expertise include corporate and regulatory matters, corporate finance, capital markets, securitisation and business restructuring. Prue is a consultant to Russell McVeagh, where she was previously a partner for 20 years.



## EXECUTIVE TEAM

### Mark Ratcliffe

Chief Executive Officer  
See above.

### Andrew Carroll, MCA (Hons)

Chief Financial Officer

Andrew joined Chorus after nine years with Telecom where, as Head of Mergers & Acquisitions, he was involved in the Gen-i acquisition and the sale of Yellow Pages. Prior to this he worked in investment banking for a decade. Andrew worked closely with the Chorus team on the UFB negotiations with Crown Fibre Holdings and throughout the demerger process.

### Ed Beattie\*

General Manager, IBuild

Ed has more than 30 years' experience in building and maintaining fixed line and mobile telecommunications networks in New Zealand. Most recently, he managed the delivery of the successful Fibre to the Node programme and played a lead role in the Christchurch crisis response and restoration activities.

### Ewen Powell, BE

Chief Technology Officer

Ewen has nearly 20 years' experience in managing the technology, services and partnerships that operate a national communications network. Much of his career was spent at Telecom where he was at the forefront of a wide range of technology changes, most recently driving the technology changes required to achieve Chorus' operational separation requirements.

### Irene Lovejoy

Executive Assistant

Irene has worked with Chorus CEO Mark Ratcliffe for more than 14 years, bringing a unique insight that adds value to the development of the Chorus executive team. Before joining Chorus, Irene spent 22 years with Telecom where she held roles in the marketing, technology and corporate teams.

### Nick Woodward

General Manager, Customer Service

Nick's career combines a wide range of IT, sales and customer management experience in the financial and telecommunications industries. His roles have seen him work across the United States and Europe for Hutchison 3G UK and Household Bank in the United Kingdom. Before joining Chorus, Nick headed up Telecom's Channel Planning and Operations group.

### Sara Broadhurst<sup>†</sup>, BA, Dip (Bus), Dip (Psych), PG Dip (Psych)

General Manager, Human Resources

Sara joined Chorus in 2008, bringing more than 10 years' experience in human resources in New Zealand and the United Kingdom from a wide range of industries, including housing, manufacturing, banking and not for profit organisations. She previously held human resources roles in New Zealand for ANZ National Bank, EFTPOS and Barnardos.

### Vanessa Oakley, LLB (Hons), PGCert (MgtSt), PGCert (CompPolicy) (UK), GAICD, MInstD

General Counsel & Company Secretary

Vanessa has extensive experience in law and policy, especially in relation to regulated infrastructure businesses. A qualified lawyer in New Zealand and England and Wales, Vanessa joined Chorus after playing a key role in the UFB contract, legislative and demerger processes. Prior to that she has held roles in the public and private sectors including as a key adviser to United Kingdom and New Zealand regulators and across the Telecom group.

### Victoria Crone, MCA

General Manager, Sales and Marketing

Victoria has extensive experience in bringing telecommunications products and services to market. She has held several senior business, sales and marketing roles with Telecom, including responsibility for the sales strategy and operations for its retail business, managing offerings for the business market and developing Telecom's proposition for next generation products and services.

\* During the year Ed Beattie assumed the role of General Manager IBuild after a reorganisation following the resignation of Chris Dyhrberg.

<sup>†</sup> Sara Broadhurst left Chorus on 23 August 2013



# Ultra-Fast Broadband

In May 2011, Chorus was selected by Crown Fibre Holdings Ltd (CFH) to roll out UFB in 24 of the 33 areas nationwide. This contract will see Chorus deploy around 17,000km of new fibre optic cables to areas covering around 70% of the UFB footprint.

By 2020, Chorus will have drilled, dug or hauled the new network past about 830,900 premises. With 60% to 70% of deployment costs relating to civil work, Chorus is using as much of its existing duct and fibre network as possible. Chorus is also working with councils and utility companies to further reduce deployment costs by, for example, trench sharing and linking with footpath replacement programmes where possible.

## UFB – an inter-generational investment

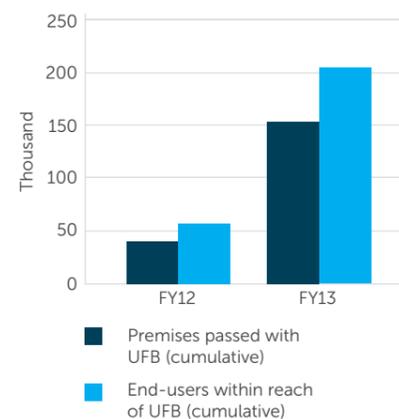
Fibre can deliver high speed connectivity over much greater distances than copper, opening up possibilities and services that aren't yet perceived. Fibre is also easier to maintain and will help future-proof the network for continuing growth in demand for bandwidth.

Alcatel Lucent's Bell Labs estimated in 2012 that the economic impact of

building the UFB and RBI networks is \$5.5 billion GDP growth over 20 years.

The Government's UFB policy, through public private partnerships with the Crown, brings forward the network investment ahead of demand and earlier than would have otherwise been made by the private sector alone. This means New Zealand can realise the economic and social benefits sooner.

## 205,500 end-users now within reach of UFB



# Rural Broadband Initiative

Chorus and Vodafone are working together to deliver the Government's RBI programme. This joint project is bringing better broadband to rural schools, health providers and tens of thousands of rural residents. There are several elements to this Government subsidised project. The main task for Chorus is laying fibre, often to exchange areas where there isn't fibre today. In addition, Chorus will deliver fibre to 154 new Vodafone mobile sites that will

be used to deliver fixed wireless broadband to rural communities.

As part of RBI, Chorus is laying approximately 3,350km of fibre and upgrading or installing about 1,000 new broadband cabinets. At 30 June 2013 Chorus had laid 2,150km of fibre and brought 51,200 lines within reach of better broadband.

# Regulatory environment

As the largest copper and fibre network operator in New Zealand, Chorus is subject to regulation.

On 3 December 2012, the Commerce Commission (Commission) released two decisions:

- The final benchmarked Unbundled Copper Local Loop (UCLL) decision reduced the price by 3.8% to \$23.52 per month. Chorus and retail service providers have applied for a 'final pricing principle' review of the decision.
- The draft benchmarked Unbundled Bitstream Access (UBA) decision proposed a reduction in price of around 60% from \$21.46 to \$8.93 per month.

On 7 August 2013, the Government released a discussion paper proposing a phased approach to a review of the telecommunications regulatory framework with an immediate focus on copper pricing. It proposes that Chorus' combined copper (UCLL and UBA) prices should be roughly equivalent with Chorus' contracted entry level fibre prices.

There are three options proposed – which generally differ in terms of whether the Commission or Government selects the appropriate price point between a range of \$37.50 – \$42.50, how the UCLL and UBA copper prices are set within that overall cap and whether new pricing applies from November 2014 or November 2015.

While the outcome of the Government's regulatory review is uncertain, all potential

options contained within the discussion paper imply reduced future earnings for Chorus. The discussion paper suggests a potential decrease of Chorus' pricing within a range of \$2.48 to \$7.48 per broadband connection per month. Based on 30 June 2013 connection volumes, Chorus anticipates this could imply a reduction in annual EBITDA in the range of \$20 million to \$100 million.

For UFB to be successful and for Chorus to maintain its current capital management settings, it is important to get an appropriate mix of Layer 1 (UCLL/UCLFS) and Layer 2 (UBA) pricing. The outcomes of this process and the Commission's parallel processes reviewing the UBA and UCLL prices are uncertain.

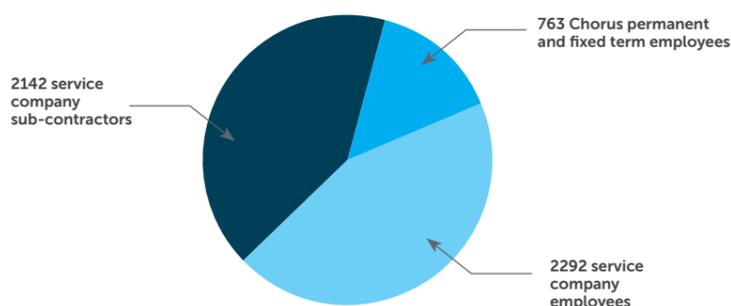
Later phases of the regulatory review are proposed to focus on the appropriate regulatory framework once the UFB build is complete in 2020 (amongst other things). Submissions are due on 13 September.

On 9 July 2013 the Government also issued a discussion document for the review of the Telecommunications Service Obligation (TSO). Chorus provides wholesale services that enable the provision of the retail TSO. Submissions on a number of potential future options for the TSO were due on 20 August 2013.

For a complete overview of Chorus' regulatory environment, please see the *competition and regulation* section in the Management Commentary.

# People

## Total people numbers at 30 June 2013



# Corporate Sustainability

Chorus aims to achieve a balance between our economic, environmental and social requirements that delivers our needs of today without compromising our needs of tomorrow. Chorus has this year been accepted into the FTSE4Good index, which measures the performance of companies that meet globally recognised corporate responsibility standards.

## Environmental highlights

During the year Chorus established an energy manager's role as part of our

commitment to manage the energy that made up 60% of our carbon footprint. We also calculated our base year carbon and submitted it to the Carbon Disclosure Project, a leading global carbon benchmark.

In addition, Chorus, in partnership with Downer, won the Ministry for the Environment Green Ribbon Award for waste minimisation through our efforts to recycle approximately 2,400 UFB drums and 20km of ducts.

## Social highlights

Last year, 274 Chorus staff took the opportunity to spend a day helping others in our community, through our Volunteer Day programme.

Starship children's hospital was nominated by Chorus people to receive a \$50,000 donation from Chorus.

We also continued to combat graffiti with our cabinet art programme, with another 35 cabinets now complete.



Artist Monique Endt  
Location Huia Road, Woodlands Park, Auckland

# Management Commentary



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Chorus reports earnings before interest, income tax, depreciation and amortisation (EBITDA) of \$663 million for the year ending 30 June 2013. After adjusting for \$1 million of insurance proceeds from the Canterbury earthquakes, underlying EBITDA is \$662 million. Chief Executive Officer Mark Ratcliffe describes this as “a good operating result particularly with both the UFB and RBI programmes slightly ahead of target, a small increase in the number of access lines and a 6% increase in copper broadband connections. On the downside, capital expenditure demands continue to be significant and regulatory headwinds remain. However, management is pleased with the principled approach the Crown is taking to the regulatory review.”

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
Operating revenue	1,057	613
Operating expenses	(394)	(214)
<b>Earnings before interest, income tax, depreciation and amortisation</b>	<b>663</b>	<b>399</b>
Depreciation and amortisation	(319)	(189)
<b>Earnings before interest and income tax</b>	<b>344</b>	<b>210</b>
Net interest expense	(108)	(68)
<b>Net earnings before income tax</b>	<b>236</b>	<b>142</b>
Income tax expense	(65)	(40)
<b>Net earnings for the period</b>	<b>171</b>	<b>102</b>
<b>EBITDA</b>		
	<b>663</b>	<b>399</b>
Less: insurance proceeds	(1)	(11)
<b>Underlying EBITDA</b>	<b>662</b>	<b>388</b>

## Highlights

- Chorus achieved modest underlying growth in EBITDA for the year ending 30 June 2013 when compared to normalised, annualised FY12 results.
- The Government announced that it is bringing forward its review of the telecommunications framework, alongside the already scheduled review of the Telecommunications Service Obligations (TSO).
- Ultra-Fast Broadband (UFB) build is progressing ahead of schedule with 153,000 premises passed and 205,500 end-users within reach at 30 June 2013.

- Total fixed line connections are stable at 1,784,000 and demand for fixed broadband connections continued to grow steadily with about 64,000 copper broadband connections added over the last twelve months.

- Fibre fixed line connections nearly doubled, with fibre revenue now 5.7% of total revenue.
- Chorus will pay a dividend for the six months ending 30 June 2013 of 15.5 cents per share (25.5 cents per share annual dividend).

## Challenges

- Ongoing uncertainty with the regulatory framework that Chorus operates in (the Telecommunications Act 2001) and alignment of the framework with the Government's UFB initiative.

- Gross capital expenditure for the year was \$681 million, with specific challenges on UFB programme deployment costs.
- Achieving ongoing efficiency in the cost of the UFB network rollout and ensuring UFB connections are made on a time and cost efficient basis.

- Start of major IT spend and migration from Telecom systems.

- Retail service provider focus on residential fibre is still developing, meaning uptake continues to grow incrementally.

- Industry changes are driving ongoing retail service provider cost focus, including greater focus on mobile substitution.

# In summary

## EBITDA

EBITDA for the year ended 30 June 2013 was \$663 million, representing around 1.2% growth in EBITDA on a normalised basis (see *normalised annualised results* on page 12). This reflects continued growth in demand for Chorus' basic and enhanced copper products, including steady broadband uptake over the year. Demand for fibre products also continued to grow, particularly for business and carrier connections. A significant amount of Chorus' revenues are from regulated products, which gives little discretionary flexibility in revenues. Costs have grown by around 7.4% relative to the normalised 2012 result (see *normalised annualised results* on page 12), reflecting increased provisioning costs, network maintenance costs and growing staff numbers (a significant number of which are working on the UFB build and information technology (IT) projects, which are fully capitalised).

A comparison of the normalised full year results, relative to the normalised annualised seven month results ended 30 June 2012, is included in *normalised annualised results* on page 12.

## Capital expenditure

Capital expenditure for the year ended 30 June 2013 was \$681 million, which is consistent with the mid point of the guidance range provided in February after adjusting for an additional \$14 million of year three UFB build initiated in this financial year (and recognised as work in progress). Approximately 85% of this capital expenditure was focused on fibre related investment, principally on the UFB and Rural Broadband Initiative (RBI) deployment programmes.

## Dividends

Chorus will pay a dividend of 15.5 cents per share on 11 October 2013 to all shareholders registered at 5.00pm on Friday 27 September 2013. The shares will be quoted on an ex-dividend basis from 25 September 2013 on the NZX Main Board and 23 September 2013 on the ASX.

The dividends will be fully imputed (at a ratio of 28/72) in line with the corporate income tax rate. In addition, a supplementary dividend of 2.7353 cents per share, will be payable to shareholders who are not resident in New Zealand.

Eligible shareholders will be able to participate in the Dividend Reinvestment Plan for the October 2013 dividend. Election notices to participate in the Dividend Reinvestment Plan must be received by 5.00pm Friday 27 September 2013.

Chorus' FY14 dividend guidance is unchanged. The Chorus Board will continue to monitor developments and expects to reassess Chorus' optimal capital management settings as the outcomes from the Government's regulatory framework review become clearer.

## Outlook

While Chorus continues to experience good growth in broadband and fibre connections there are a range of challenges for the year ahead. These include:

- Ongoing uncertainty with the regulatory framework, its lack of clear alignment with the Government's UFB initiative and the absence of fit-for-purpose regulation. Any changes to regulated pricing will likely be a strong influence on Chorus' future revenues and industry willingness to migrate to fibre.
- The year ending 30 June 2014 will also be the first full 12 months of the Commission's reduction in UCLL and Unbundled Copper Low Frequency Service (UCLFS) pricing, the annualised impact of which was estimated to reduce Chorus' EBITDA by around \$20 million per annum. It is likely that the significant regulatory programmes in FY14 will also result in increased regulatory and consultant costs in FY14.
- The need to achieve further efficiencies in the deployment cost of the UFB network rollout and end-user connections.
- Even greater focus from retail service providers on input costs. This means they are scrutinising opportunities to lower their wholesale costs from Chorus and are also considering initiatives to drive greater fixed to mobile substitution.
- Increased competitive pressure from other networks. The other UFB network builders had passed approximately 76,000 premises at 30 June 2013 and may start to gain greater market share from Chorus as their network footprints develop scale. In addition, several mobile network operators have begun offering 4G coverage in main centres, offering mobile broadband capability that may be more competitive against Chorus' fixed line offering.
- As noted at the half year, Chorus expects to incur incremental IT costs as two IT systems are run in parallel.
- If Very High Speed Digital Subscriber Line (VDSL) uptake increases materially, this is likely to have a modest near term impact on earnings as the cost of the recommended wiring upgrade is incurred up front, while the revenues are received over time.

Given the above, Chorus' current view is that the earnings outlook for FY14 is flat to low single digit percentage decline in EBITDA relative to normalised FY13 EBITDA of \$654 million (see *normalised annualised results* on page 12).

# Overview of the telecommunications wholesale market

Chorus is New Zealand's largest fixed line communications infrastructure services provider, supplying about 90% of all fixed network connections to retail service providers. Chorus has business line restrictions prohibiting it from selling directly to end-users.

Chorus is focused on leading the transition from copper to fibre-based services. Public private partnerships and open access wholesale services are at the heart of the industry model established in late 2011. It is a time of complex transition, representing both opportunity and challenge for Chorus, as well as for retail service providers.

Chorus' total of approximately 1,784,000 fixed line connections at 30 June 2013 represent an increase of approximately 8,000 lines from 30 June 2012. Real growth of 10,000 lines in the first half was offset by a reduction of approximately 2,000 lines over the six months to 30 June 2013. The relatively static nature of fixed line connections continues to reflect the slow migration of fixed voice services to mobile in New Zealand, relative to other countries. With the strong growth in mobile smart devices, fixed networks globally are increasingly seen as complementary to supporting the mobile experience. The installation of fibre network in new subdivisions is also providing some natural connection growth.

New Zealand's broadband market continues to grow steadily with Chorus adding about 64,000 copper broadband connections in the twelve months. In July 2013, the OECD reported that New Zealand was the third fastest growing broadband market in the OECD for the year to December 2012, with total broadband connections increasing 3.1% to 1.28 million. Broadband penetration per 100 inhabitants was 28.6%, ahead of both the OECD average (26.3%) and Australia (25.2%)<sup>1</sup>. The Commission estimates that broadband penetration increased to around 78% of households with a fixed line connection<sup>2</sup>. The proportion of Chorus' copper lines also taking a broadband service increased from 60% to 63% during the period.

In addition to the significant change arising from the Government's UFB policy and the separation of Chorus' open access network from retail, there is other ongoing change in the industry. There are changes in the ownership of retail service providers (as already seen in the purchase of TelstraClear by Vodafone in October 2012 and Kordia's sale of Orcon to private investors in April 2013) and the evolution of online content offerings (as seen with Coliseum Sports Media announcing in June 2013 that it has secured the broadcast rights for the English Premier League and will use an online platform).

## Other networks

Chorus' network competitors include Vodafone, Vector, FX Networks, Kordia and a range of regionally based fixed wireless network providers such as Woosh, CallPlus and Now. Vodafone is a significant Chorus customer, but is also now Chorus' largest fixed network competitor through its purchase of the TelstraClear cable network in Wellington, Kapiti and Christchurch connecting about 60,000 broadband end-users. It also has business fibre networks in all major central business areas and a national transport and backhaul network.

Three local fibre companies Northpower, Ultrafast Fibre and Enable Networks are also deploying fibre networks in public private partnerships with the Crown in 9 of the 33 UFB areas. It is expected they will deploy UFB fibre past about 365,000 premises. Chorus expects its UFB network to have passed about 830,900 premises by the end of 2019.

# Revenue commentary

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
Basic copper	631	399
Enhanced copper	215	89
Fibre	60	28
Value added network services	37	18
Infrastructure	17	14
Field services	85	47
Other	12	18
<b>Total revenue</b>	<b>1,057</b>	<b>613</b>

## Revenue overview

Chorus' focus is on sustaining demand for connections and supporting retail service providers and stakeholders by growing connections and 'leading New Zealand to fibre'. Revenues and volumes have remained relatively steady throughout the twelve months.

Unadjusted revenues were up slightly compared to the prior period (annualised). After adjusting for changes in regulated (UCLFS) pricing, revenues were up by around 3.5% on a like for like basis (see *normalised annualised results* on page 12). Total fixed line connections were stable, with a slight increase of 8,000 connections (from 1,776,000 to 1,784,000). This included adjustments to allow for:

- approximately 7,000 High Speed Network Service (HSNS) connections over copper previously omitted from the 'data services over copper' category in the 30 June 2012 total for fixed line connections; and
- excluding about 7,000 Sub Loop Unbundling (SLU)/Sub Loop Extension Services (SLES) connections that were previously double counted in the 30 June 2012 total for fixed line connections.

A summary of Chorus' connection numbers for key products is in *revenue commentary* on page 10.

Chorus' product portfolio encompasses a broad range of broadband, data and voice services. It includes a mix of regulated and commercial copper and legacy products, and contractually agreed fibre products. Chorus' revenue strategy focuses on:

- Retaining value by sustaining demand for Chorus' share of market connections;

- Delivering growth by driving demand for UFB services in line with the Government's objective to maximise fibre uptake. Chorus' goal is to deliver products that support bandwidth growth and encourage adoption of higher speed fibre products of 100Mbps or more; and

- Defining new market opportunities for Chorus' connections and services.

*Product overview* on page 16 provides an overview of the significant products and services that make up copper and fibre revenues.

## Basic copper

Basic copper incorporates core regulated products that, while an important part of the portfolio, have limited scope for further development by Chorus, or are founded on earlier technology and product variants that are being superseded by enhanced copper and fibre services. It includes most of Chorus' layer 1 network products and includes the copper voice input UCLFS, UCLL, SLU and SLES, and Basic UBA (including broadband only naked Basic UBA connections).

The migration from Basic UBA broadband services to enhanced copper services and a shift in traditional voice volumes, as retail service providers invest in Internet Protocol (IP) voice services is contributing to a continuing decline in basic copper revenues.

The majority of basic copper revenues are derived from Chorus' Baseband Copper services (including UCLFS) which retail service providers can use as an input into traditional voice offers. The Commission's final decision on UCLL pricing resulted in Baseband Copper pricing reducing from \$24.46 to \$23.52 from 1 December 2012. As a result basic copper revenues have decreased by approximately \$20 million on an annualised basis. The historical impact of this reduction in revenues is analysed further in *normalised annualised results* on page 12.

<sup>1</sup> OECD Fixed (wired) broadband subscriptions per 100 inhabitants, by technology, December 2012 <http://www.oecd.org/sti/broadband/oecebroadbandportal.htm>

<sup>2</sup> Annual Telecommunications Monitoring Report 2012, Commerce Commission, April 2013

# Revenue commentary (cont.)

At 30 June 2013 there were approximately 1,521,000 Baseband Copper lines<sup>3</sup>, a decrease of 64,000 lines from 30 June 2012. This reduction was offset by the migration of connections to Chorus' other fixed line connection products. In particular, UCLL connections grew by 25,000 lines and 'naked' connections (naked Basic UBA, naked Enhanced UBA and naked VDSL) grew by 41,000 lines.

The number of unbundled exchanges grew from 156 to 183 over the period. At 30 June 2013, approximately 128,000 access lines were being used by retail service providers to deliver unbundled services to consumers. The total comprised 122,000 UCLL lines and 6,000 SLU lines (offered in conjunction with Chorus' commercial SLES).

The number of SLU/SLES connections decreased by about 6,000 lines when allowing for 7,000 lines that had previously been double counted in the 30 June 2012 total. UCLL lines are currently charged at \$19.08 for urban and \$35.20 for non-urban following the Commission's re-benchmarking of UCLL pricing in December 2012. The urban and non-urban prices are expected to move to an averaged price of \$23.52 in December 2014 (noting that the pricing of these services are still subject to various processes – see the *competition and regulation* section).

