



# Chorus Half Year Result, FY13

25 February 2013, Wellington

For six months ending  
31 December 2012



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An aerial photograph of a coastal city at sunset. The city is built on a hillside overlooking a large body of water. The sky is a mix of orange and blue, and the water reflects the light. In the foreground, there are residential buildings and a large parking lot. In the middle ground, there is a large marina with many boats. In the background, there are more buildings and hills.

# Mark Ratcliffe

Chorus CEO



# Agenda

Mark Ratcliffe, CEO

- > Half year performance overview
- > Connection growth
- > RBI and UFB programmes
- > IT systems transition

Andrew Carroll, CFO

- > Financial results
- > Capex and UFB cost per premises passed, including guidance
- > Dividend guidance and Dividend Reinvestment Plan

Mark Ratcliffe, CEO

- > UFB initiatives and regulatory framework
- > Q&A

## A sound underlying earnings result

- > Net Profit After Tax of **\$84 million**
- > EBITDA of **\$331 million**
- > Revenue of **\$525 million**  
(an increase of 2% on prior six month period)
- > Growth in total fixed line connections to **1,793,000**
- > Fibre connections grew 50% to **15,000**
- > Broadband growth continues; **36,000** new connections

# Facing challenging headwinds

- > Regulatory uncertainty
  - Draft UBA decision undermines the fibre vision
  - Welcome the Government's decision to bring forward the wider reviews to align policy to support fibre transition
  
- > UFB production line still work in progress
  - Continued roll out progress, but not yet standardised
  - Positive gains in most areas being offset by extreme **civil costs** in a small group of areas
  - Significant variability in regional compliance requirements
  - Initiatives will take more time for cost benefits to materialise

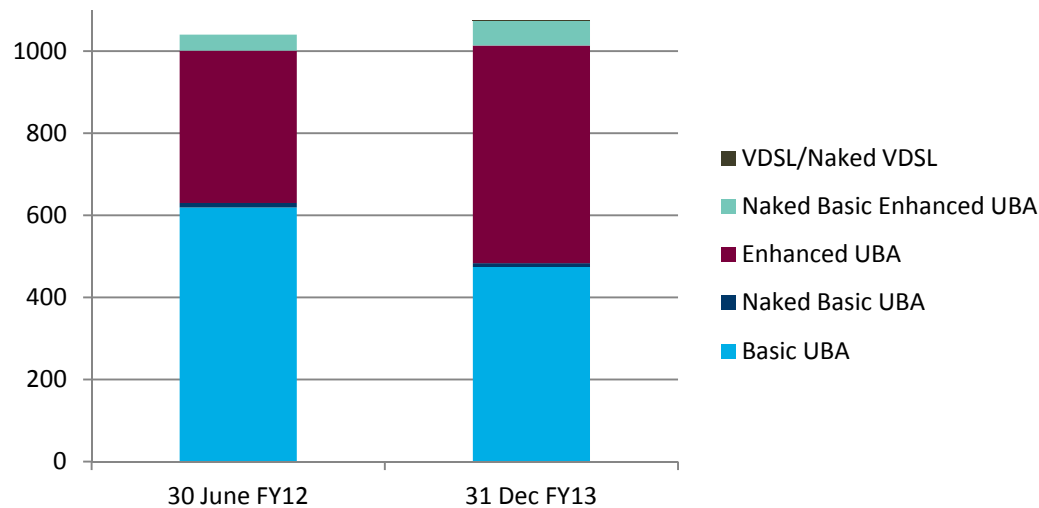
# Fixed line connection growth

Fixed line connections	30 June 2012	31 Dec 2012
Baseband copper	1,585,000	1,559,000
UCLL	97,000	109,000
SLU/SLES	19,000	16,000
Fibre	10,000	15,000
Naked Basic/Enhanced UBA and Naked VDSL	50,000	72,000
Data services over copper	15,000	22,000*
<b>Total fixed line connections</b>	<b>1,776,000</b>	<b>1,793,000</b>

- > Real growth of **10,000** connections
- > \* Allow for **7,000** lines previously omitted from data services over copper
- > Fibre connections increased by **50%**
- > **44%** growth in 'Naked' connections

# Continuing broadband growth

Broadband connections	30 June 2012	31 Dec 2012
Basic UBA	619,000	474,000
Naked Basic UBA	11,000	9,500
Enhanced UBA	371,000	530,000
Naked Enhanced UBA	39,000	60,500
VDSL/Naked VDSL	NM	2,000
<b>Total broadband connections</b>	<b>1,040,000</b>	<b>1,076,000</b>