Basic UBA is an early variant broadband service, delivered on a 'best efforts' basis using older generation technology. The number of Basic UBA connections had declined to about 331,000 connections at 30 June 2013. This reflects retail service provider systems upgrades and migration to the Enhanced UBA service.

UBA pricing was set on a retail minus basis prior to demerger and the Commission is currently considering cost based pricing for UBA services by reference to benchmarking. Any change to the UBA price would not come into effect until November 2014 at the earliest. The UBA price, and the date on which any change comes into effect may change as a result of the current regulatory review (see the *competition and regulation* section).

## Enhanced copper

Enhanced copper includes copper based next generation regulated and commercial products that deliver higher speed capability, a better end-user experience and can assist transition to fibre. It includes Enhanced UBA, VDSL, Baseband IP voice input service and HSNS Lite (Copper) for business data.

Chorus' enhanced copper category grew steadily over the period, reflecting continued migration from Basic UBA to Enhanced UBA services and continued growth in new connections. While entry level Enhanced UBA services are charged at the same regulated

price (currently \$21.46) as Basic UBA services, Enhanced UBA uses an Internet Protocol technology platform that offers the potential for a superior broadband experience and greater service differentiation.

Enhanced UBA connections were approximately 680,000 at 30 June 2013, an increase of 83% from 30 June 2012. A standard Enhanced UBA (with analogue voice) connection costs \$21.46 although Chorus can achieve higher revenue than this when retail service providers offer service differentiation to end-users and opt for higher bandwidth capability from Chorus. There were also approximately 78,000 naked Enhanced UBA connections at 30 June 2013. As noted earlier, the pricing of UBA services is currently under review (see the *competition and regulation* section).

In June 2013 Chorus began offering VDSL at a price aligned with the current Enhanced UBA wholesale price of \$21.46. VDSL had previously been offered as a premium service with commercial pricing of \$40.00 and uptake had been minimal. The new VDSL product is expected to provide more New Zealanders with the opportunity to enjoy higher speed connections, and also make New Zealand a more attractive market for the development and deployment of high bandwidth applications. Faster copper-based technology forms an important stepping stone to fibre. Like any technology upgrade, the move to fibre will be a long term transition and VDSL has an important role in the interim. The number of VDSL connections had increased to 4,000 by 30 June 2013 with retail service providers beginning to market it more widely. VDSL utilises existing copper based capability and can provide download speeds of about 20-50Mbps and upload speeds of up to 20Mbps, subject to an end-user's distance from the broadband equipment and line capability.

Chorus also began offering a Baseband IP service in April 2013 that enables retail service providers to deliver a Voice over Internet Protocol (VoIP) service over copper as either a standalone service, or in conjunction with broadband. Baseband IP is currently available across about 10% of Chorus' lines and is charged at \$23.52 per month. While initial connection numbers have been limited, Chorus has received positive interest from retail service providers and is considering the business case for future expansion of the Baseband IP footprint.

## Fibre

Fibre revenues are earned from Chorus' existing business fibre products (such as HSNS Premium) and new UFB residential and business fibre services. This category also captures UFB backhaul, and Direct Fibre, which is the equivalent of dark fibre and can also be used to deliver backhaul connections to mobile sites.

About 205,500 end-users were within reach of the UFB network at 30 June 2013. Residential UFB uptake has been constrained to date by the limited number of retail service providers in the market and relatively small size of coverage area. Telecom, New Zealand's largest retail broadband provider, began offering residential fibre services in March 2013 and Vodafone has said it also intends to begin offering residential fibre services later in 2013. Together, these two providers represent ~80% of the fixed line broadband market. Chorus is continuing to focus on educating retail service providers and New Zealanders about the benefits of fibre, supporting fibre trials, and removing barriers to bandwidth growth.

Fibre connections grew significantly during the twelve month period, increasing by 90% to 19,000 lines. This growth reflected new demand linked to the ongoing expansion of the UFB footprint and continued demand for new business and carrier connections via Chorus' existing fibre network, including Chorus' fibre in areas where it is not the UFB network builder.

About 44% of Chorus' fibre connections were predominantly residential Next Generation Access end-users (which includes UFB Bitstream 2 and 3 and education connections) or pre-UFB fibre subdivision end-users. Chorus had approximately 6,300 fibre connections within the areas where it had deployed UFB communal network at 30 June 2013. This total includes a combination of residential UFB connections and new, or pre-UFB, business fibre connections within the areas where Chorus' UFB network was built.

Direct Fibre Access grew to about 20% of total fibre connections by 30 June 2013. Bandwidth Fibre and HSNS Premium fibre connections (also referred to as Bitstream 4 under the UFB agreement) accounted for the remaining 36% of total fibre connections. To date, demand for business fibre connections has been predominantly for higher grade HSNS Premium connections rather than Bitstream 3 business services. This may change over time as the UFB network makes Bitstream 3 business services more widely available.

## Value added network services

The main revenue driver for this category is carrier network services, which provide network connectivity across backhaul links. The nature of these services means volumes and revenues in this category were largely unchanged. Changes period on period are largely related to timing differences in invoicing, which are not expected to recur.

## Infrastructure

Infrastructure revenue relates to services that provide access to Chorus' network assets, including civil works and telecommunications exchange space. It also includes co-location of equipment and access to poles.

Chorus provides commercial access to its exchanges, poles and other infrastructure. Co-location revenue derives from retail service providers and other network operators installing their equipment in Chorus exchanges, as well as leased commercial space in exchange buildings.

Infrastructure revenue grew modestly over the period, after allowing for transaction types that were included in the period to 30 June 2012 but were treated as a reduction in expenses for the current period. This growth occurred primarily as the result of increased demand for commercial co-location to enable retail service providers to interconnect with Chorus' UFB footprint.

## Field services

This category includes work performed by Chorus' service company technicians providing new services, chargeable cable location services, maintaining retail service provider networks and relocating Chorus' network on request. As Chorus utilises service companies to perform the field services' work, there is a direct cost associated with all field services revenues.

Provisioning revenues are generally based on orders for technicians to install services and are driven by the number and nature of orders, and the type of work required.

Maintenance revenues are generated when faults are proven to be on the retail service provider's, rather than Chorus', network and are driven by the number of reported faults and proactive maintenance programmes performed on behalf of retail service providers.

These revenues also include costs recovered for damage to Chorus' network by third parties.

Revenue in this category is dependent on third party demand or damages to a third party's network. The network maintenance expense is discussed in the *expenditure commentary* and has a direct impact on the revenues billed to recover costs incurred. It is therefore difficult to establish specific trends in this revenue category.

## Other

This category includes revenues from the resale of Telecom's Integrated Services Digital Network and voice related services, as well as one-off type revenue items. Approximately \$1 million (30 June 2012: \$11 million) was received for Christchurch earthquake related insurance proceeds.

<sup>3</sup> For billing purposes, this total includes instances where UCLFS is sold with UBA connections. Although the UCLFS Standard Terms Determination contemplates such connections as naked UBA connections, the price outcome is the same as if these connections were billed for naked UBA and zero for UCLFS/Baseband.

# Revenue commentary (cont.)

# Expenditure commentary

## Chorus summary connection facts

	30 JUNE 2013 CONNECTIONS	31 DEC 2012 CONNECTIONS	30 JUNE 2012 CONNECTIONS
<b>Total fixed line connections</b>	<b>1,784,000</b>	<b>1,793,000</b>	<b>1,776,000</b>
Baseband Copper	1,521,000	1,559,000	1,585,000
UCLL	122,000	109,000	97,000
SLU/SLES	6,000*	16,000	19,000
Naked Basic / Enhanced UBA / naked VDSL	91,000	72,000	50,000
Data services over copper	25,000	22,000*	15,000
Fibre	19,000	15,000	10,000
<b>Total Broadband</b>	<b>1,112,000</b>	<b>1,076,000</b>	<b>1,040,000</b>
Basic UBA (with analogue voice service)	331,000	474,000	619,000
Naked Basic UBA	11,000	9,500	11,000
Enhanced UBA (with analogue voice service)	680,000	530,000	371,000
Naked Enhanced UBA	78,000	60,500	39,000
VDSL	2,000	NM	NM
Naked VDSL	2,000	2,000	NM
Fibre	8,000	NM	NM

\* The SLU/SLES access line category has been adjusted down by about 7,000 connections for the current period to correct a double counting of lines that occurred in prior periods.

^ Approximately 7,000 HSNS connections over copper were omitted in error from the 'data services over copper' category in the 30 June 2012 total for fixed line connections.

A fibre category has been introduced into the broadband connections summary to represent those fibre connections that deliver the equivalent of a layer 2 broadband connection. This category includes Bitstream 2 and 3 services on the UFB network as well as subdivisions connected via Chorus' non-UFB fibre network.

Note: There may be further adjustments between the 'Baseband Copper' and 'data services over copper' categories in future as Chorus continues to review the classification of some legacy connections.

## Operating expenses

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
Labour costs	67	31
Provisioning	51	23
Network maintenance	100	52
Other network costs	37	22
Information technology costs	52	30
Rent and rates	12	6
Property maintenance	12	8
Electricity	13	11
Insurance	4	3
Consultants	6	5
Other	40	23
<b>Total operating expenses</b>	<b>394</b>	<b>214</b>

Operating expenditure has increased by 7.4% relative to annualised 2012 results (see *normalised annualised results* on page 12), reflecting ongoing growth in the labour force, increased provisioning activity and greater network maintenance costs. Areas of significant change include:

**Labour costs** of \$67 million for the period represent staff costs that are not capitalised. At 30 June 2013 Chorus had 763 permanent and fixed term employees. This was up from 548 employees at 30 June 2012 and includes about 90 customer services employees transitioned from Telecom in late October. Additional people have been employed to support critical programmes, such as the UFB rollout and IT systems transition (see also IT commentary in the *capital expenditure* section), and growing levels of operational activity, such as complex provisioning and fibre provisioning work. It is expected that further IT staff will be required to support the systems transition over the coming twelve months, with the majority of costs relating to these additional people being capitalised.

**Provisioning costs** are incurred where Chorus provides new or changed service to retail service providers. The total provisioning cost is driven by the volume of orders, the type of work required to fulfil them, technician labour, material and overhead costs. While the volume of provisioning truck rolls has decreased period on period, overall costs have increased due to a Consumer Price Index (CPI) price increase and change in the mix of products being purchased. As a proportion of provisioning costs are recovered from retail service providers, field services revenue has increased as well.

**Network maintenance** costs relate to fixing network faults and any operational expenditure arising from the proactive maintenance

programme. Where faults are on a retail service provider's network (rather than the Chorus network), Chorus charges the retail service provider for this service. Network maintenance costs are driven by the number of retail service provider reported faults, the type of work required to fix the faults and the extent of Chorus' proactive maintenance programme.

One of the key drivers for reported faults is the weather. During the year ended 30 June 2013, severe weather events in August 2012 and May 2013 resulted in an increased amount of maintenance required on the network. About 74% of the maintenance work was on the Chorus network and this was not recoverable (compared to 71% on the Chorus network in the period to 30 June 2012). The level, type and cost of faults is affected by factors such as rainfall, lightning, network degradation, labour costs, material costs and network growth. Chorus network faults are typically more expensive than retail service provider network faults because they can span multiple end-users, require restoration of more complex network elements and involve reinstatement. In addition, the network maintenance charges from service companies increased in line with CPI during the period.

Both provisioning and network maintenance costs contain an element of service company overhead. In the year to 30 June 2013 this has been accounted for on a straight line basis. In the previous period they were accounted for on an activity basis.

**Other network** costs relate to costs associated with service partner contract costs, engineering services and the cost of network spares.

**Information technology** costs of \$52 million represent the costs paid directly by Chorus to third party vendors, as well as the operating expenditure component of systems currently shared with Telecom.

# Expenditure commentary (cont.)

During the year ended 30 June 2013 Chorus started a number of projects to enable migration from Telecom systems. This resulted in a small amount of increased spend because Chorus is establishing systems which are still paid for in the Transitional Services Agreement.

**Rent and rates, property maintenance, electricity and insurance** costs relate to the operation of Chorus' network estate (for example, exchanges, radio sites and roadside cabinets). The principal cost is electricity, used to operate the network electronics, and this is dependent on the number of sites, electricity consumption and electricity prices.

**Electricity costs** were down compared to the previous period largely due to lower national electricity prices. In addition to this, consumption is lower than the previous period as a number of energy saving initiatives have reduced energy usage. Chorus hedges its electricity usage to minimise volatility in electricity spot prices. About 50% of Chorus' requirements have been hedged with a rolling three year horizon.

## Depreciation and amortisation

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M	ESTIMATED USEFUL LIFE (YEARS)	WEIGHTED AVERAGE USEFUL LIFE (YEARS)
<b>Depreciation:</b>				
Copper cables	66	41	10 - 30	22
Fibre cables	29	13	20	20
Ducts and manholes	16	7	50	50
Cabinets	33	15	5 - 14	10
Property	14	8	5 - 50	16
Network electronics	95	62	2 - 14	8
Other	9	5	2 - 15	6
Less: Crown funding	(4)	(1)		
<b>Total depreciation</b>	<b>258</b>	<b>150</b>		
<b>Amortisation:</b>				
Software	60	39	2 - 8	5
Other intangibles	1	-	6 - 20	20
<b>Total amortisation</b>	<b>61</b>	<b>39</b>		

**Consultant costs** for the seven months to 30 June 2012 was significant as a result of demerger and the work required to establish Chorus as a stand alone business. These costs are no longer being incurred but a significant amount of consultant spend was required in the year to 30 June 2013 to support multiple streams of regulatory work.

**'Other'** includes expenditure incurred by Chorus for shared services provided by Telecom, together with general costs such as advertising, travel, training and legal fees.

The weighted average useful life represents the useful life in each category weighted by the net book value of the assets.

During the year ended 30 June 2013 \$672 million of network assets was capitalised. The 'UFB communal and UFB connections and fibre layer 2' included in 'fibre' capital expenditure was largely capitalised against the network assets categories of fibre cables (35%) and ducts and manholes (56%). The average depreciation rate for UFB communal infrastructure spend is currently 37 years, reflecting the very high proportion of long life assets being constructed (with ducts and manholes having a depreciation rate of 50 years).

## Net finance expense

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
<b>Finance income</b>	<b>(7)</b>	<b>(4)</b>
<b>Finance expense</b>		
Interest on syndicated bank facility	58	32
Interest on EMTN	46	27
Other interest expense	16	16
Capitalised interest	(6)	(3)
<b>Total finance expenses excluding Crown funding</b>	<b>114</b>	<b>72</b>
CFH securities (notional interest)	1	-
<b>Total finance expense</b>	<b>115</b>	<b>72</b>

At a minimum, Chorus aims to maintain 50 percent of its debt obligations at a fixed rate of interest. It has fully hedged the foreign exchange exposure on the Euro Medium Term Note (EMTN) with cross currency interest rate swaps. The floating interest on these derivatives has been hedged using interest rate swap instruments. The exposure to floating rate interest on the syndicated bank facility has been reduced using interest rate swaps.

As at 30 June 2013, approximately 66% (30 June 2012: 70%) of the outstanding debt obligation was fixed through derivative or fixed rate debt arrangements.

Other interest expense includes finance lease interest of \$13 million (30 June 2012: \$9 million) and \$2 million interest in relation to shared and network systems. In the period ending 30 June 2012 there was a non-cash charge of \$7 million. The non-cash charge reflects the mark to market impact of the unhedged debt position from 1 December 2011 to 14 February 2012, when the debt was entered

The depreciation profile is expected to change, reflecting the greater mix of longer dated assets as the UFB and RBI rollouts progress.

The Crown funding release against depreciation is also expected to increase over time as additional call notices are issued and funding is received from the Crown, with the associated amortisation to depreciation increasing accordingly.

Software and other intangibles largely consist of the software components of billing, provisioning and operational systems (including Chorus spend on Telecom owned systems). A total \$42 million of capital expenditure was spent on software and other intangibles during the year, which will be amortised over an average of five years.

into a hedge relationship. At 14 February 2012, when the hedged relationship was initiated, EMTN related hedges had a fair value of \$70 million. While the hedge remains effective any future gains or losses will be processed through the hedge reserve, however the \$70 million will flow as ineffectiveness to interest expense in the income statement at some time over the life of the derivatives. It will be a non-cash charge. Neither the direction, nor the rate of the impact on the income statement can be predicted. For the current financial year there has been no ineffectiveness and therefore no impact on the income statement (30 June 2012: no ineffectiveness).

## Taxation

The 2013 effective tax rate of 28% equates to the statutory rate of 28%. There are no material differences between net earnings before income tax and what is, or will be, taxable for the period to 30 June 2013.

# Normalised annualised results

## Indicative comparison of normalised, annualised full year results

This section provides a high level trend analysis of the normalised, annualised full year results. The commentary included here is for information purposes only. These results have not been audited.

### Summary

	NORMALISED FY13 \$M	NORMALISED ANNUALISED FY12 \$M	%
Operating revenue	1,048	1,013	3.5
Operating expenses	(394)	(367)	7.4
<b>EBITDA</b>	<b>654</b>	<b>646</b>	<b>1.2</b>

The table above shows comparable underlying results for normalised FY13 when compared to normalised, annualised FY12. The details of the normalisations and adjustments will be discussed in further detail later in this section.

### Operating revenue

	NORMALISED FY13 \$M	NORMALISED ANNUALISED FY12 \$M	%
Basic copper	623	665	(6.3)
Enhanced copper	215	152	41.4
Fibre	60	48	25.0
Value added network services	37	31	19.4
Infrastructure	17	24	(29.2)
Field services	85	81	4.9
Other	11	12	(8.3)
<b>Total operating revenue</b>	<b>1,048</b>	<b>1,013</b>	<b>3.5</b>

The decline in basic copper revenues is slightly lower when the impact of the UCLFS price change is excluded. There has been continued migration from basic copper to enhanced copper, but the total combined revenue for these two revenue streams has grown by \$20 million (or 2.6%) over the period. This reflects the ongoing increase in broadband connections.

All other revenue categories are unchanged, so no additional commentary is required.

## Adjustments and normalisations of the results

Both the current and prior period results contain a number of balances that do not make them directly comparable in isolation. These balances have been removed from the balances described above so that a more direct comparison could be made. The adjustments made to the balances are discussed below.

### FY13 normalisation

	2013 (12 MONTHS) \$M	LESS: INSURANCE PROCEEDS \$M	LESS: UCLFS \$M	NORMALISED FY13 \$M
Operating revenue	1,057	(1)	(8)	1,048
Operating expenses	(394)	-	-	(394)
<b>EBITDA</b>	<b>663</b>	<b>(1)</b>	<b>(8)</b>	<b>654</b>

Included in the FY13 is \$1 million of insurance proceeds received in the second half of the year. Also adjusted is the impact of the change in price on UCLFS for the first five months of the period (effectively changing the price of UCLFS for the whole year rather than from 1 December 2012).

### FY12 normalised and annualised

	2012 (7 MONTHS) \$M	LESS: INSURANCE PROCEEDS \$M	NORMALISED 2012 \$M	NORMALISED ANNUALISED FY12 \$M
Operating revenue	613	(11)	591	1,013
Operating expenses	(214)	-	(214)	(367)
<b>EBITDA</b>	<b>399</b>	<b>(11)</b>	<b>377</b>	<b>646</b>

The seven month results for 2012 contain \$11 million insurance proceeds relating to the Canterbury earthquakes. These are one-off in nature and not expected to recur. Also excluded is the impact of the reduction in price of UCLFS, with the resulting number then annualised to provide a twelve month period.

# Capital expenditure commentary

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
Fibre	579	274
Copper	69	49
Common	33	23
<b>Gross capital expenditure</b>	<b>681</b>	<b>346</b>

Chorus reports capital expenditure in three categories reflecting its core network asset and build programmes.

- 'Fibre' includes spend specifically focused on fibre assets (layer 0 and layer 1 UFB network assets) to support the fibre network (IT delivering fibre products) and programmes largely focused on fibre (UFB and RBI).
- 'Copper' includes spend on copper related network assets and supporting capability (such as layer 2 electronics).

- 'Common' includes a range of spend unrelated to network asset classes, such as Chorus' enterprise systems, buildings and office equipment.

Gross capital expenditure for the twelve months to 30 June 2013 was \$681 million, which is consistent with the mid point of the guidance range provided in February after adjusting for an additional \$14 million of year 3 UFB build initiated in this financial year (and recognised in work in progress).

## Fibre capital expenditure

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
UFB communal	362	162
UFB connections and fibre layer 2	31	13
Fibre products and systems	27	7
Other fibre connections and growth	53	33
RBI	106	59
<b>Total fibre capital expenditure</b>	<b>579</b>	<b>274</b>

Fibre capital expenditure represents about 85% of Chorus' gross capital expenditure spend, mainly for the UFB and RBI programmes. Significant progress was made in continuing to ramp up the pace of the UFB communal network deployment during the twelve months. Build work has been completed for about 153,000 premises at 30 June 2013, exceeding the cumulative target of 149,000 premises passed and representing the addition of 111,000 premises passed during the period. There are 205,500 end-users able to be connected to the UFB network.

In February, Chorus updated its guidance on the estimated cost to build the UFB communal network by the end of 2019, increasing it from \$1.4 - \$1.6 billion to \$1.7 - \$1.9 billion. This revised guidance reflected higher than expected cost per premises passed (CPPP) with the rollout not yet standardised, positive results in some areas being offset by extreme costs in a small group of areas, significant variability in regional compliance requirements and cost benefits from initiatives taking longer to materialise.

The cost of the deployment of UFB communal network for the twelve months was \$362 million. As the UFB programme becomes more like a production line, work in any financial year will also include work scheduled to be completed in the following deployment year. As at 30 June 2013, \$30 million had been spent on work in progress for UFB communal deployment scheduled to be completed in the following year.

The average cost per premises passed was \$2,935 (when including 3,700 'greenfields' and existing broadband over fibre premises where no material capex was incurred during the twelve months) or \$3,048 if only counting premises where capital expenditure was incurred as part of this year's build programme.

Chorus has previously provided guidance of an average cost to connect standard residential end-user premises of \$900 to \$1,100 (real) across the UFB rollout. As expected, initial costs are above this, reflecting the start up nature of this programme and lack of volume to support scale efficiencies. In November, Chorus announced that it was contributing \$20 million of funding to support free installation for residential end-users in the early stage of the UFB rollout.

Chorus already funds the first 15 metres of new trenching to connect a home, or up to 100 metres of fibre where there is an available duct, or a single overhead aerial span. The funding will be used to cover the incremental cost of connecting residences that are beyond these distances, up to 200 metres.

Investment in fibre related products and systems development was \$27 million. This spend relates to new systems to improve the ordering and provisioning process for fibre connections.

## Copper capital expenditure

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
Network sustain	33	20
Copper connections	21	14
Copper layer 2	8	12
Product fixed	7	3
<b>Total copper capital expenditure</b>	<b>69</b>	<b>49</b>

Copper capital expenditure was \$69 million for the period, reflecting the ongoing shift in focus to fibre related capital expenditure.