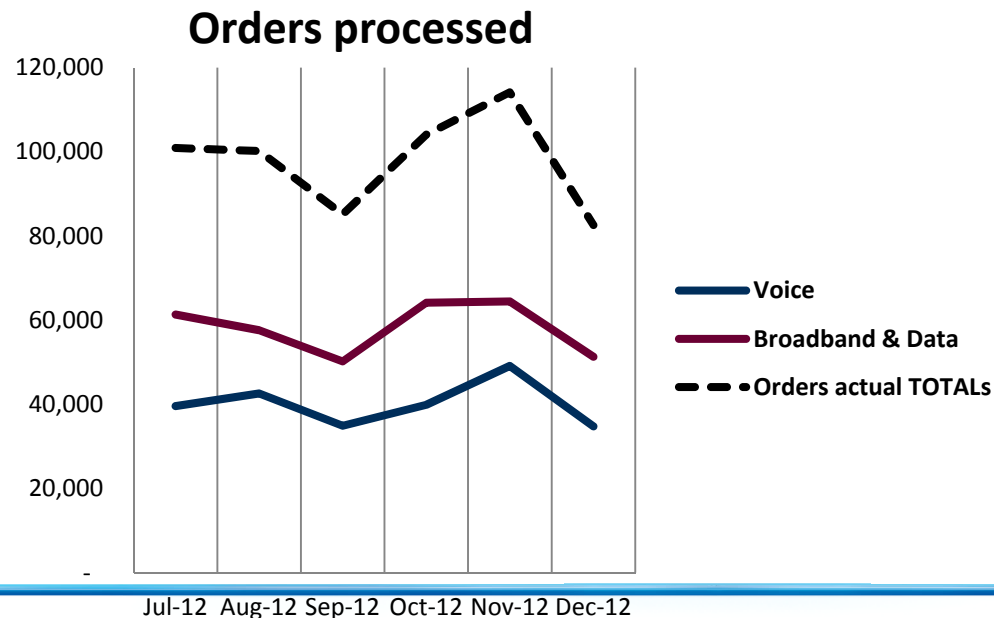


> Copper lines with Chorus provided broadband increased from 59% to 61%



# Growth and market activity

- > Fixed line and broadband growth drives small proportion of activity relative to ongoing activity 'behind the scenes'
- > **587,000 orders** processed by Chorus for voice, broadband, UCLL and data related activity over the six months
- > **254,000 truck rolls** in the same period





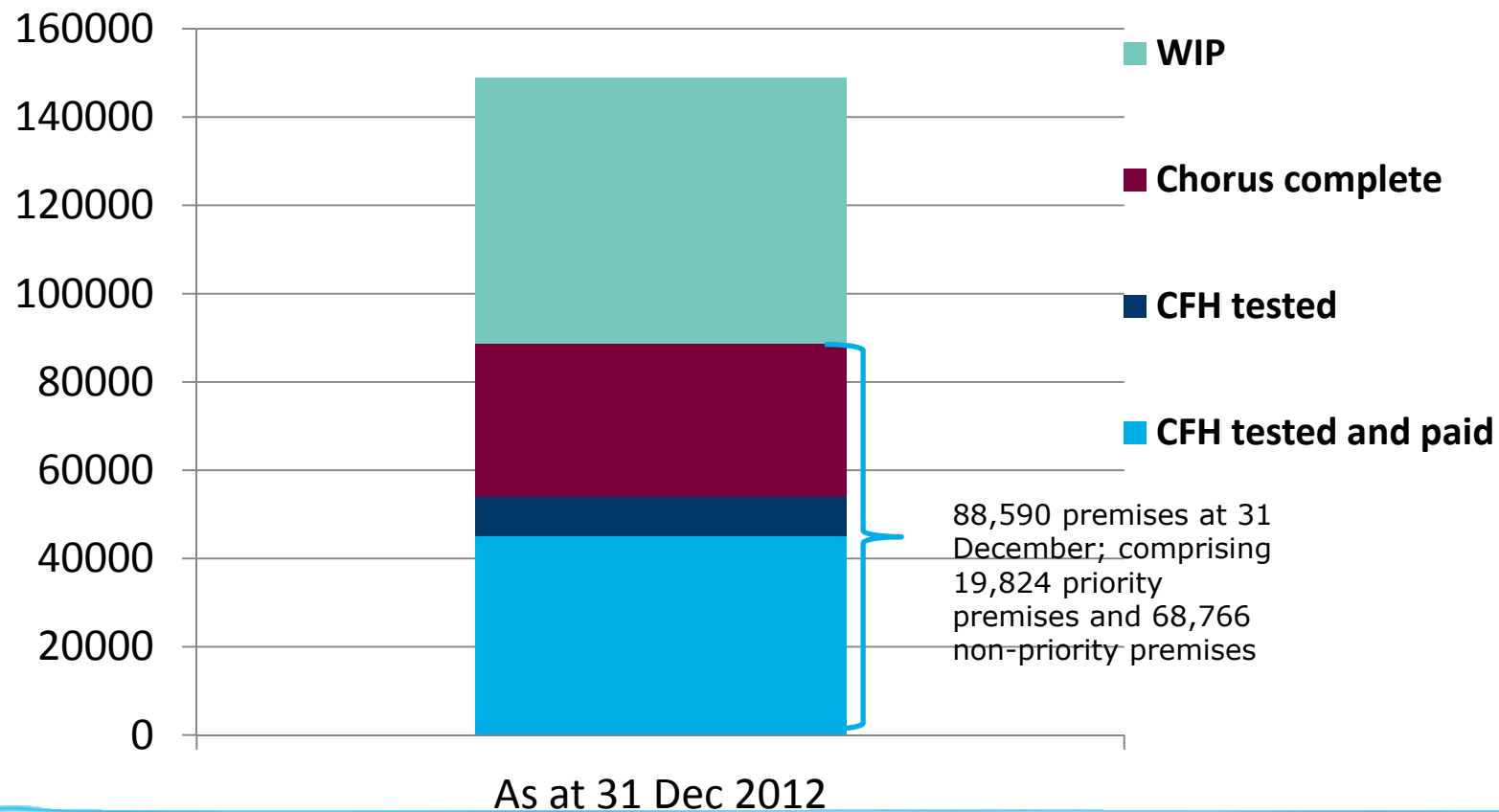
## Deliver UFB and RBI agreements

- RBI**
- > 1,300km fibre laid
  - > 36,100 lines within reach of better broadband
  - > 634 schools

- UFB**
- > 2,000km of fibre laid
  - > 88,590 premises passed
  - > 335 schools
  - > FY13 Target: cumulative 149,000 premises passed

# UFB rollout continuing at pace

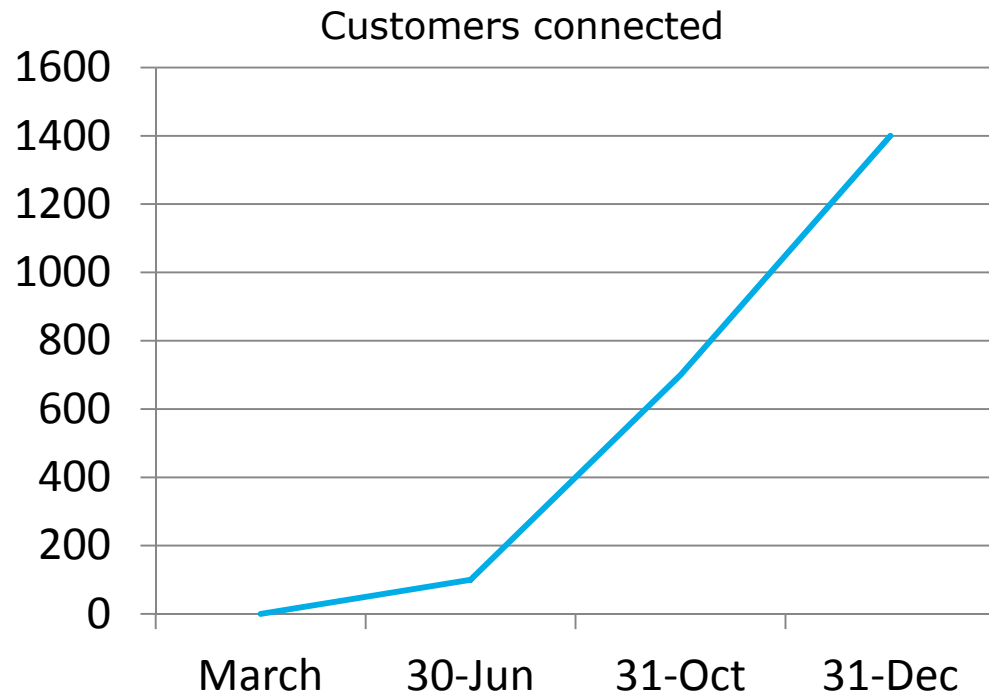
> Build **on track** for Year 2 cumulative target of **149,000** premises