Network sustain refers to capital expenditure where the network is being upgraded or network elements such as poles, cabinets and cables are replaced. This is typically where there is risk of network failure or degraded service for end-users and network replacement is deemed more cost effective than reactive maintenance.

Capital expenditure on copper connections occurs where there is demand for copper connections for residential or business end-users, such as infill housing or new buildings. Demand for

Capital expenditure of \$53 million on other fibre connections and growth reflects demand for fibre connections in areas where UFB has not yet been deployed, new 'greenfield' fibre subdivisions, fibre lifecycle investment and regional backhaul connections for retail service provider data traffic. Chorus expects to see a transition over time between this category and UFB related capital expenditure as the UFB network footprint grows.

The Rural Broadband Initiative continued at pace with 2,150 kilometres of fibre laid by 30 June 2013, bringing better broadband within reach of 779 schools and 51,200 rural end-users since the start of the programme. Some of this work was brought forward from future years of the rollout programme. The RBI is scheduled to be completed in 2016 and Chorus' role is to deploy network duct and fibre (largely grant funded, see *contributions to capital expenditure* section below) to connect schools, hospitals, wireless broadband towers and other priority users in rural areas. Chorus is also deploying cabinets and cabinet electronics to expand its broadband footprint as part of the programme. Chorus expects to receive approximately \$236 million in Government grant funding for the RBI, with the grant covering about 80-85% of Chorus' annual RBI capital expenditure.

copper connections is expected to decrease over time as the UFB network footprint expands and demand for fibre connections grows.

Copper layer 2 reflects investment in network electronics and equipment as a consequence of demand for broadband capacity and growth. This has reduced following the conclusion of the fibre to the node programme and is expected to decline further over time in line with the UFB network rollout and uptake.

Capital expenditure on 'Product fixed' is largely driven by retail service provider demand for copper related products, in the current year this largely relates to Baseband IP product development.

## Capital expenditure commentary (cont.)

### Common capital expenditure

	2013 (12 MONTHS) \$M	2012 (7 MONTHS) \$M
Information technology	16	12
Building and engineering services	16	10
Other	1	1
<b>Total common capital expenditure</b>	<b>33</b>	<b>23</b>

Common capital expenditure was \$33 million. Chorus made a \$16 million investment in information technology systems to 30 June 2013. This spend largely relates to changes required to existing systems as a result of the demerger. Chorus is continuing to undertake a significant programme of IT systems development as part of its demerger commitments.

Building and engineering services reflects the capital spent on growth and plant replacement (eg power and air conditioning) at Chorus exchanges, buildings and remote sites.

'Other' includes items such as office accommodation and equipment.

### Contributions to capital expenditure

Chorus receives significant financing and contributions towards its gross capital expenditure each year. During the year to 30 June 2013, Chorus received contributions from the following sources:

- i) **RBI funding:** The Crown is contributing grant funding of about \$236 million towards Chorus' layer 0 and layer 1 capital spend over the five year Rural Broadband Initiative. The grant is payable on completion of build work and will vary each year subject to the agreed build programme and the grantable network that is built. For the year ended 30 June 2013 \$90 million was recognised.

- ii) **Other:** Chorus is able to recover the cost of other capital spend in certain circumstances. This includes replacing network damaged by third parties, or instances where central or local government authorities ask Chorus to relocate or rebuild existing network. A total of \$12 million was recognised in the current financial period and is included as part of Crown funding given its modest size.

## Long term capital management

Chorus' principal source of liquidity is operating cash flows and external borrowing from established debt programmes such as the EMTN and bank facilities. Chorus also issues debt and equity securities to CFH as it completes relevant UFB milestones. It also receives grants from the Crown in relation to its RBI build programme.

The Chorus Board is committed to maintaining a 'BBB' long term credit rating from Standard & Poor's and a 'Baa2' long term credit rating from Moody's Investors Service. Chorus' capital management policies are designed to ensure that this objective is met in expected operating circumstances. It is Chorus' intention that in normal circumstances the ratio of net debt to EBITDA will not materially exceed 3.5 times (net debt includes the senior portion of CFH debt securities and net lease obligations). The ratio for net debt to EBITDA for Chorus' key financial covenants is 3.75 times.

At 30 June 2013, Chorus had a long term credit rating of BBB/stable by Standard & Poor's (30 June 2012: BBB/stable) and Baa2/negative by Moody's Investors Service (30 June 2012: Baa2/stable).

# Competition and regulation

Significant changes in Chorus' competitive and regulatory environment that have occurred in the last year are set out below. This should be read in conjunction with previous disclosures which are available online at: [www.chorus.co.nz/investor-centre](http://www.chorus.co.nz/investor-centre).

## Chorus Open Access Deeds of Undertaking

Chorus is bound by three open access deeds of undertaking (Deeds). The Copper, Fibre and Rural Broadband Initiative undertakings represent a series of legally binding obligations focused around the provision of services on a non-discriminatory or equivalent basis.

Chorus submitted a transition plan to the Minister in late 2012 relating to the actions required to move to ending the sharing arrangements between Telecom and Chorus, as required by the Deeds.

## Telecommunications Services Obligations (TSO) and Levies

The TSO is the regulatory mechanism by which universal service obligations for residential, local access and calling services are imposed and administered. Chorus is required to maintain lines and coverage obligations, and provide a voice input service. On 9 July 2013, the Government issued a discussion document on the TSO, as part of a scheduled review, proposing a number of potential future options for the TSO, and inviting views on any further options. Chorus is making submissions through the review process. The Government is required to complete the review by the end of 2013. There is no guarantee or certainty of the outcome of the TSO review.

The Telecommunications Development Levy (TDL) is an industry levy of \$50 million per year between FY10 and FY16 and \$10 million each year thereafter. On 27 June 2013, the Commission determined that Chorus was liable for \$6.4 million of the TDL for FY12.

Chorus is also required to contribute towards the Commerce Commission's costs through a Telecommunications Regulatory Levy (TRL). On 19 July 2013, Chorus was determined to be liable for \$690,000 of the TRL for FY12.

## UCLL and SLU pricing

The terms, including price, for UCLL and SLU are currently regulated by the Commission. On 3 December 2012, the Commission issued a final decision on its benchmarking review of the price Chorus can charge for UCLL. The final averaged UCLL price of \$23.52 represented a 3.8% drop. The UCLL price is linked to a number of other Chorus services, meaning that the UCLFS and SLU prices, and some UBA prices, were impacted by the decision.

After the final decision, Chorus applied to the Commission to review the UCLL price, using a Final Pricing Principle (FPP) of Total Service Long Run Incremental Cost (TSLRIC). The application was made on the basis that Chorus considered that the initial price set by the Commission in the 3 December 2012 decision by reference to benchmarking underestimates the TSLRIC of providing the UCLL in New Zealand. Telecom, Vodafone, CallPlus and Kordia also made FPP applications to the Commission. The Commission expects to complete the FPP process in December 2015.

## UBA pricing

The terms, including price, for UBA are currently regulated by the Commission. Under the Act, the Commission was required to review the UBA price by the end of 2012. On 3 December 2012, the Commission issued a draft decision on UBA pricing proposing a reduction in price from \$21.46 to \$8.93 per month based on benchmarking of pricing in two countries. Chorus is making submissions through the benchmarking process.

The Commission expects to complete the UBA benchmarking process in October 2013. Once the Commission issues its final decision, any party can apply for an FPP TSLRIC review of the UBA price.

## Unbundled Copper Low Frequency Service (UCLFS)

To meet its TSO requirements, Chorus has made a technology neutral voice input service, Baseband, available on a commercial basis. The pricing of a subset of this service, UCLFS (a voice input service offered over the copper access network), is set at the averaged UCLL price as determined by the Commission. Because the UCLFS price is linked to the UCLL price, a new UCLFS price of \$23.52 per month applied from 3 December 2012 (previously \$24.46 per month). Any change to the UCLL price as a result of the FPP process should flow through to the UCLFS price.

## Parallel government review announced

There is no certainty around the outcome of Commission's processes on any services that are currently under review or could be reviewed at any time or whether the Government's regulatory review will impact those processes.

On 8 February the New Zealand Government announced that it was bringing forward a review of the regulatory framework (regulatory review) to "...focus on the long-term interests of end-users of telecommunications services, taking into account the market structure, technology developments and competitive conditions in the telecommunications industry at the time of the review, including the impact of fibre, copper, wireless and other telecommunications network investment"<sup>4</sup>.

On 7 August 2013, the Government released a discussion paper on the regulatory review. In the discussion paper, the Government proposes to take a phased approach to the regulatory review – with an immediate focus on copper pricing. The discussion paper proposes that copper (UCLL and UBA) prices should be roughly equivalent with contracted entry level fibre prices (between \$37.50-\$42.50). There are three options proposed – which differ in terms of whether the Commission or Government selects the relevant price point between \$37.50 - \$42.50, how the UCLL and UBA copper prices are set within that overall cap and whether new pricing applies from November 2014 or November 2015. While the outcome of the Government's regulatory review is uncertain, all potential options contained within the discussion paper imply reduced future earnings for Chorus. The discussion paper suggests a potential decrease of Chorus' pricing within a range of \$2.48 to \$7.48 per broadband connection per month. Based on 30 June 2013 connection volumes, Chorus anticipates this could imply a reduction in annual EBITDA in the range of \$20 million to \$100 million.

Other changes are also proposed including grandfathering the availability of the Sub Loop Unbundling (SLU) service. Later phases of the regulatory review are proposed to focus on the appropriate regulatory framework once the UFB build is complete in 2020 (amongst other things). Chorus is making submissions through the review process.

## Other legislation

Chorus is subject to other legislative requirements such as the requirements of the Commerce Act 1986, Fair Trading Act 1986, as well as telecommunications codes.

Chorus is also subject to the Telecommunications (Interception Capability) Act 2004 (the Act), which requires network operators to ensure that every public telecommunications network that they own, control or operate, and every telecommunications service that they provide in New Zealand, has interception capability meeting the specifications set out in the Act. In June 2013, the Government issued a discussion paper on a review of the Act. Chorus made submissions on the discussion paper on 13 June 2013. The requirements under the Act have the potential to drive significant compliance costs.

# Litigation

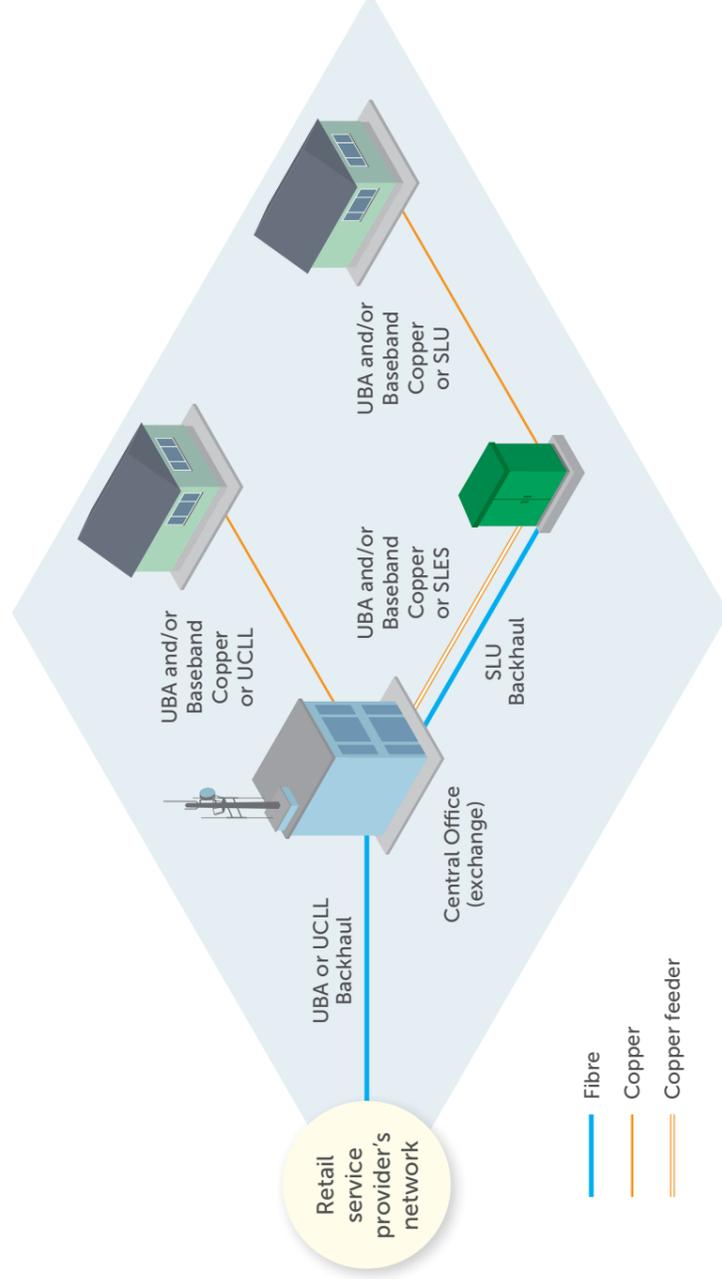
Chorus has ongoing claims, investigations and inquiries, none of which are currently expected to have significant effect on the financial position or profitability of Chorus.

Chorus cannot reasonably estimate the adverse effect, if any, on Chorus if any of the outstanding claims or inquiries are ultimately resolved against Chorus' interest. There can be no assurance that such cases will not have a significant effect on Chorus' business, financial position, and results of operations or profitability.

<sup>4</sup> <http://beehive.govt.nz/release/review-provide-certainty-consumers-industry>

# Product overview

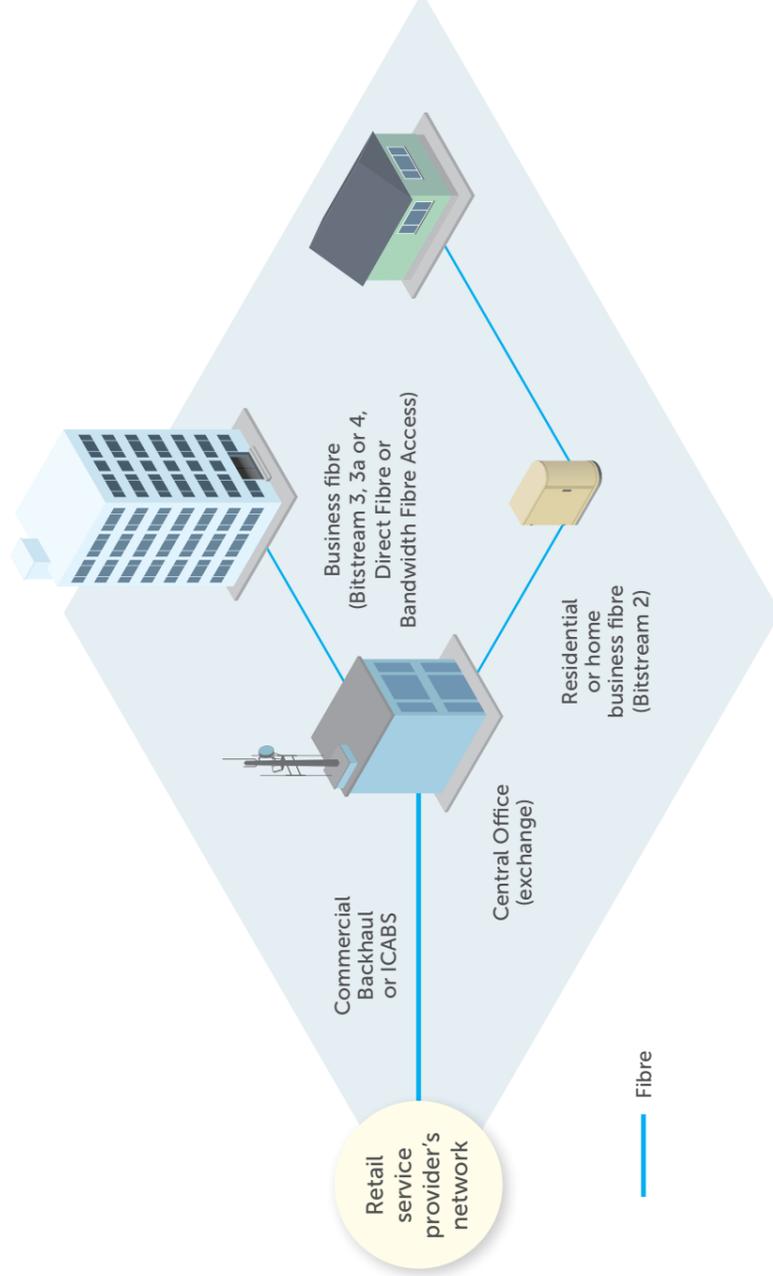
## Copper product overview



PRODUCT	DESCRIPTION	PREVIOUS PRICING (EXCL GST) BEFORE DECEMBER 2012	CURRENT PRICING (EXCL GST)
<b>Sub Loop Extension Service</b>	Allows retail service providers to connect a sub loop UCLL line from a cabinet to the local exchange so they can offer phone and/or broadband service from the exchange in cabinetised areas.	Commercial pricing	Commercial pricing
<b>Baseband Copper (UCLFS)</b>	A voice input service available on all copper lines that are in place between the premises and the exchange, irrespective of cabinetisation. The Unbundled Copper Low Frequency Service (UCLFS) is a subset of this service.	\$24.46 per month	\$23.52 per month
<b>UCLL</b>	The unbundled copper local loop service. Can be used by retail service providers to offer voice and broadband services. Available on copper lines between the premises and the exchange where there has been no cabinetisation.	Urban \$19.84 per month Non-urban \$36.63 per month	Urban \$19.08 per month Non-urban \$35.20 per month Changes to nationally averaged price of \$23.52 from December 2014
<b>Naked UBA</b>	An unbundled bitstream service that is taken standalone (i.e. without a voice service also being offered over the line). Can be used by retail service providers to offer broadband services.	\$45.92 per month (for Basic UBA or Enhanced UBA 0)	\$44.98 per month (for Basic UBA or Enhanced UBA 0)
<b>Sub Loop UCLL</b>	The unbundled sub loop service. Can be used by retail service providers to offer voice and broadband services. Available on copper lines between the premises and cabinet (i.e. only on cabinetised lines).	Urban \$11.98 per month Non-urban \$22.12 per month	Urban \$11.52 per month Non-urban \$21.26 per month
<b>Sub-loop backhaul</b>	The fibre connection between a retail service provider's UCLL equipment in a distribution cabinet and the associated local exchange.	Regulated pricing formula	No change
<b>UCLL Backhaul (commercial or regulated options)</b>	Enables access and interconnection with other UCLL services across the wider access network, between multiple exchanges. Gives retail service providers access to transmission capacity so they can aggregate their traffic between the local exchange to the handover point within their own network.	Pricing varies subject to capacity and distance	No change
<b>Unbundled Bitstream Access</b>	Allows retail service providers direct access to high speed copper bitstream access links, enabling them to use Chorus' equipment to deliver high speed broadband services. Retail service providers can choose between Basic or Enhanced variants of UBA.	\$21.46 per month (for Basic UBA FS/FS or Enhanced UBA 0)	No change
<b>VDSL</b>	VDSL is the third generation of DSL access technology targeted towards high bandwidth broadband users and can deliver download speeds around 20-50Mbps and upload speeds up to 20Mbps.	Varied depending on commercial pricing terms	\$21.46 per month with analogue voice or \$44.98 per month without analogue voice

# Product overview (cont.)

## Fibre product overview



PRODUCT	DESCRIPTION	CURRENT PRICING (EXCL GST)
Direct Fibre Access	Offers a fibre optic connection between an end-user and their retail service provider's equipment in the local exchange. Commonly known as 'dark fibre', it will typically suit tailored solutions for large businesses or businesses with the in-house resources to manage their own services.	\$355 per month
Bandwidth Fibre Access	A step up from Direct Fibre Access, this service includes the installation of a Chorus media converter at a point (or points) in the service and provides dedicated bandwidth from end-user premises with no switching or additional latency.	From: \$380 per month (up to 100Mbps download speeds); \$455 per month (up to 1Gbps download speeds); and \$1,355 per month (up to 10Gbps download speeds).
Bitstream 2	A relatively simple but flexible UFB service for introducing end-users to an entry level service, while giving the retail service provider the ability to build on the service as the end-user demands increase and develop. It supports the development of mass market residential or small to medium enterprise offerings, and includes the ability to deliver existing voice services over fibre.	Up to 30Mbps downstream / 10Mbps upstream plan for \$37.50 per month; or up to 100Mbps downstream / 50Mbps upstream plan for \$55.00 per month.
Bitstream 3 & 3a	A flexible UFB service designed to support business-grade applications, like virtual private networks. It delivers up to 100Mbps of dedicated downstream and upstream bandwidth and is ideal for medium businesses or branch offices. It has a wide range of committed and excess information rate (CIR/ EIR) options.	From \$175.00 per month
Bitstream 4 (also referred to as HSNS Premium)	A premium UFB access service offering high performance for corporate end-users and UFB priority users. It is ideal for supporting complex business-grade applications for large businesses, or corporate hubs, and has a wide range of committed information rate (CIR) options.	From \$380 per month (up to 100Mbps download speeds); \$455 per month (up to 1Gbps download speeds); \$1,355 per month (up to 10Gbps download speeds). CIR can be purchased from \$10 for up to 10Mbps.
Central Office and Co-location	Supports the installation of retail service provider network equipment in the fibre exchange or Central Office and provide fibre-based services to end-users who are connected to the fibre network.	From: \$215 per month to \$1,900 per month depending on site and requirements.
Intra Candidate Area Backhaul Service (ICABS)	Used by retail service providers to extend a fibre access connection to their equipment in another exchange, or to connect footprints in two exchanges within the same candidate area.	From: \$450 per month to \$1,400 per month

# Financial Statements



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# Independent auditor's report

## To the shareholders of Chorus Limited

### Report on the company and group financial statements

We have audited the accompanying financial statements of Chorus Limited ("the company") and the group, comprising the company and its subsidiary, on pages 19 to 41. The financial statements comprise the statements of financial position as at 30 June 2013, the income statements and statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, for both the company and the group.

### Directors' responsibility for the company and group financial statements

The directors are responsible for the preparation of company and group financial statements in accordance with generally accepted accounting practice in New Zealand and International Financial Reporting Standards that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of company and group financial statements that are free from material misstatement whether due to fraud or error.

### Auditor's responsibility

Our responsibility is to express an opinion on these company and group financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the company and group financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the company and group financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company and group's preparation of the financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company and group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Our firm has also provided other assurance and tax compliance services to the company and group. These matters have not impaired our independence as auditor of the company and group. The firm has no other relationship with, or interest in, the company and group.

### Opinion

In our opinion the financial statements on pages 19 to 41:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards;
- give a true and fair view of the financial position of the company and the group as at 30 June 2013 and of the financial performance and cash flows of the company and the group for the year then ended.

### Report on other legal and regulatory requirements

In accordance with the requirements of sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993, we report that:

- we have obtained all the information and explanations that we have required; and
- in our opinion, proper accounting records have been kept by Chorus Limited as far as appears from our examination of those records.

*KPMG*

25 August 2013  
Wellington

## Income statement

FOR THE YEAR ENDED 30 JUNE 2013

(DOLLARS IN MILLIONS)	NOTES	GROUP		PARENT	
		YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M	YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M
Operating revenue	7	1,057	613	86	-
Operating expenses	8	(394)	(214)	(1)	(1)
<b>Earnings/(loss) before interest, income tax, depreciation and amortisation</b>		<b>663</b>	<b>399</b>	<b>85</b>	<b>(1)</b>
Depreciation	1	(258)	(150)	1	-
Amortisation	2	(61)	(39)	-	-
<b>Earnings/(loss) before interest and income tax</b>		<b>344</b>	<b>210</b>	<b>86</b>	<b>(1)</b>
Finance income	7	7	4	106	62
Finance expense	9	(115)	(72)	(105)	(66)
<b>Net earnings/(loss) before income tax</b>		<b>236</b>	<b>142</b>	<b>87</b>	<b>(5)</b>
Income tax (expense)/benefit	13	(65)	(40)	-	1
<b>Net earnings/(loss) for the period</b>		<b>171</b>	<b>102</b>	<b>87</b>	<b>(4)</b>
<b>Earnings per share</b>					
Basic earnings per share (dollars)	18	0.44	0.26		
Diluted earnings per share (dollars)	18	0.42	0.26		

## Statement of comprehensive income

FOR THE YEAR ENDED 30 JUNE 2013

(DOLLARS IN MILLIONS)	NOTE	GROUP		PARENT	
		YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M	YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M
<b>Net earnings/(loss) for the period</b>		<b>171</b>	<b>102</b>	<b>87</b>	<b>(4)</b>
<b>Other comprehensive income</b>					
Effective portion of changes in fair value of cash flow hedges (pre-tax)		13	(14)	13	(14)
Tax (expense)/ benefit on cash flow hedge	13	(4)	4	(4)	4
<b>Other comprehensive income/(loss) net of tax</b>		<b>9</b>	<b>(10)</b>	<b>9</b>	<b>(10)</b>
<b>Total comprehensive income/(loss) for the period net of tax</b>		<b>180</b>	<b>92</b>	<b>96</b>	<b>(14)</b>

The notes on pages 23 to 41 are an integral part of these financial statements



# Statement of changes in equity, continued

FOR THE YEAR ENDED 30 JUNE 2013

YEAR ENDED 30 JUNE 2013 (DOLLARS IN MILLIONS)	PARENT			TOTAL \$M
	SHARE CAPITAL \$M	RETAINED EARNINGS \$M	CASH FLOW HEDGE RESERVE \$M	
Balance at 1 July 2012	581	(4)	(10)	567
<b>Comprehensive income</b>				
Net earnings for the year	-	87	-	87
<b>Other comprehensive income</b>				
Net effective portion of changes in fair value of cash flow hedges	-	-	9	9
<b>Total comprehensive income</b>	-	<b>87</b>	<b>9</b>	<b>96</b>
<b>Contributions by and (distributions to) owners:</b>				
Dividends	-	(95)	-	(95)
Supplementary dividends	-	(8)	-	(8)
Tax credit on supplementary dividends	-	8	-	8
Dividend reinvestment plan	12	-	-	12
<b>Total transactions with owners</b>	<b>12</b>	<b>(95)</b>	<b>-</b>	<b>(83)</b>
<b>Balance at 30 June 2013</b>	<b>593</b>	<b>(12)</b>	<b>(1)</b>	<b>580</b>

SEVEN MONTHS ENDED 30 JUNE 2012 (DOLLARS IN MILLIONS)	PARENT			TOTAL \$M
	SHARE CAPITAL \$M	RETAINED EARNINGS \$M	CASH FLOW HEDGE RESERVE \$M	
Balance at 1 December 2011	581	-	-	581
<b>Comprehensive income</b>				
Net loss for the period	-	(4)	-	(4)
<b>Other comprehensive income</b>				
Net effective portion of changes in fair value of cash flow hedges	-	-	(10)	(10)
<b>Total comprehensive loss</b>	-	<b>(4)</b>	<b>(10)</b>	<b>(14)</b>
<b>Balance at 30 June 2012</b>	<b>581</b>	<b>(4)</b>	<b>(10)</b>	<b>567</b>

The notes on pages 23 to 41 are an integral part of these financial statements

# Statement of cash flows

FOR THE YEAR ENDED 30 JUNE 2013

(DOLLARS IN MILLIONS)	GROUP		NOTE	PARENT	
	YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M		YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M
<b>Cash flows from operating activities</b>					
Cash was provided from/(applied to):					
Cash received from customers	967	530		-	-
Finance income	7	4		106	48
Intercompany dividend received	-	-		86	-
Payment to suppliers and employees	(378)	(147)		(1)	(1)
Taxation paid	(65)	(20)		(7)	-
Interest paid on debt and derivatives	(108)	(35)		(99)	(25)
<b>Net cash flows from operating activities</b>	<b>423</b>	<b>332</b>		<b>85</b>	<b>22</b>
<b>Cash flows applied to investing activities</b>					
Cash was applied to:					
Subsidiary funding	-	-		(189)	(13)
Purchase of network assets and software and intangible assets	(681)	(256)		-	-
Capitalised interest paid	(6)	(3)		-	-
<b>Net cash flows applied to investing activities</b>	<b>(687)</b>	<b>(259)</b>		<b>(189)</b>	<b>(13)</b>
<b>Cash flows from financing activities</b>					
Cash was provided from/(applied to):					
Net (repayment of)/proceeds from finance leases	(1)	2		-	-
Crown funding (including CFH securities)	198	25		105	12
Proceeds from debt	190	51		190	51
Repayment of debt	(100)	(51)		(100)	(51)
Dividends paid	(83)	-		(83)	-
<b>Net cash flows from financing activities</b>	<b>204</b>	<b>27</b>		<b>112</b>	<b>12</b>
<b>Net cash flow</b>	<b>(60)</b>	<b>100</b>		<b>8</b>	<b>21</b>
Cash at the beginning of the period	140	40		61	40
<b>Cash at the end of the period</b>	<b>80</b>	<b>140</b>	14	<b>69</b>	<b>61</b>

The notes on pages 23 to 41 are an integral part of these financial statements

## Statement of cash flows, continued

RECONCILIATION OF NET EARNINGS/(LOSS) TO NET CASH FLOWS FROM OPERATING ACTIVITIES

	GROUP		PARENT	
	YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M	YEAR ENDED 30 JUNE 2013 \$M	SEVEN MONTHS ENDED 30 JUNE 2012 \$M
<b>(DOLLARS IN MILLIONS)</b>				
Net earnings/(loss) for the period	171	102	87	(4)
Adjustment for:				
Depreciation charged on network assets	262	151	-	-
Amortisation of Crown funding	(4)	(1)	(1)	-
Amortisation of software and other intangible assets	61	39	-	-
Deferred income tax	9	6	-	-
Other	6	(4)	4	9
	<b>505</b>	<b>293</b>	<b>90</b>	<b>5</b>
<i>Change in current assets and liabilities:</i>				
Change in trade and other receivables	(70)	(101)	-	(6)
Change in trade and other payables	(3)	126	2	24
Change in income tax payable/receivable	(9)	14	(7)	(1)
	<b>(82)</b>	<b>39</b>	<b>(5)</b>	<b>17</b>
<b>Net cash flows from operating activities</b>	<b>423</b>	<b>332</b>	<b>85</b>	<b>22</b>

The notes on pages 23 to 41 are an integral part of these financial statements

# Notes to the financial statements

## Reporting entity and statutory base

Chorus Limited is registered in New Zealand under the Companies Act 1993 and is an issuer for the purposes of the Financial Reporting Act 1993. Chorus Limited was established as a standalone, publicly listed entity on 1 December 2011, upon its demerger from Telecom Corporation of New Zealand Limited (Telecom). The demerger was a condition of an agreement with Crown Fibre Holdings Limited (CFH) to enable Chorus Limited to be the Crown's Ultra-Fast Broadband (UFB) provider in 24 regions, representing approximately 70% of the UFB coverage area. Chorus Limited is listed and its ordinary shares quoted on the NZX main board equity security market (NZX Main Board) and on the Australian Stock Exchange (ASX). American Depository Shares (ADSs), each representing five ordinary shares (and evidenced by American Depository Receipts (ADRs)), are not listed but are traded on the over-the-counter (OTC) market in the United States.

The financial statements presented are those of Chorus Limited (the Company, Parent or the Parent Company) together with its subsidiary (the Chorus Group, Group or Chorus).

## Nature of operations

Chorus is New Zealand's largest fixed line communications infrastructure service provider. Chorus maintains and builds a network predominantly made up of local telephone exchanges, cabinets, copper and fibre cables. Chorus has approximately 1.8 million fixed line connections. There are around 130,000 kilometres of copper cable and about 32,000 kilometres of fibre cable connecting homes and businesses to local exchanges, and roadside cabinets throughout the country.

## Basis of preparation

These financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand and the Financial Reporting Act 1993. They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) as appropriate for profit-oriented entities. They also comply with International Financial Reporting Standards.

These financial statements are expressed in New Zealand dollars, which is Chorus' functional currency. References in these financial statements to '\$', 'NZ\$', and 'NZD' are to New Zealand dollars, references to 'USD' are to US dollars, references to 'AUD' are to Australian dollars, references to 'EUR' are to Euros and references to 'GBP' are to pounds sterling. All financial information has been rounded to the nearest million, unless otherwise stated.

## Measurement basis

The measurement basis adopted in the preparation of these financial statements is historical cost, modified by the revaluation of financial instruments as identified in the specific accounting policies below and the accompanying notes.

## Specific accounting policies

Chorus was established as a standalone publicly listed entity on 1 December 2011. The accounting policies adopted have been applied consistently throughout the periods presented in these financial statements. Certain comparative information has been reclassified to conform with the current year's presentation.

## Basis of consolidation

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiary are prepared for the same reporting period as the Parent Company, using consistent accounting policies. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated in full. Subsidiaries are recorded at cost less any impairment losses in the Parent Company financial statements.

## Critical accounting estimates and assumptions

In preparing the financial statements management has made estimates and assumptions about the future that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The principal areas of judgement in preparing these financial statements are set out below.

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following notes:

### Crown funding (note 5)

Chorus must exercise judgement when recognising Crown funding to determine if conditions of the funding contract have been satisfied. This judgement will be based on the facts and circumstances that are evident for each contract at the time of preparing the financial statements.

### Leases (note 15)

Determining whether a lease agreement is a finance lease or operating lease requires judgement as to whether the agreement transfers substantially all the risks and rewards of ownership to Chorus.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

### Network assets (note 1)

Assessing the appropriateness of useful life and residual value estimates of network assets requires a number of factors to be considered such as the physical condition of the asset, expected period of use of the asset by Chorus, technological advances, regulation and expected disposal proceeds from the future sale of the asset.

### CFH securities (note 4)

Determining the fair value of the CFH securities requires assumptions on expected future cash flow and discount rate based on future long dated swap curves.

### Note 1 – Network assets

In the statement of financial position, network assets are stated at cost less accumulated depreciation and any accumulated impairment losses. The cost of additions to network assets and capital work in progress constructed by Chorus includes the cost of all materials used in construction, direct labour costs specifically associated with construction, interest costs that are attributable to the asset, resource management consent costs and attributable overheads.

Repairs and maintenance costs are recognised in the income statement as incurred.

#### Estimating useful lives and residual values of network assets

The determination of the appropriate useful life for a particular asset requires management to make judgements about, amongst other factors, the expected period of service potential of the asset, the likelihood of the asset becoming obsolete as a result of technological advances, the likelihood of Chorus ceasing to use the asset in its business operations and the effect of government regulation.

Where an item of network assets comprises major components having different useful lives, the components are accounted for as separate items of network assets.

Where the remaining useful lives or recoverable values have diminished due to technological, regulatory or market condition changes, depreciation is accelerated. The asset's residual values, useful lives, and methods of depreciation are reviewed annually and adjusted prospectively, if appropriate.

Depreciation is charged on a straight-line basis to write down the cost of network assets to its estimated residual value over its estimated useful life. Estimated useful lives are as follows:

Copper cables	10-30 years
Fibre cables	20 years
Ducts and manholes	50 years
Cabinets	5-14 years
Property	5-50 years
Network electronics	2-14 years
Other	2-15 years

Other network assets include motor vehicles, network management and administration systems and radio infrastructure.

Any future adverse impacts arising in assessing the carrying value or lives of Chorus' network assets could lead to future impairment losses or increases in depreciation charges that could affect future earnings.

An item of network assets and any significant part is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Where network assets are disposed of, the profit or loss recognised in the income statement is calculated as the difference between the sale price and the carrying value of the asset.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Land and work in progress are not depreciated.

### Note 1 – Network assets continued

AS AT 30 JUNE 2013	GROUP							TOTAL \$M	
	COPPER CABLES \$M	FIBRE CABLES \$M	DUCTS AND MANHOLES \$M	CABINETS \$M	PROPERTY \$M	NETWORK ELECTRONICS \$M	OTHER \$M		WORK IN PROGRESS \$M
<b>Cost</b>									
Balance as at 1 July 2012	2,393	567	791	380	475	1,306	188	119	6,219
Additions	-	-	-	-	-	-	-	646	646
Other	-	-	-	-	-	-	1	1	2
Disposals	(93)	-	-	-	-	-	-	-	(93)
Transfers	1	(1)	-	-	1	-	(1)	-	-
Transfers from work in progress	48	186	301	29	25	71	12	(672)	-
<b>Balance as at 30 June 2013</b>	<b>2,349</b>	<b>752</b>	<b>1,092</b>	<b>409</b>	<b>501</b>	<b>1,377</b>	<b>200</b>	<b>94</b>	<b>6,774</b>
<b>Accumulated Depreciation</b>									
Balance as at 1 July 2012	(1,734)	(207)	(324)	(156)	(200)	(1,013)	(174)	-	(3,808)
Depreciation	(66)	(29)	(16)	(33)	(14)	(95)	(9)	-	(262)
Disposals	92	-	-	-	-	-	-	-	92
<b>Balance as at 30 June 2013</b>	<b>(1,708)</b>	<b>(236)</b>	<b>(340)</b>	<b>(189)</b>	<b>(214)</b>	<b>(1,108)</b>	<b>(183)</b>	<b>-</b>	<b>(3,978)</b>
<b>Net carrying amount</b>	<b>641</b>	<b>516</b>	<b>752</b>	<b>220</b>	<b>287</b>	<b>269</b>	<b>17</b>	<b>94</b>	<b>2,796</b>

AS AT 30 JUNE 2012	GROUP							TOTAL \$M	
	COPPER CABLES \$M	FIBRE CABLES \$M	DUCTS AND MANHOLES \$M	CABINETS \$M	PROPERTY \$M	NETWORK ELECTRONICS \$M	OTHER \$M		WORK IN PROGRESS \$M
<b>Cost</b>									
Balance as at 1 December 2011	2,368	492	705	372	469	1,283	185	69	5,943
Additions	-	-	-	-	-	-	-	282	282
Disposals	-	-	-	(5)	-	(1)	-	-	(6)
Transfers from work in progress	25	75	86	13	6	24	3	(232)	-
<b>Balance as at 30 June 2012</b>	<b>2,393</b>	<b>567</b>	<b>791</b>	<b>380</b>	<b>475</b>	<b>1,306</b>	<b>188</b>	<b>119</b>	<b>6,219</b>
<b>Accumulated Depreciation</b>									
Balance as at 1 December 2011	(1,693)	(194)	(317)	(146)	(192)	(952)	(169)	-	(3,663)
Depreciation	(41)	(13)	(7)	(15)	(8)	(62)	(5)	-	(151)
Disposals	-	-	-	5	-	1	-	-	6
<b>Balance as at 30 June 2012</b>	<b>(1,734)</b>	<b>(207)</b>	<b>(324)</b>	<b>(156)</b>	<b>(200)</b>	<b>(1,013)</b>	<b>(174)</b>	<b>-</b>	<b>(3,808)</b>
<b>Net carrying amount</b>	<b>659</b>	<b>360</b>	<b>467</b>	<b>224</b>	<b>275</b>	<b>293</b>	<b>14</b>	<b>119</b>	<b>2,411</b>

## Note 1 – Network assets continued

The Parent does not hold any network assets.

There are no restrictions on Chorus network assets or any network assets pledged as securities for liabilities. At 30 June 2013 the contractual commitment for acquisition and construction of network assets was \$28 million (30 June 2012: \$23 million).

### Depreciation

Chorus receives funding from the Crown to finance the capital expenditure associated with the development of the Ultra-Fast

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Depreciation charged on network assets	262	151	-	-
Less: Crown funding – Ultra-Fast Broadband	(1)	-	(1)	-
Crown funding – Rural Broadband Initiative	(1)	-	-	-
Crown funding – other	(2)	(1)	-	-
<b>Total depreciation</b>	<b>258</b>	<b>150</b>	<b>(1)</b>	<b>-</b>

Refer to note 5 for information on Crown funding.

### Property Exchanges

Chorus has leased property exchange space owned by Telecom subject to finance lease arrangements. These have been included in Chorus' network assets under the property category. As at 30 June 2013 the property exchange assets capitalised under a finance lease had a cost of \$157 million (30 June 2012: \$157 million) together with accumulated depreciation of \$7 million (30 June 2012: \$3 million).

### Network electronics

Chorus has joint arrangements for use of certain network electronics assets with Telecom. The equipment used by Chorus is included in the network electronics category of network assets. As at 30 June 2013 the equipment capitalised had a cost of \$16 million (30 June 2012: \$16 million) together with accumulated depreciation of \$7 million (30 June 2012: \$3 million).

Broadband network, rural broadband services and other services. The contract for Ultra-Fast Broadband is agreed between the Parent and Crown Fibre Holdings. The Parent receives the Crown funding directly, however the construction of the network assets is carried out by the subsidiary. Funding is offset against depreciation over the life of the assets the funding is used to construct. Crown funding released against depreciation for the current period is as follows:

Other intangibles mainly consist of land easements.

Software	2-8 years
Other intangibles	6-20 years

## Note 2 – Software and other intangibles

Software and other intangible assets are initially measured at cost. The direct costs associated with the development of network and business software for internal use are capitalised where project success is probable and the capitalisation criteria is met. Following initial recognition, software and other intangible assets are stated at cost less accumulated amortisation and impairment losses. Software and other intangible assets with a finite life are amortised from the date the asset is ready for use on a straight-line basis over its estimated useful life which is as follows

Where estimated useful lives or recoverable values have diminished due to technological change or market conditions, amortisation is accelerated.

	GROUP			
	SOFTWARE \$M	OTHER INTANGIBLES \$M	WORK IN PROGRESS \$M	TOTAL \$M
<b>AS AT 30 JUNE 2013</b>				
<b>Cost</b>				
Balance as at 1 July 2012	367	6	34	407
Additions	-	-	35	35
Disposals	(1)	-	-	(1)
Transfers from work in progress	42	-	(42)	-
<b>Balance as at 30 June 2013</b>	<b>408</b>	<b>6</b>	<b>27</b>	<b>441</b>
<b>Accumulated amortisation</b>				
Balance as at 1 July 2012	(227)	-	-	(227)
Amortisation	(60)	(1)	-	(61)
<b>Balance as at 30 June 2013</b>	<b>(287)</b>	<b>(1)</b>	<b>-</b>	<b>(288)</b>
<b>Net carrying amount</b>	<b>121</b>	<b>5</b>	<b>27</b>	<b>153</b>

	GROUP			
	SOFTWARE \$M	OTHER INTANGIBLES \$M	WORK IN PROGRESS \$M	TOTAL \$M
<b>AS AT 30 JUNE 2012</b>				
<b>Cost</b>				
Balance as at 1 December 2011	338	5	-	343
Additions	-	-	64	64
Transfers from work in progress	29	1	(30)	-
<b>Balance as at 30 June 2012</b>	<b>367</b>	<b>6</b>	<b>34</b>	<b>407</b>
<b>Accumulated amortisation</b>				
Balance as at 1 December 2011	(188)	-	-	(188)
Amortisation	(39)	-	-	(39)
<b>Balance as at 30 June 2012</b>	<b>(227)</b>	<b>-</b>	<b>-</b>	<b>(227)</b>
<b>Net carrying amount</b>	<b>140</b>	<b>6</b>	<b>34</b>	<b>180</b>



#### Note 4 – CFH securities

Chorus receives funding from the Crown to finance construction costs associated with the development of the UFB network. Chorus receives funding at a rate of \$1.118 for every premises passed (as certified by CFH), in return Chorus issues CFH equity securities, CFH debt securities and CFH warrants. The equity and debt securities issued by Chorus have an issue price of \$1 and are issued on a 50:50 basis. For each premises passed, \$559 of equity securities and \$559 of debt securities are issued by Chorus for which Chorus receives \$1.118 funding in return. CFH warrants are issued for nil value. The total committed funding available for Chorus over the period of UFB network construction is expected to be \$929 million.

The CFH equity and debt securities are recognised initially at fair value plus any directly attributable transaction costs. Subsequently they are measured at amortised cost using the effective interest method. The fair value is derived by discounting the \$559 of equity securities and \$559 of debt securities per premises passed by the effective interest rate based on market rates. The difference between funding received (\$1.118 per premises passed) and the fair value of the securities is recognised as Crown funding. Over time, the CFH debt and equity securities increase to face value and the Crown funding is released against depreciation and reduces to nil.

##### CFH equity securities

CFH equity securities are a class of non interest bearing security that carry no right to vote at meetings of holders of Chorus ordinary shares, but entitle the holder to a preferential right to repayment on liquidation and additional rights that relate to Chorus' performance under its construction contract with CFH.

Dividends will become payable on a portion of the CFH equity securities from 2025 onwards, with the portion of CFH equity securities that attract dividends increasing over time. A greater portion of CFH equity securities attract dividends if the proportion of premises with a fibre connection within Chorus' coverage area at 30 June 2020 does not exceed 20%. The dividend rate will be equal to the New Zealand 180-day bank bill rate plus a margin of 6%. CFH equity instruments can be settled by issuing Chorus shares valued at a 5% discount to the 20-day volume weighted average price for Chorus shares traded in ordinary trading on the NZX Main Board.

The CFH equity securities are treated as a compound financial instrument with a Crown funding component due to the instrument including an interest free loan from a government entity. On initial recognition, the fair value of the liability component of the

compound instrument is calculated using market inputs with no residual amounts allocated to equity. Until the liability component of the compound instrument expires the CFH equity securities are required to be disclosed as a liability. The difference between the face value of the CFH equity securities and the fair value of the liability component is then recorded as Crown funding.

After this, the liability component is measured at amortised cost using the effective interest method and the Crown funding is amortised to depreciation on a systematic basis over the useful lives of the relevant UFB assets.

##### CFH debt securities

CFH debt securities are unsecured, non interest bearing and carry no voting rights at meetings of holders of Chorus ordinary shares. Chorus is required to redeem the CFH debt securities in tranches from 2025 to 2036 (at the latest) by repaying the face value to CFH. An accelerated repayment schedule applies if the proportion of premises with a fibre connection within Chorus' coverage area at 30 June 2020 does not exceed 20%.

The CFH debt securities are treated as a financial liability with a Crown funding component due to the instrument including an interest free loan from a government entity. On initial recognition the difference between the face value of the CFH debt securities and their fair value (calculated using market inputs) is recorded as Crown funding. After this the liability component is measured at amortised cost using the effective interest method and the Crown funding is amortised to depreciation on a systematic basis over the useful lives of the relevant UFB assets.