## Transition to a fibre world

- > ~95,000 customers within reach of Chorus' UFB network at 31 Dec
- > UFB uptake gains momentum with 1,400 connected



### RSPs trialling

24

RSPs in business market

~8

RSPs in residential market

~5

### Types of connections

1,400

30Mbps down, 10Mbps up

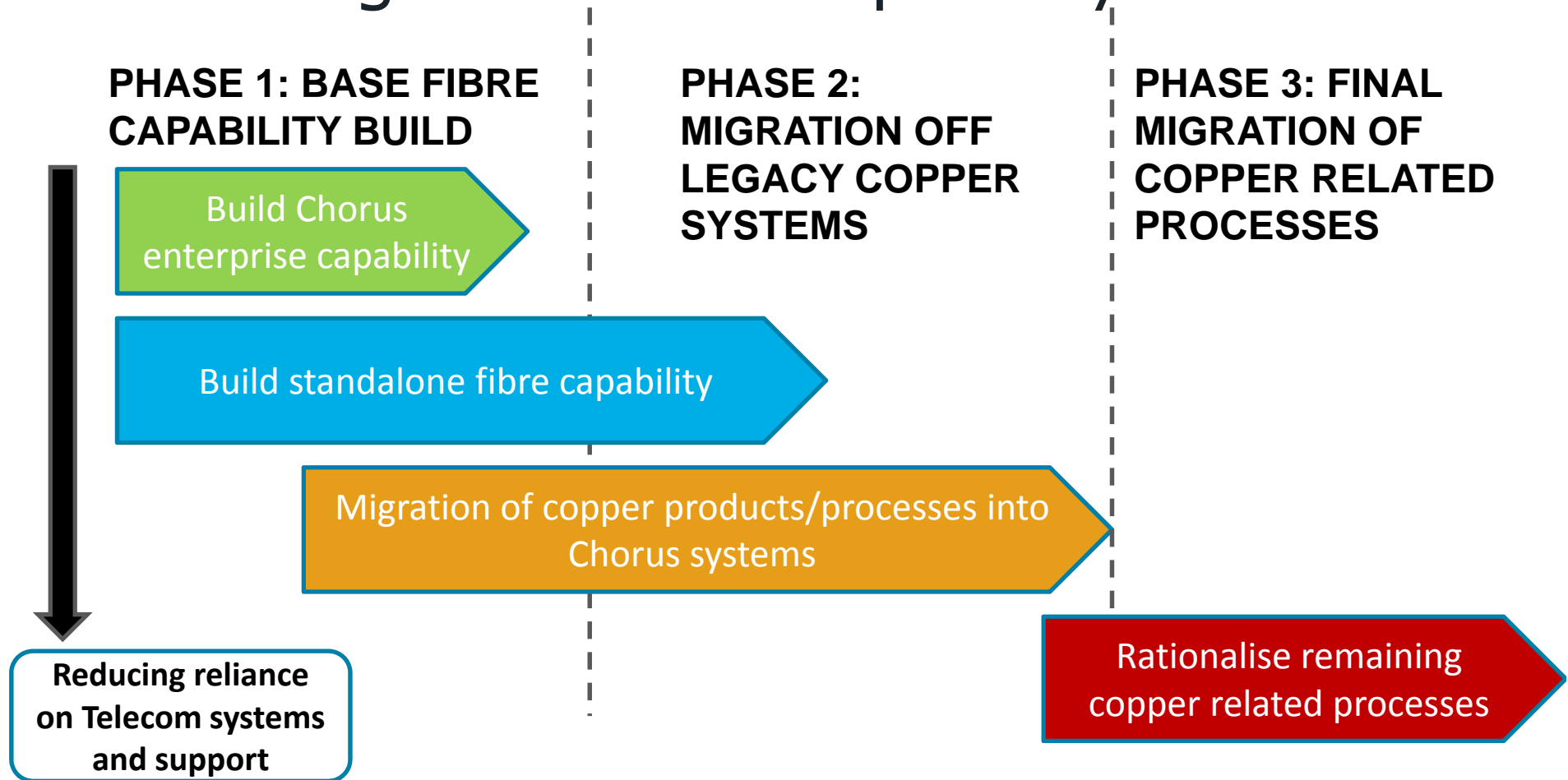
850

100Mbps down, 50Mbps up

550



# Building Chorus IT capability



**NOTE: pace of transition subject to customer choices and regulatory settings**

# Andrew Carroll

Chorus CFO

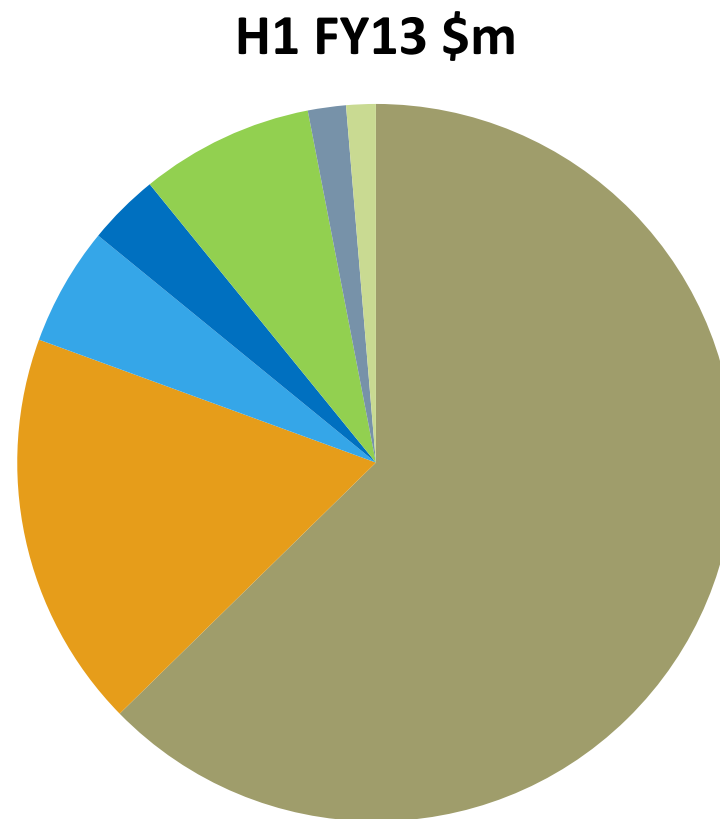


# Income statement

	H1 FY13 (6 months) \$m	Prior 6 months (normalised) \$m
Operating revenue	525	514
Operating expenses	(194)	(185)
<b>Earnings before interest, tax, depreciation and amortisation (EBITDA)</b>	<b>331</b>	<b>329</b>
Depreciation and amortisation	(160)	(161)
Earnings before interest and income tax	171	168
Net interest expense	(54)	(59)
Net earnings before income tax	117	109