The principal amount of CFH debt securities consists of a senior portion and a subordinated portion. The senior portion ranks equally with all other unsecured, unsubordinated creditors of Chorus, and has the benefit of any negative pledge covenant that may be contained in any of Chorus' debt arrangements. The subordinated portion ranks above ordinary shares of Chorus. The initial value of the senior portion is the present value (using a discount rate of 8.5%) of the sum repayable on the CFH debt securities, and the initial subordinated portion will be the difference between the issue price of the CFH debt security and the value of the senior portion.

#### Note 4 – CFH securities continued

##### CFH warrants

Chorus issues CFH warrants to CFH for nil consideration along with each tranche of CFH equity securities. Each CFH warrant gives CFH the right, on a specified exercise date, to purchase at a set strike price a Chorus share to be issued by Chorus. A CFH warrant will therefore be 'in the money' to the extent that the price that CFH can realise for the Chorus share exceeds the price paid to exercise the CFH warrant. The strike price for a CFH warrant is based on a total shareholder return of 16% per annum on Chorus shares over the period December 2011 to June 2036. Therefore, a holder of a CFH warrant is only likely to exercise the CFH warrant if total shareholder return on Chorus shares has exceeded 16% per annum over the period June 2025 to June 2036.

At balance date Chorus had issued in total 2,838,382 warrants which had a fair value and carrying value that approximated zero (30 June 2012: 272,207 warrants issued). The number of fibre connections made by 30 June 2020 impacts the number of warrants that could be exercised. Should fibre connections at 30 June 2020 exceed 20% then the number of warrants that would be able to be exercised is 1,204,971 (30 June 2012: 116,742).

At balance date the component parts of debt and equity instruments including notional interest were

	GROUP AND PARENT	
	2013 \$M	2012 \$M
CFH debt securities	20	2
CFH equity securities	10	1
<b>Total CFH securities</b>	<b>30</b>	<b>3</b>

The carrying value of CFH debt and equity securities approximates its fair value and includes \$1 million (30 June 2012: nil) of notional interest.

##### Key assumptions

Although Chorus believes that the estimate of the liability components of the CFH securities on initial recognition is appropriate, the use of different methodologies or assumptions could lead to different measurements of these component parts. The liability components of the CFH securities have been calculated using expected cash flows discounted at risk-adjusted discount rates. As the number of CFH securities expected to be issued increases over time the potential impact of alternative methodologies and assumptions will become increasingly material. Key inputs and assumptions used in these calculations on initial recognition include:

##### Discount rate

On initial recognition, the discount rate between 10.36% to 10.77% (30 June 2012: 10.77% to 10.87%) for the CFH equity securities and 6.37% to 6.95% (30 June 2012: 6.65% to 6.90%) for the CFH debt securities applied to the expected cash flows is based on long dated NZ swap curves. The swap rates were adjusted for Chorus specific

credit spreads (based on market observed credit spreads for debt issued with similar credit ratings and tenure). The discount rate on the CFH equity securities is capped at Chorus' estimated cost of (ordinary) equity.

##### Expected cash flows

Timing of principal repayments and dividend cash flows has been based on forecasts that reflect economically rational outcomes given the terms of the CFH debt and equity securities.

Repayment dates have been based on an estimate that the proportion of premises with a fibre connection within Chorus' coverage area will exceed 20% at 30 June 2020.

#### Note 4 – CFH securities continued

##### Sensitivity analysis

Chorus considers that it is reasonably possible that future outcomes may be different from the assumptions applied and could require a material adjustment to the carrying amount of the component parts of the CFH securities. The number of fibre connections assumed to

have been made by 30 June 2020 is one of the key sensitivities implicit in the measurement of the CFH securities. A change in this proportion would result in the following impact on the financial statements:

AS AT 30 JUNE 2013	ACTUAL	ALTERNATIVE OUTCOME	IMPACT ON FINANCIAL STATEMENTS
<b>CFH debt securities</b>			
Fibre connection proportion	≥ 20%	< 20%	Increase CFH debt securities liability by \$2.9 million Decrease Crown funding by \$2.9 million
<b>CFH equity securities</b>			
Fibre connection proportion	≥ 20%	< 20%	Increase CFH equity securities liability by \$2.3 million Decrease Crown funding by \$2.3 million
AS AT 30 JUNE 2012			
<b>CFH debt securities</b>			
Fibre connection proportion	≥ 20%	< 20%	Increase CFH debt securities liability by \$263,000 Decrease Crown funding by \$263,000
<b>CFH equity securities</b>			
Fibre connection proportion	≥ 20%	< 20%	Increase CFH equity securities liability by \$221,000 Decrease Crown funding by \$221,000

#### Note 5 – Crown funding

Funding from the Crown is recognised at fair value where there is reasonable assurance that the funding is receivable and Chorus complies with all attached conditions. Crown funding is then recognised in earnings as a reduction to depreciation expense

on a systematic basis over the useful life of the asset the funding was used to construct. The accumulated funding has been recognised as follows:

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Ultra-Fast Broadband	103	10	103	10
Rural Broadband Initiative	107	18	-	-
Other	18	8	-	-
	<b>228</b>	<b>36</b>	<b>103</b>	<b>10</b>
<b>Current</b>	<b>6</b>	<b>2</b>	<b>2</b>	<b>-</b>
<b>Non-current</b>	<b>222</b>	<b>34</b>	<b>101</b>	<b>10</b>

#### Note 5 – Crown funding continued

##### Ultra-Fast Broadband

Chorus receives funding from the Crown to finance construction costs associated with the development of the UFB network. During the year the Group received \$105 million in funding from CFH (30 June 2012: \$13 million) which equated to 94,291 (30 June 2012: 11,388) premises passed. This \$105 million of funding was allocated as follows: CFH debt securities \$15 million, CFH equity securities \$8 million, Crown funding \$82 million. A further \$15 million

(30 June 2012: nil) has been accrued in respect of 13,515 premises passed in areas where user acceptance testing was complete at 30 June 2013 but funds were received post 30 June 2013. The \$15 million of funding accrued was allocated as CFH debt securities \$2 million, CFH equity securities \$1 million and Crown funding \$12 million.

The component parts of this funding can be summarised as follows:

	GROUP AND PARENT	
	2013 \$M	2012 \$M
Accumulated funding recognised	133	13
Less: CFH securities excluding notional interest	(29)	(3)
Less: accumulated amortisation of funding	(1)	-
<b>Ultra-Fast Broadband funding</b>	<b>103</b>	<b>10</b>

Continued recognition of the full amount of the Crown funding is contingent on certain material performance targets being met by Chorus. The most significant of these material performance targets relate to the number of premises passed by fibre optic cables by key dates and compliance with certain specifications under user acceptance testing by CFH.

The change in the Ultra-Fast Broadband Crown funding balance is summarised below:

	GROUP AND PARENT	
	2013 \$M	2012 \$M
Balance at beginning of the period	10	-
Funding received (excluding CFH securities)	82	10
Funding accrued (excluding CFH securities)	12	-
Amortisation	(1)	-
<b>Balance at end of the period</b>	<b>103</b>	<b>10</b>

## Note 5 – Crown funding continued

### Rural Broadband Initiative

Chorus receives Crown funding from the Ministry of Business, Innovation and Employment (MBIE) for capital expenditure incurred under the Rural Broadband Initiative.

Chorus is entitled to claim payment for the grantable costs attributable to the relevant milestones for deploying the rural link or rural cabinets. The MBIE will pay Chorus one dollar of funding for

each dollar of grantable costs incurred by Chorus up to a maximum funding limit of around \$236 million. In addition the MBIE reimburses Chorus for all capital expenditure attributable to school lead-ins.

During the year Chorus recognised \$90 million in funding from the MBIE (30 June 2012: \$18 million). The component parts of this funding can be summarised as follows:

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Accumulated funding recognised	108	18	-	-
Less: accumulated amortisation of funding	(1)	-	-	-
<b>Rural Broadband Initiative funding</b>	<b>107</b>	<b>18</b>	<b>-</b>	<b>-</b>

The change in the Rural Broadband Initiative funding balance is summarised below:

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Balance at the beginning of period	18	-	-	-
Funding recognised	90	18	-	-
Amortisation	(1)	-	-	-
<b>Balance at end of the period</b>	<b>107</b>	<b>18</b>	<b>-</b>	<b>-</b>

### Other

Chorus receives funding towards the cost of relocation of telecommunications equipment, school lead-ins and extending the network coverage to rural areas. The component parts of this funding can be summarised as follows:

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Accumulated funding recognised	21	9	-	-
Less: accumulated amortisation of funding	(3)	(1)	-	-
<b>Other funding</b>	<b>18</b>	<b>8</b>	<b>-</b>	<b>-</b>

The change in the other funding is summarised below:

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Balance at the beginning of period	8	-	-	-
Funding recognised	12	9	-	-
Amortisation	(2)	(1)	-	-
<b>Balance at end of the period</b>	<b>18</b>	<b>8</b>	<b>-</b>	<b>-</b>

## Note 6 – Segmental reporting

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses and for which operating results are regularly reviewed by the entity's chief operating decision maker and for which discrete financial information is available.

Chorus' Chief Executive Officer has been identified as the chief operating decision maker for the purpose of segmental reporting.

Chorus has determined that it operates in one segment providing nationwide fixed line access network infrastructure.

The determination is based on the reports reviewed by the Chief Executive Officer in assessing performance, allocating resources and making strategic decisions.

All of Chorus' operations are provided in New Zealand, therefore no geographic information is provided.

Two Chorus customers met the reporting threshold of 10 percent of Chorus' operating revenue in the year to 30 June 2013. The total revenue for the year ending 30 June 2013 from one customer was \$815 million and from the other customer was \$101 million. In the seven months ended 30 June 2012 one customer met the reporting threshold and accounted for \$523 million of revenue.

## Note 7 – Operating revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to Chorus and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable.

Chorus recognises revenue as it provides services to its customers. Billings are generally made on a monthly basis. Unbilled revenues from the billing cycle date to the end of each month are recognised as revenue during the month the service is provided. Revenue is deferred in respect of the portion of fixed monthly charges that have been billed in advance. Revenue from installations and connections are recognised upon completion of the installation or connection.

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Basic copper	631	399	-	-
Enhanced copper	215	89	-	-
Fibre	60	28	-	-
Value added network services	37	18	-	-
Infrastructure	17	14	-	-
Field services	85	47	-	-
Other	12	18	-	-
Intercompany dividend income	-	-	86	-
<b>Total operating revenue</b>	<b>1,057</b>	<b>613</b>	<b>86</b>	<b>-</b>

### Note 8 – Operating expenses

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Labour costs	(67)	(31)	-	-
Provisioning	(51)	(23)	-	-
Network maintenance	(100)	(52)	-	-
Other network costs	(37)	(22)	-	-
Information technology costs	(52)	(30)	-	-
Rent and rates	(12)	(6)	-	-
Property maintenance	(12)	(8)	-	-
Electricity	(13)	(11)	-	-
Insurance	(4)	(3)	-	-
Consultants	(6)	(5)	-	(1)
Other	(40)	(23)	(1)	-
<b>Total operating expenses</b>	<b>(394)</b>	<b>(214)</b>	<b>(1)</b>	<b>(1)</b>

#### Labour costs

Labour costs of \$67 million (30 June 2012: \$31 million) represents staff costs related to non-capital expenditure.

#### Pension contributions

Included in labour costs are payments to the New Zealand Government Superannuation Fund of \$333,000 (30 June 2012: \$149,000) and contributions to KiwiSaver of \$1,112,000 (30 June 2012: \$346,000). At 30 June 2013 there were 27 employees in New Zealand Government Superannuation Fund (30 June 2012: 28 employees) and 545 employees in Kiwisaver (30 June 2012: 335 employees). Chorus has no other obligations to provide pension benefits in respect of employees.

#### Charitable and political donations

Other costs include charitable donations of \$50,000 (30 June 2012: nil). Chorus has not made any political donations (30 June 2012: nil).

#### Operating leases

Rent and rates costs include leasing and rental expenditure of \$5 million for property, network infrastructure and items of equipment (30 June 2012: \$3 million).

#### Auditor remuneration

Included in other expenses are fees paid to auditors of \$430,000 for the audit and review of the statutory accounts (30 June 2012: \$550,000), \$150,000 for regulatory assurance services and \$58,000 in respect of technical accounting guidance, other assurance and tax compliance services.

### Note 9 – Finance expense

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Interest on syndicated bank facility	(58)	(32)	(58)	(32)
Interest on EMTN	(46)	(27)	(46)	(27)
Other interest expense	(16)	(16)	-	(7)
Capitalised interest	6	3	-	-
<b>Total finance expense excluding CFH securities</b>	<b>(114)</b>	<b>(72)</b>	<b>(104)</b>	<b>(66)</b>
CFH securities (notional interest)	(1)	-	(1)	-
<b>Total finance expense</b>	<b>(115)</b>	<b>(72)</b>	<b>(105)</b>	<b>(66)</b>

Other interest expense includes \$13 million finance lease interest expenses (30 June 2012: \$9 million). The period ended 30 June 2012 included a \$7 million non-cash charge for mark to market of derivatives.

### Note 10 – Trade and other receivables

Trade and other receivables are initially recognised at the fair value of the amounts to be received, plus transaction costs (if any). They are subsequently measured at amortised cost (using the effective interest method) less impairment losses.

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Trade receivables	229	135	-	-
Other receivables	51	62	32	18
Intercompany receivables	-	-	211	22
	<b>280</b>	<b>197</b>	<b>243</b>	<b>40</b>
Prepayments	14	1	-	-
<b>Trade and other receivables</b>	<b>294</b>	<b>198</b>	<b>243</b>	<b>40</b>

Trade receivables are non-interest bearing and are generally on terms 20 working days or less.

Chorus maintains a provision for impairment losses when there is objective evidence of its customers being unable to make required payments. Chorus has minimal provision for doubtful debt in the

current period and there have been no significant individual impairment amounts recognised as an expense. Trade receivables are net of allowances for disputed balances with customers.

## Note 10 – Trade and other receivables continued

The ageing profile of trade receivables as at 30 June 2013 is as follows:

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Not past due	208	124	-	-
Past due 1-30 days	13	10	-	-
Past due 31-60 days	3	1	-	-
Past due 61-90 days	1	-	-	-
Past due over 90 days	4	-	-	-
	<b>229</b>	<b>135</b>	-	-

Chorus has a concentrated customer base consisting predominantly of a small number of retail service providers. The concentration of Chorus' customer base heightens the risk that a dispute with a customer, or a customer's failure to pay for services, will have a material adverse effect on Chorus' collectability of receivables.

Any disputes arising that may affect the relationship between the parties will be raised by relationship managers and follow the Chorus dispute resolution process. Chorus has \$21 million of accounts receivable that are past due but not impaired (30 June 2012: \$11 million). The carrying value of trade and other receivables approximate the fair value. The maximum credit exposure is limited to the carrying value of trade and other receivables.

## Note 11 – Trade and other payables

Trade and other payables are initially recognised at fair value less transaction costs (if any). They are subsequently measured at amortised cost using the effective interest method.

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Trade payables	121	147	-	-
Joint arrangements	11	21	-	-
Accruals	154	125	33	31
Personnel accrual	17	14	-	-
Revenue billed in advance	27	30	-	-
<b>Trade and other payables</b>	<b>330</b>	<b>337</b>	<b>33</b>	<b>31</b>
<b>Current</b>	<b>328</b>	<b>328</b>	<b>33</b>	<b>31</b>
<b>Non-current</b>	<b>2</b>	<b>9</b>	-	-

Trade and other payables are non-interest bearing and normally settled within 30 day terms. The carrying value of trade and other payables approximate their fair values.

### Joint arrangements

Certain network electronic assets and shared systems owned by Telecom are required for continued use by Chorus post demerger. The right to use these assets have been granted by Telecom under joint arrangements over the life of the assets.

## Note 12 – Commitments

### Network infrastructure project agreement

Chorus is committed to deploying infrastructure for premises in the UFB candidate areas awarded to Chorus, to be built according to annual build milestones and to be complete by no later than 31 December 2019. In total it is expected that the communal infrastructure will pass an estimated 830,900 premises. Chorus has estimated that it will cost \$1.7 - \$1.9 billion to build the communal UFB network by the end of 2019.

### Rural Broadband Initiative

As part of the Rural Broadband Initiative Phase 1, Chorus is committed to deploying approximately 3,100 kilometres of fibre to connect approximately 850 schools and enable approximately 57% of rural users to access broadband speeds of at least 5Mbps. In addition, under phase 2 of the Rural Broadband Initiative, Chorus

will be deploying a further 250 kilometres of fibre to connect 189 provincial schools, up to 181 rural public libraries and 45 rural hospitals and family health centres.

The estimated cost of the build is in the range of \$280 – \$295 million.

### Capital expenditure

Refer to note 1 and note 2 for details of capital expenditure commitments.

### Lease commitments

Chorus has building, car parks and site licenses under operating lease arrangements. The future non cancellable minimum operating lease commitment as at 30 June 2013 for the Group was \$26 million (30 June 2012: \$19 million).

## Note 13 – Taxation

Current and deferred tax is calculated on the basis of the laws enacted or substantively enacted at balance date.

Deferred taxation is recognised in respect of temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Future tax benefits are recognised where realisation of the asset is probable.

Current and deferred tax are recognised in the income statement, except when the tax relates to items charged or credited to other comprehensive income, in which case the tax is also recognised in other comprehensive income.

**Note 13 – Taxation continued**
**Income tax**

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
<b>Income statement</b>				
Current income tax				
Current period income tax (expense)/credit	(62)	(34)	-	1
Adjustments in respect of prior periods	6	-	-	-
Deferred income tax				
Network assets, software and other intangibles	2	(13)	-	-
Employee entitlements	-	2	-	-
Other	(6)	5	-	-
Adjustments in respect of prior periods	(5)	-	-	-
<b>Income tax (expense)/credit recognised in income statement</b>	<b>(65)</b>	<b>(40)</b>	<b>-</b>	<b>1</b>
<b>Other comprehensive income</b>				
Current income tax				
Current period income tax expense	-	-	-	-
Deferred income tax				
Changes in fair value of cash flow hedges	(4)	4	(4)	4
<b>Income tax (expense)/credit recognised in other comprehensive income</b>	<b>(4)</b>	<b>4</b>	<b>(4)</b>	<b>4</b>

The taxation expense charged to earnings includes both current and deferred tax and is calculated after allowing for adjustments.

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
<b>Reconciliation of effective tax rate</b>				
<b>Net earnings/(loss) for the period</b>	<b>171</b>	<b>102</b>	<b>87</b>	<b>(4)</b>
Add: Income tax (expense)/credit	(65)	(40)	-	1
<b>Net earnings/(loss) before income tax</b>	<b>236</b>	<b>142</b>	<b>87</b>	<b>(5)</b>
Income tax at 28%	(66)	(40)	(24)	1
<b>Adjustment to taxation</b>				
Non taxable intercompany dividends	-	-	24	-
Adjustments in respect of prior periods	1	-	-	-
	<b>(65)</b>	<b>(40)</b>	<b>-</b>	<b>1</b>

For the year ended 30 June 2013 the effective tax rate of 28% equates to the statutory rate of 28% (30 June 2012: 28%).

**Note 13 – Taxation continued**
**Movement in deferred tax balance during the period**

	GROUP			
	BALANCE 1 JULY 2012 \$M	RECOGNISED IN PROFIT AND LOSS \$M	RECOGNISED IN OTHER COMPREHENSIVE INCOME \$M	BALANCE 30 JUNE 2013 \$M
<b>(Assets)/liabilities</b>				
Fair value portion of derivatives	16	-	-	16
Network assets, software and other intangibles	214	3	-	217
Employee entitlements	(4)	3	-	(1)
Finance leases	(35)	-	-	(35)
Other	(10)	3	-	(7)
Changes in fair value of cash flow hedges	(4)	-	4	-
<b>Total</b>	<b>177</b>	<b>9</b>	<b>4</b>	<b>190</b>
	GROUP			
	BALANCE 1 DECEMBER 2011 \$M	RECOGNISED IN PROFIT AND LOSS \$M	RECOGNISED IN OTHER COMPREHENSIVE INCOME \$M	BALANCE 30 JUNE 2012 \$M
<b>(Assets)/liabilities</b>				
Fair value portion of derivatives	16	-	-	16
Network assets, software and other intangibles	201	13	-	214
Employee entitlements	(2)	(2)	-	(4)
Finance leases	(35)	-	-	(35)
Other	(5)	(5)	-	(10)
Changes in fair value of cash flow hedges	-	-	(4)	(4)
<b>Total</b>	<b>175</b>	<b>6</b>	<b>(4)</b>	<b>177</b>

### Note 13 – Taxation continued

	PARENT		BALANCE 30 JUNE 2013 \$M
	RECOGNISED IN PROFIT AND LOSS \$M	RECOGNISED IN OTHER COMPREHENSIVE INCOME \$M	
<b>(Assets)/liabilities</b>			
Fair value portion of derivatives	16	-	16
Changes in fair value of cash flow hedges	(4)	4	-
<b>Total</b>	<b>12</b>	<b>4</b>	<b>16</b>

	PARENT		BALANCE 30 JUNE 2012 \$M
	RECOGNISED IN PROFIT AND LOSS \$M	RECOGNISED IN OTHER COMPREHENSIVE INCOME \$M	
<b>(Assets)/liabilities</b>			
Fair value portion of derivatives	16	-	16
Changes in fair value of cash flow hedges	-	(4)	(4)
<b>Total</b>	<b>16</b>	<b>(4)</b>	<b>12</b>

### Imputation credits

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Imputation credits available for subsequent reporting periods	63	33	5	-

The imputation credit amount represents the balance of the imputation credit account as at the end of the reporting period, adjusted for imputation credits that will arise from the payment of the provision for income tax. Imputation credits are available for

use subject to the requirements of the Income Tax Act 2007 being satisfied. For the purposes of the Income Tax Act 2007 Telecom demerger transactions do not give rise to, and are ignored for the purposes of calculating available subscribed capital of Chorus.

### Note 14 – Cash and call deposits

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Cash and call deposits	80	140	69	61

#### Cash flow

Cash flows from derivatives in cash flow and fair value hedge relationships are recognised in the cash flow statement in the same category as the hedged item.

There are no cash or call deposit balances held by Chorus that are not available for use.

The carrying values of cash approximate their fair values.

The maximum credit exposure is limited to the carrying value of cash and call deposits.

Cash denominated in foreign currencies are retranslated into New Zealand dollars at the spot rate of exchange at the reporting date. All differences arising on settlement or translation of monetary items are taken to the income statement.

For the purposes of the statement of cash flows, cash is considered to be cash on hand, in banks and cash equivalents, including bank overdrafts and highly liquid investments that are readily convertible to known amounts of cash which are subject to an insignificant risk of changes in values.

### Note 15 – Leases

Chorus is a lessee of certain network assets under both operating and finance lease arrangements. Lease costs relating to operating leases are recognised on a straight-line basis over the life of the lease. Finance leases, which effectively transfer to Chorus substantially all the risks and benefits of ownership of the leased assets, are capitalised at the lower of the leased asset's fair value or the present value of the minimum lease payments at inception of the lease. The leased assets and corresponding liabilities are recognised, and the leased assets are depreciated over their estimated useful lives.

Determining whether a lease agreement is a finance lease or an operating lease requires judgement as to whether the agreement transfers substantially all the risks and rewards of ownership to

Chorus. Judgement is required on various aspects that include, but are not limited to, the fair value of the leased asset, the economic life of the leased asset, whether or not to include renewal options in the lease term, and determining an appropriate discount rate to calculate the present value of the minimum lease payments.

Classification as a finance lease means the asset is recognised in the statement of financial position as network assets whereas for an operating lease no such asset is recognised.

Chorus has exercised its judgement on the appropriate classification of network asset leases, and has determined a number of lease arrangements are finance leases.

**Note 15 – Leases continued**

**Finance leases**

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
<b>Assets/(liabilities)</b>				
<b>Expected future lease payments:</b>				
Less than one year	(8)	(8)	-	-
Between one and five years	(31)	(31)	-	-
More than five years	(387)	(395)	-	-
<b>Total expected future lease payments</b>	<b>(426)</b>	<b>(434)</b>	-	-
Less: future finance charges	306	316	-	-
<b>Present value of expected future lease payments</b>	<b>(120)</b>	<b>(118)</b>	-	-
<b>Present value of expected future lease payments payable:</b>				
Less than one year	3	3	-	-
Between one and five years	14	13	-	-
More than five years	(137)	(134)	-	-
<b>Total present value of expected future lease payments</b>	<b>(120)</b>	<b>(118)</b>	-	-
<b>Classified as:</b>				
Current asset - finance lease receivable	3	3	-	-
Non-current liability - finance lease payable	(123)	(121)	-	-
<b>Total</b>	<b>(120)</b>	<b>(118)</b>	-	-

The carrying value of the finance leases approximates their fair value.

**Property exchanges**

Chorus has leased exchange space and commercial co-location space owned by Telecom which is subject to finance lease arrangements. Chorus in turn leases exchange space and commercial co-location space owned by Chorus to Telecom under a finance lease arrangement. The term of the leases where Chorus is lessee is for ten years with multiple rights of renewal for a further twenty five years. The term of the lease where Chorus is lessor is for three years with two rights of renewal for a further three years each.

The full term has been used in the calculation of finance lease payables and receivables as it is likely, due to the specialised nature of the buildings, the leases will be renewed to the maximum term. The payable and receivable under these finance lease arrangements are net settled in cash. The finance lease arrangement above reflects the net finance lease receivable and payable position.

**Note 15 – Leases continued**

**Operating leases**

	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
<b>Non-cancellable operating lease rentals are payable as follows:</b>				
Less than one year	6	4	-	-
Between one and five years	14	11	-	-
More than five years	6	4	-	-
<b>Total</b>	<b>26</b>	<b>19</b>	-	-

Chorus has entered into leasing arrangements for properties, network infrastructure and other items of equipment which are classified as operating leases. Certain leases are subject to Chorus being able to renew or extend the lease period based on terms that would then be agreed with the lessor. There are no other significant lease terms that relate to contingent rents, purchase options or other restrictions on Chorus.

**Note 16 – Investments and advances**

Chorus New Zealand Limited incorporated in New Zealand is a wholly owned operating subsidiary of Chorus Limited.

The investment in the subsidiary is carried at cost less any impairments losses and comprises:

	PARENT	
	2013 \$M	2012 \$M
Shares at cost	538	538
Term advance	1,700	1,700
<b>Total investments and advances</b>	<b>2,238</b>	<b>2,238</b>

There were no impairment losses on investments and advances at 30 June 2013 (30 June 2012: nil).

## Note 17 – Equity

### Share capital

Movements in Chorus Limited's issued ordinary shares were as follows:

	GROUP AND PARENT	
	2013 M	2012 M
<b>NUMBER OF SHARES (MILLIONS)</b>		
Balance at beginning of the period	385	385
Dividend Reinvestment Plan	4	-
<b>Balance at the end of the period</b>	<b>389</b>	<b>385</b>

Chorus Limited has 389,299,049 fully paid ordinary shares (30 June 2012: 385,082,123 fully paid ordinary shares). The issued shares have no par value. The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of Chorus Limited. Under Chorus Limited's constitution, Crown approval is required if a shareholder wishes to have a holding of 10% or more of Chorus Limited ordinary shares, or if a shareholder who is not a New Zealand national wishes to have a holding of 49.9% or more of ordinary shares.

In the year ended 30 June 2013 Chorus Limited implemented a Dividend Reinvestment Plan. Under the Plan, eligible shareholders (those who have an address in New Zealand or Australia) can choose to have Chorus Limited reinvest all or part of their future dividends in additional Chorus Limited shares. In respect of the year ended

30 June 2013, 4,216,926 shares with a total value of \$12 million were issued in lieu of dividends.

Chorus Limited issues securities to CFH based on the number of premises passed. CFH securities are a class of security that carry no right to vote at meetings of holders of Chorus Limited ordinary shares but carry preference on liquidation. Refer to note 4 for additional information on CFH securities.

Should Chorus Limited return capital to shareholders, any return of capital that arose on demerger is expected to be taxable as Chorus Limited had zero available subscribed capital on demerger.

The following dividends were declared and paid by Chorus Limited for the year ended 30 June 2013:

	GROUP AND PARENT	
	2013 \$M	2013 CENTS PER SHARE
2012 dividend paid	56	14.6
2013 interim dividend paid	39	10.0
<b>Dividends paid during the year</b>	<b>95</b>	

Final dividend declared subsequent to balance date not provided (refer to note 23)

No dividend was paid during the seven months ended 30 June 2012.

## Note 17 – Equity continued

### Reserves

#### Cash flow hedge reserve

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet affected earnings.

For cash flow hedges, the effective portion of gains or losses from remeasuring the fair value of the hedging instrument is recognised in other comprehensive income and accumulated in the cash flow hedge reserve. Accumulated gains or losses are subsequently transferred to the income statement when the hedged item affects

the income statement, or when the hedged item is a forecast transaction that is no longer expected to occur. Alternatively, when the hedged item results in a non-financial asset or liability, the accumulated gains and losses are included in the initial measurement of the cost of the asset or liability.

The remeasurement gain or loss on the ineffective portion of a cash flow hedge is recognised immediately in the income statement.

A reconciliation of movements in the cash flow hedge reserve follows:

	GROUP AND PARENT	
	2013 \$M	2012 \$M
Opening balance	10	-
(Gain)/loss recognised in other comprehensive income	(9)	10
Net amounts reclassified from cash flow hedge reserve to income statement	-	-
<b>Closing balance</b>	<b>1</b>	<b>10</b>

**Note 17 – Equity continued**

The periods in which the cash flows associated with cash flow hedges are expected to impact earnings are as follows:

AS AT 30 JUNE 2013	GROUP AND PARENT					
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M
Cross currency interest rate swaps	-	-	-	-	-	1
Interest rate swaps	-	1	-	1	-	(2)
Forward exchange contracts	-	-	-	-	-	-
Electricity contracts	-	-	-	-	-	-
	-	1	-	1	-	(1)

AS AT 30 JUNE 2012	GROUP AND PARENT					
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M
Cross currency interest rate swaps	-	-	-	-	-	(16)
Interest rate swaps	-	-	2	-	4	20
Forward exchange contracts	-	-	-	-	-	-
Electricity contracts	-	-	-	-	-	-
	-	-	2	-	4	4

**Fair value hedge reserve**

For fair value hedges, gains or losses from remeasuring the fair value of the hedging instrument are recognised in the income statement together with any changes in the fair value of the hedged asset or liability.

Chorus did not have any hedging arrangements designated as a fair value hedge in the current year (30 June 2012: nil).

**Note 18 – Earnings per share**

The calculation of basic earnings per share at 30 June 2013 is based on the net earnings for the year of \$171 million (30 June 2012: \$102 million), and a weighted average number of ordinary shares

outstanding during the period of 386 million (30 June 2012: 385 million), calculated as follows:

	GROUP	
	2013	2012
<b>Basic earnings per share</b>		
Net earnings attributable to ordinary shareholders (\$ millions)	171	102
Denominator - weighted average number of ordinary shares (millions)	386	385
<b>Basic earnings per share (dollars)</b>	<b>0.44</b>	<b>0.26</b>
<b>Diluted earnings per share</b>		
Net earnings attributable to ordinary shareholders (\$ millions)	171	102
Weighted average number of ordinary shares (millions)	386	385
Ordinary shares required to settle CFH equity securities (millions)	25	2
Denominator - diluted weighted average number of shares (millions)	411	387
<b>Diluted earnings per share (dollars)</b>	<b>0.42</b>	<b>0.26</b>

CFH equity securities can be settled by issuing Chorus shares valued at a 5% discount to the 20-day volume weighted average price for Chorus shares traded in ordinary trading on the NZX Main Board. The number of ordinary shares that would have been required to

settle all CFH equity securities on issue at 30 June 2013 has been used for the purposes of the diluted earnings per share calculation. There was no dilution effect at 30 June 2012.

## Note 19 – Related party transactions

### Transactions with related parties

Certain Chorus directors have relevant interests in a number of companies with which Chorus has transactions in the normal course of business. A number of Chorus' directors are also non-executive

directors of other companies. Any transactions undertaken with these entities have been entered into independently on an arm's length commercial basis.

### Key management personnel compensation

	GROUP		PARENT	
	2013 \$'000s	2012 \$'000s	2013 \$'000s	2012 \$'000s
Short term employee benefits	5,494	3,108	-	-
Post employment benefits	-	-	-	-
Termination benefits	242	-	-	-
Other long term benefits	650	542	-	-
Share based payments	-	-	-	-
	<b>6,386</b>	<b>3,650</b>	<b>-</b>	<b>-</b>

This table above includes remuneration of \$863,500 (30 June 2012: \$467,000) paid to directors for the period.

### Parent/subsidiary relationship

Chorus Limited is the listed holding company with the debt obligation for the EMTN and syndicated bank facility and is the issuer of the CFH securities. Chorus New Zealand Limited is an operational subsidiary providing fixed access and aggregation services in New Zealand. Chorus Limited provides funding to Chorus

New Zealand Limited for the operation and construction of the network. Chorus New Zealand Limited has provided a guarantee to the lenders in respect of the Chorus Limited syndicated bank facility and EMTN debt.

	PARENT	
	2013 \$M	2012 \$M
Intercompany dividend	86	-
Intercompany interest income	104	60
Intercompany short term receivable	211	22
Intercompany term advance	1,700	1,700

## Note 20 – Derivative financial instruments

### Derivative financial instruments

Chorus uses derivative financial instruments to reduce its exposure to fluctuations in foreign currency exchange rates, interest rates and the spot price of electricity. The use of hedging instruments is governed by the treasury policy approved by the Board of Directors.

or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The method of recognising the resulting remeasurement gain or loss depends on whether the derivative is designated as a hedging instrument, the remeasurement gain or loss is recognised immediately in the income statement.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to fair value. The fair values are estimated on the basis of the quoted market prices for similar instruments in an active market or quoted prices for identical

	GROUP AND PARENT	
	2013 \$M	2012 \$M
<b>Non-current derivative assets</b>		
Interest rate swaps	7	-
Forward exchange rate contracts	-	-
Cross currency interest rate swaps	-	2
Currency options	-	-
Electricity contracts	-	-
	<b>7</b>	<b>2</b>
<b>Non-current derivative liabilities</b>		
Interest rate swaps	2	32
Forward exchange rate contracts	-	-
Cross currency interest rate swaps	103	78
Currency options	-	-
Electricity contracts	1	-
	<b>106</b>	<b>110</b>

The notional values of contract amounts outstanding are as follows:

	CURRENCY	MATURITY	GROUP AND PARENT	
			2013 \$M	2012 \$M
Interest rate swaps	NZD	2014-2020	1,242	1,242
Forward exchange rate contracts				
	NZD:AUD	2013	3	-
	NZD:EUR	2012-2016	11	5
	NZD:USD	2012	-	4
Cross currency interest rate swaps	NZD:GBP	2020	677	677
Currency options				
	NZD:AUD	2012	-	4
	NZD:EUR	2012	-	6
	NZD:USD	2012	-	4
Electricity contracts	NZD	2013-2015	7	-
			<b>1,940</b>	<b>1,942</b>

Credit risk associated with derivative financial instruments is managed by ensuring that transactions are executed with counterparties with high quality credit ratings along with credit exposure limits for

different credit classes. The counterparty credit risk is monitored and reviewed by the Board on a regular basis.

**Note 21 – Financial risk management**

**Financial risk management**

Chorus' financial instruments consist of cash, short-term deposits, trade and other receivables (excluding prepayments), investments and advances, trade payables and certain other payables, syndicated bank facility, EMTN, derivative financial instruments and CFH securities. Financial risk management for currency and interest rate risk is carried out by the treasury function under policies approved by the Board. Chorus' risk management policy, approved by the Board, provides the basis for overall risk management.

Chorus does not hold or issue derivative financial instruments for trading purposes. All contracts have been entered into with major creditworthy financial institutions. The risk associated with these transactions is the cost of replacing these agreements at the current market rates in the event of default by a counterparty.

**Currency risk**

Chorus' exposure to foreign currency fluctuations predominantly arise from the foreign currency debt and future commitment to purchase foreign currency denominated assets. The primary objective in managing foreign currency risk is to protect against the risk that Chorus assets, liabilities and financial performance will fluctuate due to changes in foreign currency exchange rates. Chorus enters into foreign exchange contracts, foreign currency options and cross currency interest rate swaps to manage the foreign exchange exposure.

Chorus has issued GBP260 million foreign currency debt in the form of EMTN. Chorus has in place cross currency interest rate swaps under which Chorus receives GBP260 million principal and GBP fixed coupon payments for \$677 million principal and floating NZD interest payments. The exchange gain or loss resulting from the translation of EMTN denominated in foreign currency to New Zealand dollars is recognised in the income statement. The movement is offset by the translation of the principal value of the related cross currency interest rate swap.

As at 30 June 2013, Chorus did not have any significant unhedged exposure to currency risk (30 June 2012: no significant unhedged exposure to currency risk). A 10% increase or decrease in the exchange rate, with all other variables held constant, has minimal impact on profit and equity reserves of Chorus.

**Price risk**

In the normal course of business, Chorus is exposed to a variety of financial risks which include the volatility in electricity prices. Chorus has entered into electricity swap contracts to reduce the exposure to electricity spot price movements. Chorus has designated the electricity contracts in cash flow hedge relationships. A 10% increase or decrease in the spot price of electricity, with all other variables held constant, has minimal impact on profit and equity reserves of Chorus.

**Interest rate risk**

Chorus has interest rate risk arising from the cross currency interest rate swap converting the foreign debt into a floating rate New Zealand dollar obligation and the floating rate on the drawn down portion of the syndicated bank facility. Chorus aims to reduce the uncertainty of changes in interest rates by entering into interest rate swaps to fix the effective interest rate to minimise the cost of net debt and manage the impact of interest rate volatility on earnings.

The interest risk on the cross currency interest rate swaps has been hedged using interest rate swaps. The interest rate exposure on the syndicated banking facility has been hedged up to \$565 million with the remaining paying floating interest.

**Note 21 – Financial risk management continued**

**Interest rate repricing analysis**

	GROUP						TOTAL \$M
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M	
<b>AS AT 30 JUNE 2013</b>							
<b>Floating rate</b>							
Cash and deposits	80	-	-	-	-	-	80
Debt	630	-	-	-	-	-	630
<b>Fixed rate</b>							
Joint arrangements	8	3	-	-	-	-	11
Debt (after hedging)	-	350	-	215	-	677	1,242
CFH securities	-	-	-	-	-	30	30
Finance lease (net settled)	(3)	(3)	(3)	(4)	(4)	137	120
	<b>715</b>	<b>350</b>	<b>(3)</b>	<b>211</b>	<b>(4)</b>	<b>844</b>	<b>2,113</b>

	GROUP						TOTAL \$M
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M	
<b>AS AT 30 JUNE 2012</b>							
<b>Floating rate</b>							
Cash and deposits	140	-	-	-	-	-	140
Debt	540	-	-	-	-	-	540
<b>Fixed rate</b>							
Joint arrangements	11	7	3	-	-	-	21
Debt (after hedging)	-	-	350	-	215	677	1,242
CFH securities	-	-	-	-	-	3	3
Finance lease (net settled)	(3)	(3)	(3)	(3)	(4)	134	118
	<b>688</b>	<b>4</b>	<b>350</b>	<b>(3)</b>	<b>211</b>	<b>814</b>	<b>2,064</b>

## Note 21 – Financial risk management continued

The Parent has floating rate exposures of cash (30 June 2013: \$69 million, 30 June 2012: \$61 million) and debt (30 June 2013: \$630 million, 30 June 2012: \$540 million) both of which are due within one year. The exposures of debt (after hedging) and CFH securities are the same as for the Group for the current year and the prior period.

### Sensitivity analysis

As at 30 June 2013 a change of 100 basis points in interest rate, with all other variables held constant, would increase/(decrease) equity (after hedging) and earnings after tax by the amounts shown below:

	GROUP AND PARENT			
	2013 PROFIT OR (LOSS) \$M	2013 EQUITY \$M	2012 PROFIT OR (LOSS) \$M	2012 EQUITY \$M
100 basis point increase	(3)	(5)	(5)	21
100 basis point decrease	3	13	5	(23)

### Credit risk

In the normal course of its business, Chorus incurs counterparty credit risk from financial instruments, including cash, trade and other receivables, finance lease receivables and derivative financial instruments.

Chorus has certain derivative transactions that are subject to bilateral credit support agreements that require Chorus or the counterparty to

post collateral to support the value of certain derivatives.

As at 30 June 2013 no collateral was posted.

The maximum exposure to credit risk at the reporting date was as follows:

NOTES	GROUP		PARENT	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M
Cash and call deposits	14	80	140	69
Trade and other receivables	10	280	197	243
Derivative financial instruments	20	7	2	7
Finance lease receivable	15	3	3	-
<b>Maximum exposure to credit risk</b>		<b>370</b>	<b>342</b>	<b>319</b>

Refer to individual notes for additional information on credit risk.

## Note 21 – Financial risk management continued

### Liquidity risk

Liquidity risk is the risk that Chorus will encounter difficulty raising liquid funds to meet commitments as they fall due or foregoing investment opportunities, resulting in defaults or excessive debt costs. Prudent liquidity risk management implies maintaining sufficient cash and the ability to meet its financial obligations. Chorus' exposure to liquidity risk based on contractual cash flows relating to financial liabilities is summarised below:

	GROUP									
	CARRYING AMOUNT \$M	CONTRACTUAL CASHFLOW \$M	LESS THAN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	5+ YEARS \$M		
<b>AS AT 30 JUNE 2013</b>										
<b>Non derivative financial liabilities</b>										
Trade and other payables	286	286	283	3	-	-	-	-	-	-
Finance lease (net settled)	120	426	7	8	8	8	8	8	8	387
Debt	1,697	2,091	77	77	741	54	564	578		578
CFH securities	30	67	-	-	-	-	-	-	-	67
<b>Derivative financial liabilities</b>										
Interest rate swaps	2	75	13	12	12	10	9	19		
Gross currency interest rate swaps	-	(750)	(34)	(34)	(34)	(35)	(35)	(578)		
Inflows	103	938	37	37	37	37	38	752		
Electricity contracts	1	7	3	3	1	-	-	-		
Forward exchange contracts	-	(14)	(10)	(2)	(2)	-	-	-		
Inflows	-	14	10	2	2	-	-	-		
Outflows	-	-	-	-	-	-	-	-		

	GROUP									
	CARRYING AMOUNT \$M	CONTRACTUAL CASHFLOW \$M	LESS THAN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	5+ YEARS \$M		
<b>AS AT 30 JUNE 2012</b>										
<b>Non derivative financial liabilities</b>										
Trade and other payables	293	295	285	7	3	-	-	-	-	-
Finance lease (net settled)	118	434	8	8	8	8	7	395		
Debt	1,609	2,024	74	74	737	50	472	617		617
CFH securities	3	6	-	-	-	-	-	-		6
<b>Derivative financial liabilities</b>										
Interest rate swaps	32	82	12	12	12	11	10	25		
Gross currency interest rate swaps	-	(279)	(35)	(35)	(35)	(35)	(35)	(104)		
Inflows	78	304	38	38	38	38	38	114		
Electricity contracts	-	-	-	-	-	-	-	-		
Forward exchange contracts	-	(9)	(9)	-	-	-	-	-		
Inflows	-	9	9	-	-	-	-	-		
Outflows	-	-	-	-	-	-	-	-		

### Note 21 – Financial risk management continued

The liquidity risk for the Parent is the same as for all disclosures for the Group except trade and other payables and finance leases. The carrying amount of trade and other payables in the Parent is \$33 million (30 June 2012: \$31 million), which is equal to the contractual cash flow and is all payable in less than one year. The Parent does not have finance leases for the current year and the prior period.

The gross (inflows)/outflows of derivative financial liabilities disclosed in the previous table represent the contractual undiscounted cash flows relating to derivative financial liabilities held for risk management purposes and which are usually not closed out prior to contractual maturity. The disclosure shows net cash flow amounts for derivatives that are net cash settled and gross cash inflow and outflow amounts for derivatives that have simultaneous gross cash settlement (for example forward exchange contracts).

Chorus manages the liquidity risk by ensuring sufficient access to committed facilities, continuous cash flow monitoring and maintaining prudent levels of short term debt maturities. At balance date, Chorus has available approximately \$155 million under the syndicated bank facility for its immediate use (30 June 2012: \$245 million). In addition, a \$10 million overdraft facility was established in the current year to manage short term cash funding requirements.

#### Capital risk management

Chorus manages its capital considering shareholders' interests, the value of Chorus assets and Chorus' credit ratings. The capital Chorus manages consists of cash and debt balances.

The Board is committed to maintaining a 'BBB' long term credit rating from Standard & Poor's and a 'Baa2' long term credit rating from Moody's Investor Services. Chorus' capital management policies are designed to ensure that this objective is met. It is Chorus' intention that in normal circumstances the ratio of net debt to EBITDA will not materially exceed 3.5 times.

#### Hedge accounting

Chorus designates and documents the relationship between hedging instruments and hedged items, as well as the risk management objective and strategy for undertaking various hedge transactions. At hedge inception (and on an ongoing basis), hedges are assessed to establish if they are effective in offsetting changes in fair values or cash flows of hedged items. Chorus discontinues hedge accounting if (a) the hedging instrument expires or is sold, terminated, or exercised; (b) the hedge no longer meets the criteria for hedge accounting; or (c) the hedge designation is revoked.

Hedges are classified into two primary types: cash flow hedges and fair value hedges. Refer to note 17 for additional information on cash flow and fair value hedge reserves.

#### Fair value

Under NZ IFRS, financial instruments are either carried at amortised cost, less any provision for impairment losses, or fair value. The only significant variances between instruments held at amortised cost and their fair value relates to the EMTN.

For those instruments, recognised at fair value in the statement of financial position, fair values are determined as follows:

**Level 1:** Quoted market prices – financial instruments with quoted prices for identical instruments in active markets.

**Level 2:** Valuation techniques using observable inputs – financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

**Level 3:** Valuation techniques with significant non-observable inputs – financial instruments valued using models where one or more significant inputs are not observable.

The relevant financial assets and financial liabilities and their respective fair values are outlined in note 20 and are all Level 2 (30 June 2012: Level 2).

#### Cross currency interest rate swaps and interest rate swaps

Fair value is estimated by using a valuation model involving discounted future cash flows of the derivative using the applicable forward price curve (for the relevant interest rate and foreign exchange rate) and discount rate.

#### Electricity swaps

Fair value is estimated on the ASX forward price curve that relates to the derivative.

### Note 21 – Financial risk management continued

The carrying amounts of financial assets and liabilities in each of the NZ IAS 39 categories are as follows:

	GROUP					
	FAIR VALUE THROUGH PROFIT AND LOSS \$M	HELD TO MATURITY \$M	LOANS AND RECEIVABLES \$M	AVAILABLE FOR SALE \$M	DESIGNATED IN A HEDGING RELATIONSHIP \$M	OTHER FINANCIAL LIABILITIES AT AMORTISED COST \$M
<b>AS AT 30 JUNE 2013</b>						
<b>Assets</b>						
Cash and call deposits	-	-	80	-	-	-
Trade receivables	-	-	229	-	-	-
Other receivables	-	-	51	-	-	-
Derivative financial instruments	-	-	-	-	7	-
	-	-	<b>360</b>	-	<b>7</b>	-
<b>Liabilities</b>						
Trade accounts payable	-	-	-	-	-	121
Joint arrangements	-	-	-	-	-	11
Accruals	-	-	-	-	-	154
Derivative financial instruments	-	-	-	-	106	-
Finance lease (net settled)	-	-	-	-	-	120
Debt	-	-	-	-	-	1,697
CFH securities	-	-	-	-	-	30
	-	-	-	-	<b>106</b>	<b>2,133</b>

	GROUP					
	FAIR VALUE THROUGH PROFIT AND LOSS \$M	HELD TO MATURITY \$M	LOANS AND RECEIVABLES \$M	AVAILABLE FOR SALE \$M	DESIGNATED IN A HEDGING RELATIONSHIP \$M	OTHER FINANCIAL LIABILITIES AT AMORTISED COST \$M
<b>AS AT 30 JUNE 2012</b>						
<b>Assets</b>						
Cash and call deposits	-	-	140	-	-	-
Trade receivables	-	-	135	-	-	-
Other receivables	-	-	62	-	-	-
Derivative financial instruments	-	-	-	-	2	-
	-	-	<b>337</b>	-	<b>2</b>	-
<b>Liabilities</b>						
Trade accounts payable	-	-	-	-	-	147
Joint arrangements	-	-	-	-	-	21
Accruals	-	-	-	-	-	125
Derivative financial instruments	-	-	-	-	110	-
Finance lease (net settled)	-	-	-	-	-	118
Debt	-	-	-	-	-	1,609
CFH securities	-	-	-	-	-	3
	-	-	-	-	<b>110</b>	<b>2,023</b>

## Note 21 – Financial risk management continued

AS AT 30 JUNE 2013	PARENT					
	FAIR VALUE THROUGH PROFIT AND LOSS \$M	HELD TO MATURITY \$M	LOANS AND RECEIVABLES \$M	AVAILABLE FOR SALE \$M	DESIGNATED IN A HEDGING RELATIONSHIP \$M	OTHER FINANCIAL LIABILITIES AT AMORTISED COST \$M
<b>Assets</b>						
Cash and call deposits	-	-	69	-	-	-
Other receivables	-	-	32	-	-	-
Intercompany receivables	-	-	211	-	-	-
Investments and advances	-	-	1,700	-	-	-
Derivative financial instruments	-	-	-	-	7	-
	-	-	<b>2,012</b>	-	<b>7</b>	-
<b>Liabilities</b>						
Accruals	-	-	-	-	-	33
Derivative financial instruments	-	-	-	-	106	-
Debt	-	-	-	-	-	1,697
CFH securities	-	-	-	-	-	30
	-	-	-	-	<b>106</b>	<b>1,760</b>

AS AT 30 JUNE 2012	PARENT					
	FAIR VALUE THROUGH PROFIT AND LOSS \$M	HELD TO MATURITY \$M	LOANS AND RECEIVABLES \$M	AVAILABLE FOR SALE \$M	DESIGNATED IN A HEDGING RELATIONSHIP \$M	OTHER FINANCIAL LIABILITIES AT AMORTISED COST \$M
<b>Assets</b>						
Cash and call deposits	-	-	61	-	-	-
Other receivables	-	-	18	-	-	-
Intercompany receivables	-	-	22	-	-	-
Investments and advances	-	-	1,700	-	-	-
Derivative financial instruments	-	-	-	-	2	-
	-	-	<b>1,801</b>	-	<b>2</b>	-
<b>Liabilities</b>						
Accruals	-	-	-	-	-	31
Derivative financial instruments	-	-	-	-	110	-
Debt	-	-	-	-	-	1,609
CFH securities	-	-	-	-	-	3
	-	-	-	-	<b>110</b>	<b>1,643</b>

## Note 22 – Contingencies

There are no matters of litigation giving rise to a contingent liability or asset.

## Note 23 – Post balance date events

### Dividends

On 25 August 2013, Chorus declared a dividend in respect of the year ended 30 June 2013. The total amount of the dividend is \$60 million, which represents a fully imputed dividend of 15.5 cents per share.

### CFH securities and Crown funding

Chorus issued a call notice on 5 July 2013 to CFH with an aggregate issue price of \$25 million which is allocated as follows: CFH debt

securities \$4 million, CFH equity securities \$2 million and Crown funding \$19 million. \$15 million of this funding has been accrued in the financial statements at 30 June 2013 representing the portion of the call notice where user acceptance testing was complete.

### New debt arrangement

On 2 August 2013 Chorus entered into a new \$250 million bank facility with a 2019 maturity date. The proceeds were used to reduce drawings under existing syndicated bank facilities which mature in November 2015 and November 2017 respectively.

## Note 24 – New standards, amendments and interpretations to existing standards have been published but not yet adopted

Certain new standards, amendments and interpretations have been published that have not been early adopted, and which are relevant to Chorus are listed below. The financial statements impact of adoption of these standards has not yet been analysed but is not expected to be material.

### NZ IFRS 9 (2010) Financial instruments

Effective for periods beginning on or after 1 January 2015.

The standard adds requirements related to the classification, measurement and derecognition of financial assets and liabilities.

### NZ IFRS 10 Consolidated financial statements

Effective for periods beginning on or after 1 January 2013.

The standard introduces new principles in identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess.

### NZ IFRS 11 Joint arrangements

Effective for periods beginning on or after 1 January 2013.

The standard outlines the accounting by entities that jointly control an arrangement. Joint control involves the contractual agreed sharing of control and arrangements subject to joint control are classified as either a joint venture (representing a share of net assets

and equity accounted) or a joint operation (representing rights to assets and obligations for liabilities, accounted for under proportional consolidation).

### NZ IFRS 12 Disclosure of interest in other entities

Effective for periods beginning on or after 1 January 2013.

The standard applies to entities that have an interest in subsidiaries, joint arrangements, associates or unconsolidated structured entities. It establishes disclosure objectives and specifies minimum disclosures that an entity must provide to meet those objectives.

### NZ IFRS 13 Fair value measurement

Effective for periods beginning on or after 1 January 2013.

The standard establishes a single framework for measuring fair value where that is required by other standards and is applicable to both financial and non-financial items. The company is currently reviewing its methodologies in determining fair values and its impact on the financial statements.

### NZ IAS 27 Separate financial statements

Effective for periods beginning on or after 1 January 2013.

These amendments remove the accounting and disclosure requirements for consolidated financial statements as a result of the issue of NZ IFRS 10 Consolidated financial statements and NZ IFRS 12 Disclosure of interests in other entities.

# Governance & Disclosures

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## GOVERNANCE AT CHORUS

Chorus' Board and management are committed to ensuring that our people act ethically, with integrity and in accordance with our policies and values.

### Framework

Chorus is incorporated in New Zealand and listed on the New Zealand and Australian stock exchanges.

The governance practices and policies we have adopted therefore reflect, and are consistent with, the:

- NZX Listing Rules and Corporate Governance Best Practice Code;
- New Zealand Securities Commission's (now Financial Markets Authority (FMA)) 'Corporate Governance in New Zealand Principles and Guidelines'; and
- ASX Listing Rules and the ASX Corporate Governance Council's Principles and Recommendations.

The Board regularly reviews and assesses Chorus' governance policies, processes and practices to identify opportunities for enhancement and to ensure they reflect Chorus' operations and culture.

### Compliance with corporate governance codes, principles and recommendations

Chorus considers that during the reporting period:

- the corporate governance principles adopted and followed by it did not materially differ from NZX's Corporate Governance Best Practice Code; and
- it followed each of the recommendations set by the ASX Corporate Governance Council.

### Managing risk

Chorus has a Managing Risk Policy that mandates one framework for the management of risk in Chorus to:

- ensure the Board sets the risk appetite and reviews principal risks annually;
- integrate risk management in line with the Board's risk appetite into structures, policies, processes and procedures; and
- deliver regular principal risk reviews and monitoring.

A copy of Chorus' Managing Risk Policy is available at <http://www.chorus.co.nz/governance>.

As part of its role, the Audit and Risk Management Committee (ARMC) is responsible for assisting the Board to ensure that a risk management framework has been established and

for monitoring compliance with that framework. The ARMC and the Board regularly receive reports on risk management and the effectiveness of Chorus' management of its material business risks.

Chorus requires its CEO and CFO to make an annual declaration in relation to Chorus' financial statements relating to the matters set out in s295A of the Australian Corporations Act 2001, namely that in their opinion:

- the financial records of Chorus have been properly maintained;
- the financial statements of Chorus and accompanying notes set out in this annual report comply with generally accepted accounting practice in New Zealand and International Financial Reporting Standards; and
- the financial statements of Chorus and accompanying notes set out in this annual report give a true and fair view of the financial position and performance of Chorus.

The CEO and CFO also provide the Board with an assurance that the above declaration is founded on a sound system of risk management and internal control and that system is operating effectively in all material respects in relation to financial reporting risks.

The non-audit related fees paid to the auditor during the financial period (as detailed in Note 8 to the Financial Statements) were permitted non-audit services under Chorus' External Auditor Independence Policy.

### Code of ethics

Chorus expects its directors and employees to conduct themselves in accordance with the highest ethical standards. Chorus has Codes of Ethics for its directors and employees that set the expected standards for their professional conduct. These codes are intended to facilitate decisions that are consistent with Chorus' values, business goals and legal and policy obligations. The director Code of Ethics is available at [www.chorus.co.nz/governance](http://www.chorus.co.nz/governance).

Chorus has communicated the Codes of Ethics to directors and employees and has provided training to its employees. Chorus encourages its people to report any unethical behaviour through a compliance function that investigates any such reports.

A whistle blowing policy allows for confidential reporting of serious misconduct or wrongdoing and a fraud policy for the reporting of suspected fraud or corruption.

Chorus has not received any reports of serious instances of unethical behaviour during the financial period.

## THE CHORUS BOARD

### Role of the Board and delegation of authority

The Board is appointed by Chorus' shareholders and has statutory responsibility for the business and affairs of Chorus. The Board has overall responsibility for the strategy, culture, governance and performance of Chorus working with, and through, the CEO.

As described in the Board Charter, to allow for the effective day-to-day management and leadership of Chorus, the Board has delegated its authority, in part, to the CEO. The CEO may, in turn, sub-delegate authority to other Chorus people. Formal policies and procedures govern the parameters and operation of these delegations.

The Board has also appointed three standing Board Committees to assist it in carrying out its responsibilities and has delegated some of its responsibilities, powers and authorities to those Board Committees. Those Committees are described below. The Board may also establish other ad-hoc or standing committees and delegate specific responsibilities, powers and authorities to those committees and to particular directors.

The Board and Board Committee Charters and other key governance documents are available on Chorus' website at [www.chorus.co.nz/governance](http://www.chorus.co.nz/governance). The annex to the Board Charter contains a diagram that illustrates the key governance documents and the roles and responsibilities of the Board and Board Committees.

### Board membership

The Board seeks to ensure that through its skills mix and composition it is positioned to add value to Chorus, as outlined in the Board Charter.

The Board currently has seven directors (six independent directors and an executive director) with a broad range of managerial, financial, accounting and industry experience. See page 3 for more information on the skills and experience of the directors.

The independence status of each director is noted in their biographies on page 3. For a director to be considered independent, the Board must affirmatively determine that the director does not have a disqualifying relationship (other than solely as a consequence of being a director). The disqualifying relationships are set out in the Board Charter. While the Board has not set financial materiality thresholds for determining independence, it considers the materiality basis of all relationships having regard to the materiality to Chorus, the director

and the relevant person or organisation (eg customer, supplier or adviser) with which the director is related. Materiality is assessed in the context of each relationship and from the perspective of both parties to that relationship.

### Board Committees

Each standing Board Committee has a Board approved Charter and a chairman. The Board Committees assist the Board by focusing on specific responsibilities in greater detail than is possible for the Board as a whole.

#### Audit and Risk Management Committee

The ARMC assists the Board in ensuring oversight of all matters relating to risk management, financial management and controls and the financial accounting, audit and reporting of Chorus.

All Committee members are non-executive directors. For information on Committee members' qualifications, see page 3.

Members: Anne Urlwin (chairman), Jon Hartley and Sue Sheldon.

#### Human Resources and Compensation Committee

The Human Resources and Compensation Committee (HRCC) assists the Board in overseeing people policies and strategies, including:

- Chorus' remuneration frameworks; and
- reviewing candidates for, and the performance and remuneration of, the CEO.

Members: Clayton Wakefield (chairman), Prue Flacks and Keith Turner.

#### Nominations and Corporate Governance Committee

The Nominations and Corporate Governance Committee (NCGC) assists the Board in promoting and overseeing continuous improvement of good corporate governance. The NCGC's role includes identifying and recommending suitable candidates for nomination to be members of the Board and Board Committees, and establishing, developing and overseeing a process for the Board to annually review and evaluate the performance of the Board, its Committees and individual directors.

Members: Sue Sheldon (chairman), Prue Flacks and Jon Hartley.

## Director restrictions

The Chorus Constitution provides that no person who is an 'associated person' of a person that provides telecommunications services in New Zealand (other than the services provided by Chorus) shall be appointed or hold office as a director. NZX has granted Chorus a waiver to allow the Chorus Constitution to include this restriction on the persons who may hold office as director.

## Board and Board Committee meeting attendance

The table below sets out attendance at the Board and Board Committee meetings in the year ended 30 June 2013.

	BOARD MEETINGS	SPECIAL BOARD MEETINGS	ARMC	HRCC	NCGC
<b>Total number of meetings held</b>	<b>9</b>	<b>5</b>	<b>5</b>	<b>7</b>	<b>2</b>
Sue Sheldon (chairman)	9	5	5	7*	2
Anne Urlwin	9	5	5	5*	-
Clayton Wakefield	9	5	1*	7	-
Jon Hartley	9	3	5	5*	2
Keith Turner	9	3	2*	7	-
Mark Ratcliffe	9	5	3^	6^	1^
Prue Flacks	9	5	4*	7	2

\* Attended meetings as an observer and not as a Committee member.

^ Mark Ratcliffe is not a member of any Board Committees but attends all Board Committee meetings as CEO and as an observer, and may be asked to leave at any time.

## Trading in Chorus shares

All non-executive directors are encouraged to hold Chorus ordinary shares (Chorus Shares).

Directors are subject to limitations on their ability to deal in Chorus Shares and other relevant Chorus securities (Chorus Securities) by Chorus' Insider Trading Policy, the New Zealand Securities Market Act 1988 and the Australian Corporations Act 2001. These limitations prohibit directors from dealing in Chorus Securities while in possession of inside information.

As a matter of policy, Chorus also requires that directors, prior to dealing in Chorus Securities, notify and obtain consent from the chairman and that trading may only occur in accordance with Chorus' Insider Trading Policy.

All changes in any interests in Chorus Securities held by directors are required to be reported to the Board, the NZX and the ASX.

## Director induction and education

The Board seeks to ensure new directors are appropriately introduced to management and the Chorus business, that all directors are acquainted with relevant industry knowledge and economics and that they receive a copy of the Board and Board Committee Charters and the key governance documents.

It is expected that all directors continuously educate themselves to ensure they have appropriate expertise to effectively perform their duties.

In addition, visits to Chorus operations, briefings from key management, industry experts and key advisers to Chorus, together with educational and stakeholder visits, briefings or meetings are arranged for the Board.

## Independent advice

A director may, with the chairman's prior approval, take independent professional advice (including legal advice). A director may request the attendance of such an adviser at a Board or Board Committee meeting where this is necessary to fulfil their role and responsibilities for Chorus. The costs of any such adviser is paid for by Chorus.

## Review and evaluation of Board performance

The chairman meets regularly with directors to discuss individual performance.

The Board has carried out, in the reporting period, an annual review of the Board's performance, that of individual directors and Board Committees utilising the Board evaluation process developed and overseen by the NCGC.

## Market disclosures

Chorus is committed to providing timely, orderly, consistent and credible information consistent with legal and regulatory requirements, to enable orderly behaviour in the market and to promote investor confidence. Chorus believes it is imperative that disclosure be evenly balanced during good times and bad and that all parties in the investment community have fair access to this information.

# DIVERSITY AT CHORUS

## Diversity and inclusiveness at Chorus

Chorus has a Board approved Diversity and Inclusiveness Policy. Chorus believes that having a team of individuals working together who all have different experiences, views and self-reflections makes it stronger and better as an organisation. Chorus defines diversity as the characteristics that make one individual similar to or different from another. It defines inclusiveness as the recognition that diverse backgrounds, experiences and perspectives lead to a better experience of work for its people, makes teams stronger, leads to greater creativity and performance, contributes to a more meaningful relationship with its retail service provider customers and stakeholders, and ultimately leads to increased value to shareholders.

Valuing diversity is more than a moral imperative; it is also sensible business practice.

The focus of the policy is to leverage differences as a competitive advantage through its attraction and development practices, develop inclusiveness as a core capability for its people leaders and as a channel to its people, and to continue to recognise individual contribution and performance.

The HRCC recommends measurable objectives to the Board that are set and assessed annually.

Chorus is a funder of DiverseNZ Inc. DiverseNZ Inc is a collaboration project with support from the New Zealand public and private sectors to harness the economic benefit, business gain and GDP uplift that results from diverse leadership and diversity of thought.

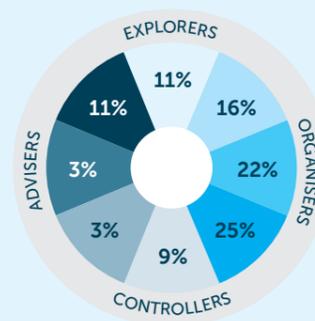
## Working preferences

Chorus uses a tool to assess the working preferences of its people. This promotes diversity of thought, working style and contribution across teams, and understanding of how to leverage differences.

The graphic here shows Chorus has the full spectrum of working preferences across the distribution. This fully validated self-assessment tool is a Team Management Index\* of the 507 contributors who had completed the workshops at the time of preparing this data.

Chorus has embedded diversity and inclusiveness into its culture through its values, communications, leadership and diversity dialogues.

\* The distribution only reflects the Major Role preference of the 507 contributors – as opposed to a representation of their preference across all factors at all levels. For more information go to [www.tms.co.nz](http://www.tms.co.nz)



## Diversity metrics as at 30 June 2013

The Board has set the following measurable objectives for achieving greater diversity at Chorus

MEASURE	DESCRIPTION	ACTUAL AS AT 30 JUNE 2013	ACTUAL AS AT 30 JUNE 2012	BENCHMARK
Age profiles	Median age	41.4 years	42.7 years	42 years. Statistics New Zealand National Labour Force Projections updated August 2012
Employee satisfaction	Response to the diversity question "The work environment is very open and accepting of individual differences"	84%	83%	83% Aon Hewitt Best Employer
Ethnicity by role	Organisational groupings by ethnicity	Not currently available	Not available	People leader population distribution = total company population distribution
Flexible working arrangements	Percentage of the population utilising flexible working arrangements	4.3% working part-time hours	4.5% working part-time hours	>4% working part-time hours
Gender by role	Organisational groupings by gender	38% ♀ 62% ♂ all 33% ♀ 67% ♂ people leaders 40% ♀ 60% ♂ executive team 43% ♀ 57% ♂ Board 50% ♀ 50% ♂ non-executive Board	39% ♀ 61% ♂ all 34% ♀ 66% ♂ people leaders 40% ♀ 60% ♂ executive team 43% ♀ 57% ♂ Board 50% ♀ 50% ♂ non-executive Board	People leader population distribution = total company population distribution
Rookie ratio	The previous year's intake by age, ethnicity and gender	Average age 37.2 years. Gender 41% ♀ 59% ♂ Ethnicity not available	Average age 37.8 years. Gender 42% ♀ 58% ♂ Ethnicity not available	No measure – for information
Internal hire rate	The previous year's appointments identifying internal vs external hire rate	39% of all appointments have been internal. 61% of roles in layers 1-3 were recruited internally.	59% of all appointments have been internal. 86% of roles in layers 1-3 were recruited internally.	66% of roles in layers 1-3

Based on the annual review of the effectiveness of Chorus' Diversity and Inclusiveness Policy and Chorus' measurable diversity objectives, the Board considers that overall Chorus is making good progress towards achieving its diversity and inclusiveness objectives and has performed well against the policy generally.

Chorus' Diversity and Inclusiveness Policy can be found at [www.chorus.co.nz/governance](http://www.chorus.co.nz/governance).

## REMUNERATION AT CHORUS

### Directors' fees

The total remuneration available to non-executive directors in the year ended 30 June 2013 was fixed at Chorus' 2012 AGM at \$980,000.

During the year ended 30 June 2013, the total remuneration earned by the directors of Chorus (in their capacity as such) was as follows:

DIRECTOR	TOTAL FEES \$
Sue Sheldon (chairman)	208,000
Anne Urlwin	135,000
Clayton Wakefield	125,000
Jon Hartley	127,500
Keith Turner	145,500
Mark Ratcliffe	-
Prue Flacks	122,500
<b>Total</b>	<b>863,500</b>

#### Notes:

- The figures shown are gross amounts and exclude GST where applicable.
- Directors are entitled to be paid or reimbursed for reasonable travelling, accommodation and other expenses incurred in relation to management of Chorus without requiring authorisation of shareholders. Any such expenses are not included in the table above.
- All non-executive directors receive a base fee.
- Board Committee fees are not paid to the chairman of the Board.
- A fee for being a member of a Board Committee or the UFB Steering Committee is paid in addition to the base fees.
- Directors (other than the CEO) do not receive any other benefits.
- Mark Ratcliffe, as CEO, does not receive any remuneration in his capacity as a director of Chorus. The remuneration of the CEO is summarised below.

The HRCC reviews the remuneration of directors based on criteria developed by that Committee.

Based on advice from independent consultants:

- for the year ended 30 June 2013 the Board used; and
- from 1 July 2013 the Board has set,

the Board fee structure below:

	ANNUAL FEE STRUCTURE YEAR TO 30 JUNE 2013 (\$)	ANNUAL FEE STRUCTURE FROM 1 JULY 2013 (\$)
<b>BASE FEES:</b>		
Chairman of the Board	208,000	214,000
Non-executive director	104,000	107,000
<b>BOARD COMMITTEE FEES:</b>		
<b>Audit and Risk Management Committee</b>		
Chairman	31,000	32,000
Member	15,500	16,000
<b>Human Resources and Compensation Committee</b>		
Chairman	21,000	21,500
Member	10,500	11,000
<b>Nominations and Corporate Governance Committee</b>		
Chairman	15,500	16,000
Member	8,000	8,500
<b>UFB Steering Committee</b>		
Chairman	Not applicable	Not applicable
Member	31,000	32,000

#### Notes:

- With the exception of the chairman of the Board, directors receive a fee for each Board Committee of which the director is the chairman or a member.
- Directors may be paid an additional daily rate of \$2,400 for additional work as determined and approved by the chairman of the Board and where the payment is within the total fee pool available for the relevant financial year based on advice of the General Counsel & Company Secretary. No such fees were paid in the year ended 30 June 2013.

No director receives compensation in share options. No director (except the CEO) participates in a bonus or profit-sharing plan.

No superannuation was paid to, or other scheme for retirement benefits exist for, any director (except for the CEO) in the year ended 30 June 2013.

### CEO remuneration

#### Remuneration package for the financial period

Mark Ratcliffe's remuneration as CEO consists of a mixture of fixed remuneration, short term incentives (STI) and long term incentives (LTI). The actual remuneration paid to Mark Ratcliffe in the financial period is as follows:

Fixed remuneration (1 July 2012 - 30 June 2013)	\$782,971.16 (gross)
Short term incentive for the period (1 July 2012 - 30 June 2013)	\$661,000.00 (gross)
Long term incentive and non-taxable accommodation payments	\$358,508.10
<b>Total remuneration received</b>	<b>\$1,802,479.26 (gross)</b>

In addition, in the year to 30 June 2013, payments totalling \$45,183.88 with regard to KiwiSaver and medical insurance were made on behalf of Mark Ratcliffe.

The following LTI payments were made, or liabilities are due to be calculated and paid, in the following manner. They are all cash payments:

GRANT YEAR	VESTING YEAR	DETAIL	POTENTIAL VALUE
2011	2012	Following a cash LTI payment of \$200,000 (gross) in December 2012, Mark Ratcliffe purchased shares in Chorus, which he agreed to retain for the term of his employment.	n/a (payment made/shares purchased)
2011	2014	A cash LTI grant was made by Telecom in September 2011. Chorus carried across a liability for the value of \$250,000 (gross). The cash value was converted into Equity Equivalent Units (EEUs) based on dividing the target value by the volume weighted average price (VWAP) of Chorus Shares for the first 20 days of trading, following demerger. A number of post-allocation performance hurdles have been introduced by the Board for this grant. Performance against these measures is considered annually but for the purposes of the grant it is the collated three year performance that determines the vesting multiplier on the grant.	A maximum of 82,281 EEUs converted back into a cash value at vesting based on share price performance at that time.
2012	2015	A cash LTI grant was made by Chorus in September 2012 for the value of \$349,779 (gross). The cash value was converted into EEUs based on dividing the target value by the VWAP of Chorus Shares for a defined 20 day trading period. A number of post-allocation performance hurdles have been introduced by the Board for this grant. Performance against these measures is considered annually but for the purposes of the grant it is the collated three year performance that determines the vesting multiplier on the grant.	A maximum of 104,853 EEUs converted back into a cash value at vesting based on share price performance at that time.

The CEO remuneration package is reviewed annually by the HRCC and Board, after seeking advice from external remuneration specialists and reviewing CEO and Chorus' performance. In future years, the target values may be revised as a result of future adjustments to the CEO remuneration package and components.

### Chorus remuneration model

The Board reviews the remuneration model for Chorus and has established principles of alignment to shareholder outcomes, simplicity, clarity and fairness, and remuneration outcomes which are based on performance.

All Chorus employees have a fixed remuneration and STI component in their remuneration packages. A limited number of employees also have an LTI component.

#### Fixed remuneration

The fixed remuneration model is informed and adjusted each year based on data from multiple independent remuneration specialists. Employees' fixed remuneration is based on a matrix of their own performances and their current remuneration position in the market range.

#### STI plan

STI values are calculated as a percentage of fixed remuneration and determined based on the complexity of the roles. Employees' STI payments are determined following review of company performance and individual performance and may be paid out at a multiplier of 0x to 2.8x. This model is focussed on articulating performance goals, driving for outcomes, differentiating high performance and rewarding delivery.

#### LTI plan

Chorus operates an LTI plan for its executives and an identified number of senior leaders. The Board has reviewed this model, on the basis of independent advice, and will be introducing a new model in 2013. This will involve the incorporation of a new subsidiary to act as trustee of the scheme.

### Managing performance

Chorus' performance management process is based on all Chorus people having performance and development plans for the year, which are regularly reviewed with their people leaders. The performance plan is developed initially by the individual after participating in 'Line of Sight' sessions, which enable them to link Chorus' strategy with their day to day work and focus areas. The performance plan includes both outcome based objectives and behavioural measures, along with a development plan. End of year performance reviews are undertaken for all Chorus people. In these the people leader for the individual seeks additional feedback and participates in a peer review and moderation process, resulting in an overall rating and remuneration recommendation that impacts the individual's total reward (fixed remuneration and target STI).

This same process has been undertaken for the Chorus executive team, with the CEO making recommendations to the HRCC for the executive team and the chairman of the HRCC leading the performance review of the CEO and making recommendations to the Board. This process is consistent with that set out in the HRCC Charter and allows the Board to provide input into these individuals' performance outcomes, total reward approvals (fixed remuneration, target STI and LTI) and development plans.

## Employee remuneration range

The table alongside shows the number of employees and former employees who, in their capacity as employees, received remuneration and other benefits in excess of \$100,000 during the year to 30 June 2013.

Employees can choose to receive telephone concessions, including contributions towards telephone line rental, national and international phone calls and online services. In addition, certain employees receive contributions towards membership of the Marram Trust (a community healthcare and holiday accommodation provider), contributions to the Government Superannuation Fund (a legacy benefit provided to a small number of employees) and, if the individual is a KiwiSaver member, a contribution of up to 3% of gross earnings towards that individual's KiwiSaver scheme. These amounts are not included in these remuneration figures.

Any benefits received by employees that do not have an attributable value are not included.

REMUNERATION RANGE \$ (GROSS)	NUMBER OF EMPLOYEES IN THE YEAR ENDED 30 JUNE 2013 (BASED ON ACTUAL PAYMENTS)	REMUNERATION RANGE \$ (GROSS)	NUMBER OF EMPLOYEES IN THE YEAR ENDED 30 JUNE 2013 (BASED ON ACTUAL PAYMENTS)
1,780,001-1,790,000	1	230,001-240,000	2
820,001-830,000	1	220,001-230,000	10
480,001-490,000	1	210,001-220,000	4
440,001-450,000	1	200,001-210,000	8
420,001-430,000	1	190,001-200,000	9
410,001-420,000	1	180,001-190,000	6
400,001-410,000	1	170,001-180,000	3
390,001-400,000	1	160,001-170,000	12
330,001-340,000	1	150,001-160,000	14
320,001-330,000	1	140,001-150,000	26
310,001-320,000	1	130,001-140,000	23
290,001-300,000	3	120,001-130,000	32
270,001-280,000	2	110,001-120,000	31
250,001-260,000	5	100,000-110,000	44
240,001-250,000	3		

## DISCLOSURES

### Directors

#### Directors during the year ended 30 June 2013

Current directors are listed on page 3. No directors resigned during the year ended 30 June 2013.

#### Indemnities and insurance

As permitted by its Constitution, Chorus has entered into deeds of indemnity with each of the directors for potential liabilities or costs they may incur for acts or omissions in their capacity as directors.

Deeds of indemnity have also been given to certain senior staff for potential liabilities and costs they may incur for acts or omissions in their capacity as employees of Chorus.

directors of Chorus subsidiaries or as directors of non-Chorus companies in which Chorus holds interests.

Chorus has a directors' and officers' liability insurance policy in place. This provides insurance for the liabilities of the directors and employees of Chorus for acts or omissions in their capacity as directors or employees. It does not cover dishonest, fraudulent, malicious or wilful acts or omissions.

#### Director interests in Chorus Shares

As at 30 June 2013, directors had a relevant interest (as defined in the Securities Markets Act 1988) in Chorus Shares as follows:

AS 30 JUNE 2013			TRANSACTIONS DURING THE REPORTING PERIOD		
DIRECTOR	SHARES	INTEREST	NUMBER OF SHARES PURCHASED (SOLD)	CONSIDERATION	DATE OF TRANSACTION
Sue Sheldon	15,000	Registered holder as trustee of family trust	15,000	\$51,767.45	20 September 2012
Clayton Wakefield	19,647	Beneficial interest	10,000	\$34,900.00	10 September 2012
			7,000	\$20,711.95	14 March 2013
			643*	\$1,768.25	12 April 2013
Keith Turner	5,686	Legal and beneficial interest	186*	\$511.50	12 April 2013
Anne Urlwin	10,000	Director and shareholder of registered holder	10,000	\$34,000.00	19 September 2012
Mark Ratcliffe	100,778	Beneficial interest	84,000	\$248,747.40	12, 13 and 15 March 2013
Prue Flacks	10,118	Legal and beneficial interest Trustee of family trusts Legal and beneficial interest Legal and beneficial interest	2,900	\$10,004.84	6 September 2012
			5,240	\$18,168.30	6 September 2012
			98*	\$269.50	12 April 2013
			1,880	\$4,888.00	31 May 2013
<b>Total</b>	<b>161,229</b>				

\* Purchased under Chorus' Dividend Reinvestment Plan

As at 30 June 2013, directors had a relevant interest representing approximately 0.041% of the Chorus Shares outstanding.

#### Interests Register

Directors disclosed, pursuant to section 140 of the Companies Act 1993, a change in, or cessation of, interest in the following entities during the year ended 30 June 2013:

**Sue Sheldon:** Changes in interests: Paymark Ltd (chairman), Reserve Bank of New Zealand (deputy chairman), Global Women Trust (trustee). Cessation of interests: Nil.

**Anne Urlwin:** Changes in interests: Ngai Tahu Te Runanga Audit & Risk Committee (independent chairman), OnePath Insurance Services (NZ) Ltd (director), OnePath Life (NZ) Ltd (director), Steel & Tube Holdings Ltd (director), Naylor Love Properties Ltd (director)\*. Cessation of interests: Lakes Environmental Ltd (chairman), SR 2 Ltd (director), SR 3 Ltd (director), SR 4 Ltd (director), SR 5 Ltd (director), SR 6 Ltd (director), SR 7 Ltd (director), SR 8 Ltd (director), SR 9 Ltd (director), SR 10 Ltd (director), SR 11 Ltd (director).

**Clayton Wakefield:** Changes in interests: Nil. Cessation of Interests: Endace Ltd (director).

**Jon Hartley:** Changes in interests: Mission Foods Ltd (director). Cessation of interests: Mighty River Power Ltd (director).

**Keith Turner:** Changes in interests: Nil. Cessation of interests: Waitaki Wind Ltd (director)\*.

**Mark Ratcliffe:** Changes in interests: Telecom Corporation of New Zealand Ltd (shareholder). Cessation of interests: Nil.

**Prue Flacks:** Changes in interests: Mighty River Power LTI Ltd (director). Cessation of interests: BNZ Life Insurance Ltd (chairman)\*, BNZ Insurance Services Ltd (chairman)\*.

\* Disclosed after 30 June 2013

^ Prue Flacks ceased to be a director of these companies after 30 June 2013.

### Shares and shareholders

#### Stock exchange listings and American Depositary Receipts

Chorus Shares are quoted on the NZX Main Board and on the ASX. Chorus trades under the ticker 'CNU'.

American Depositary Shares (ADSs), each representing five ordinary shares and evidenced by American Depositary Receipts (ADRs), are not listed but are traded on the over-the-counter (OTC) market in the United States under the ticker symbol 'CHRY'. Chorus' depositary is the Bank of New York Mellon.

#### NZX waivers

A summary of all waivers granted and published by NZX within or relied upon by Chorus in the 12 month period ending on the date two months before the date of this annual report, is available on Chorus' website at [www.chorus.co.nz](http://www.chorus.co.nz). This summary will be published for 12 months following publication of this annual report.

#### ASX disclosures

Chorus has been admitted to the official list of the ASX. As a result, Chorus is required to make the following disclosures:

- Chorus' place of incorporation is New Zealand.
- Chorus is not subject to Chapters 6, 6A, 6B and 6C of the Australian Corporations Act 2001 dealing with the acquisition of shares (including substantial shareholdings and takeovers).
- Chorus' Constitution contains limitations on the acquisition of securities, as disclosed below.
- Chorus used the cash and assets in a form readily convertible to cash that it had at the time of admission in a way consistent with its business objectives as set out in the scheme booklet.

#### Registration as a foreign company

Chorus has registered with the Australian Securities and Investments Commission (ASIC) as a foreign company. Chorus has been issued an Australian Registered Body Number (ARBN) of 152 485 848.



### Quoted securities

As at 30 June 2013 there were 389,299,049 Chorus Shares on issue.

Each Chorus Share confers on its holder the right to attend and vote at a meeting of Chorus, including the right to cast one vote on a poll on any resolution.

### Non-standard designation

NZX has attached a 'non-standard' designation to the listing of the Chorus Shares owing to the ownership restrictions in Chorus' Constitution, as described below.

### Chorus' constitutional ownership restrictions

Chorus' Constitution includes ownership restrictions that prohibit any person:

- from having a relevant interest in 10% or more of Chorus Shares, unless the prior written consent of the New Zealand Government is obtained; or
- other than a New Zealand national, from having a relevant interest in more than 49.9% of Chorus Shares, unless the prior written consent of the New Zealand Government is obtained.

If the Board or the New Zealand Government determines there are reasonable grounds for believing that a person has a relevant interest in voting shares in excess of the ownership restrictions, the Board may, after following certain procedures, prohibit the exercise of voting rights (in which case the voting rights shall vest in the chairman) and may force the sale of shares. The Board may also decline to register a transfer of shares if it reasonably believes the transfer would breach the ownership restrictions.

NZX has granted Chorus waivers allowing Chorus' Constitution to include the power of forfeiture, the restrictions on transferability of Chorus Shares and the Board's power to prohibit the exercise of voting rights relating to these ownership restrictions.

Chorus has been advised by the Crown that AMP Capital Holdings Ltd and its related companies have been granted approval, should they choose to exercise it in future, to acquire a relevant interest in 10% or more (but not exceeding 15%) of Chorus Shares.

### Unquoted securities

SECURITY	NUMBER OF SECURITIES ISSUED IN YEAR ENDED 30 JUNE 2013	TOTAL NUMBER OF SECURITIES ON ISSUE AS AT 19 AUGUST 2013	HOLDER	PERCENTAGE HELD
CFH Equity Securities	52,708,669	71,729,203	Crown Fibre Holdings Ltd	100%
CFH Debt Securities	52,708,669	71,729,203	Crown Fibre Holdings Ltd	100%
CFH Warrants	2,838,382*	3,532,423*	Crown Fibre Holdings Ltd	100%

\* The CFH warrants have been issued in two series, with different repayment schedules. On 30 June 2020 one series will be cancelled depending on whether the 20% fibre up-take threshold is met.

The CFH equity securities are a unique class of security that carry no right to vote at meetings of holders of Chorus Shares but entitle the holder to a right to a repayment preference on liquidation.

The CFH debt securities are unsecured, non-interest bearing and carry no voting rights at meetings of holders of Chorus Shares.

The CFH warrants are an option to acquire Chorus Shares on a specified exercise date at a set strike price.

The terms of the issue for each of the CFH equity securities, CFH debt securities and the CFH warrants are summarised on pages 139-142 of the scheme booklet (available here <http://www.chorus.co.nz/file/4926/scheme-booklet.pdf>).

### Distribution of shareholders and shareholdings of Chorus Shares as at 19 August 2013

SIZE OF SHAREHOLDING	NUMBER OF HOLDERS	NUMBER OF SHARES HELD	% OF CHORUS SHARES ISSUED
1 to 1,000	26,121	8,038,131	2.06
1,001 to 5,000	8,619	21,577,906	5.54
5,001 to 10,000	2,442	18,329,383	4.71
10,001 to 100,000	1,995	47,084,011	12.09
100,001 and over	112	294,269,618	75.60
<b>Total</b>	<b>39,289</b>	<b>389,299,049</b>	<b>100</b>

### Substantial security holders as at 19 August 2013

As at 19 August 2013 Chorus had received notices under Section 26 of the Securities Markets Act 1988 that the following shareholders were substantial security holders in respect of Chorus Shares:

SUBSTANTIAL SECURITY HOLDER	NUMBER OF VOTING SECURITIES	DATE OF NOTICE
Accident Compensation Corporation	24,046,750	23 July 2013
Schroder Investment Management Australia Limited	38,288,978	4 February 2013
The Bank of New York Mellon Corporation	28,681,648	31 December 2012

### Twenty largest holders of Chorus Shares as at 19 August 2013

RANK	HOLDER NAME	HOLDING	%
1.	National Nominees New Zealand Limited*	60,288,503	15.48
2.	JP Morgan Chase Bank NA*	32,029,843	8.22
3.	Accident Compensation Corporation*	23,341,750	5.99
4.	JP Morgan Nominees Australia Limited	18,258,067	4.68
5.	HSBC Nominees (New Zealand) Limited A/C State Street*	16,799,898	4.31
6.	HSBC Nominees (New Zealand) Limited*	16,396,338	4.21
7.	National Nominees Limited	11,758,593	3.02
8.	FNZ Custodians Limited	11,361,287	2.91
9.	Citibank Nominees (New Zealand) Limited*	9,664,089	2.48
10.	Forsyth Barr Custodians Limited	7,891,023	2.02
11.	BNP Paribas Nominees (NZ) Limited*	7,557,664	1.94
12.	Westpac NZ Shares 2002 Wholesale Trust*	4,942,584	1.26
13.	Citicorp Nominees PTY Limited	4,547,173	1.16
14.	Forsyth Barr Custodians Limited	4,497,699	1.15
15.	New Zealand Superannuation Fund Nominees Limited*	4,367,784	1.12
16.	HSBC Custody Nominees (Australia) Limited	4,229,021	1.08
17.	Premier Nominees Ltd – Onepath Wholesale Australasian Shr Fund*	3,828,928	0.98
18.	Investment Custodial Services Limited	2,594,204	0.66
19.	BT NZ Unit Trust Nominees Limited*	2,492,160	0.64
20.	RBC Investor Services Australia Nominees PTY Limited	2,486,293	0.63

\* Held through New Zealand Central Securities Depository Limited (NZCSD). NZCSD provides a custodial depository service which allows electronic trading of securities by its members. As at 19 August 2013, 186,797,319 Chorus Shares (or 47.98% of the ordinary shares on issue) were held through NZCSD.

### Shareholders holding less than a marketable parcel

As at 19 August 2013, there were 6,071 shareholders holding between 1 and 99 Chorus Shares (less than a minimum holding under the NZX Listing Rules) and, based on the market price of A\$2.55, there were 11,808 holders that held less than a marketable parcel of A\$500 of Chorus Shares under the ASX Listing Rules.

On-market buy-back: There is no current on-market buy-back.

### Net tangible assets per security

As at 30 June 2013, the consolidated net tangible assets per share was NZ\$1.21 (30 June 2012: 0.90). Net tangible assets per share is a non-GAAP financial measure and is not prepared in accordance with NZ IFRS.

### Company Secretary

Vanessa Oakley

### Donations

Chorus New Zealand Ltd made a donation of \$50,000 to the Starship Foundation in the financial period.

### Subsidiaries

#### Chorus New Zealand Ltd

**Directors:** Mark Ratcliffe (Chairman), Andrew Carroll, Brian Hall, Vanessa Oakley and Lucy Riddiford (as alternate director for Vanessa Oakley).

No directors of Chorus New Zealand Ltd resigned during the reporting period.

#### Director Remuneration:

The directors of Chorus New Zealand Ltd are all employees and do not receive any remuneration in their capacity as directors.

#### Directors' interests:

**Mark Ratcliffe:** Changes in interests: Telecom Corporation of New Zealand Ltd (shareholder). Cessation of interests: Nil.

**Andrew Carroll:** Changes in interests: Nil. Cessation of interests: Nil.

**Brian Hall:** Changes in interests: Chorus Ltd (shareholder). Cessation of interests: Nil.

**Lucy Riddiford:** Changes in interests: Chorus Ltd (shareholder). Cessation of interests: Telecom Corporation of New Zealand Ltd (shareholder).

**Vanessa Oakley:** Changes in interests: Nil. Cessation of interests: Nil.

#### Indemnities and Insurance:

See Indemnities and Insurance on page 45 for further information.

#### Other subsidiaries

The Board will be introducing a new long term incentive scheme for the CEO and Executive in 2013. A new subsidiary will be incorporated to act as a trustee of the scheme.

# Glossary

<b>Basic UBA</b>	Basic Unbundled Bitstream Access
<b>CFH</b>	Crown Fibre Holdings Limited
<b>Chorus</b>	Chorus Limited and, where the context requires, its subsidiary
<b>Commission</b>	Commerce Commission
<b>CPI</b>	Consumer Price Index
<b>CPPP</b>	Cost per premises passed
<b>DSL</b>	Digital Subscriber Line, a family of communications technologies allowing high-speed data over existing copper
<b>EBITDA</b>	Earnings before interest, income tax, depreciation and amortisation
<b>EMTN</b>	Euro Medium Term Note
<b>Enhanced UBA</b>	Enhanced Unbundled Bitstream Access
<b>FY</b>	Financial period – twelve months ended 30 June
<b>HSNS Lite (Fibre)</b>	High Speed Network Service Lite over fibre
<b>HSNS Lite (Copper)</b>	High Speed Network Service Lite over copper
<b>HSNS Premium</b>	High Speed Network Service Premium (Bitstream 4)
<b>IP</b>	Internet Protocol
<b>MBIE</b>	Ministry of Business, Innovation and Employment
<b>Naked UBA</b>	Broadband only UBA connections
<b>POTS</b>	Plain Old Telephone Service
<b>RBI</b>	Rural Broadband Initiative
<b>Scheme booklet</b>	The Telecom demerger scheme booklet, published on 13 September 2011
<b>SLES</b>	Sub Loop Extension Service
<b>SLU</b>	Sub Loop Unbundling
<b>TDL</b>	Telecommunications Development Levy
<b>Telecom</b>	Telecom Corporation of New Zealand Limited and subsidiaries
<b>TRL</b>	Telecommunications Regulatory Levy
<b>TSO</b>	Telecommunications Service Obligation
<b>UBA</b>	Unbundled Bitstream Access
<b>UCLFS</b>	Unbundled Copper Low Frequency Service
<b>UCLL</b>	Unbundled Copper Local Loop
<b>UFB</b>	Ultra-Fast Broadband
<b>VDSL</b>	Very High Speed Digital Subscriber Line – a DSL technology
<b>VoIP</b>	Voice over Internet Protocol

## DIRECTORY

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