Income tax expense	(33)	(31)
Net earnings for the period	\$84m	\$78m

# H1 FY13 Revenue

Revenue category	H1 FY13 (6 months) \$m	Prior 6 months (normalised) \$m
Basic copper	329	340
Enhanced copper	94	76
Fibre	28	24
Value Added Network Services	17	15
Field Services	41	40
Infrastructure	9	13
Other	7	6
<b>Total revenue</b>	<b>525</b>	<b>514</b>





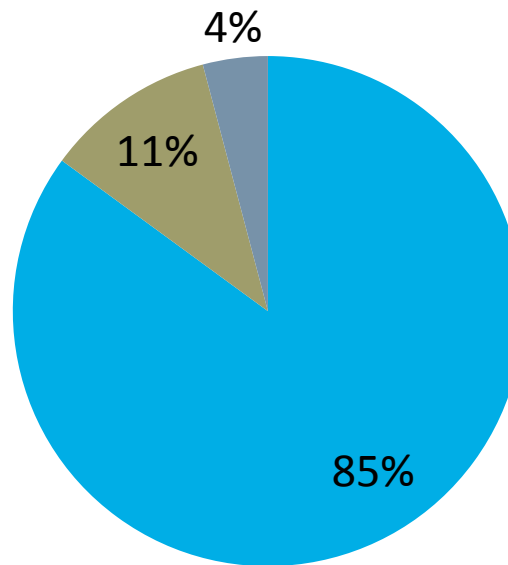
# H1 FY13 Operating expenses

	H1 FY13 (6 months) \$m	Prior 6 months (normalised)
Labour costs	33	27
Provisioning	26	20
Network maintenance	50	44
Other direct costs	17	19
Electricity	6	10
Rents, rates and property maintenance	11	12
IT costs	24	26
Consultants	3	4
Other	24	23
<b>Total operating expenses</b>	<b>194</b>	<b>185</b>

# H1 FY13 gross capex by category

Total capex of \$341m for six month period

Fibre capex	\$290m
UFB communal	187
UFB connections & fibre layer 2	11
Fibre products & systems	10
Other fibre connections & growth	23
RBI	59

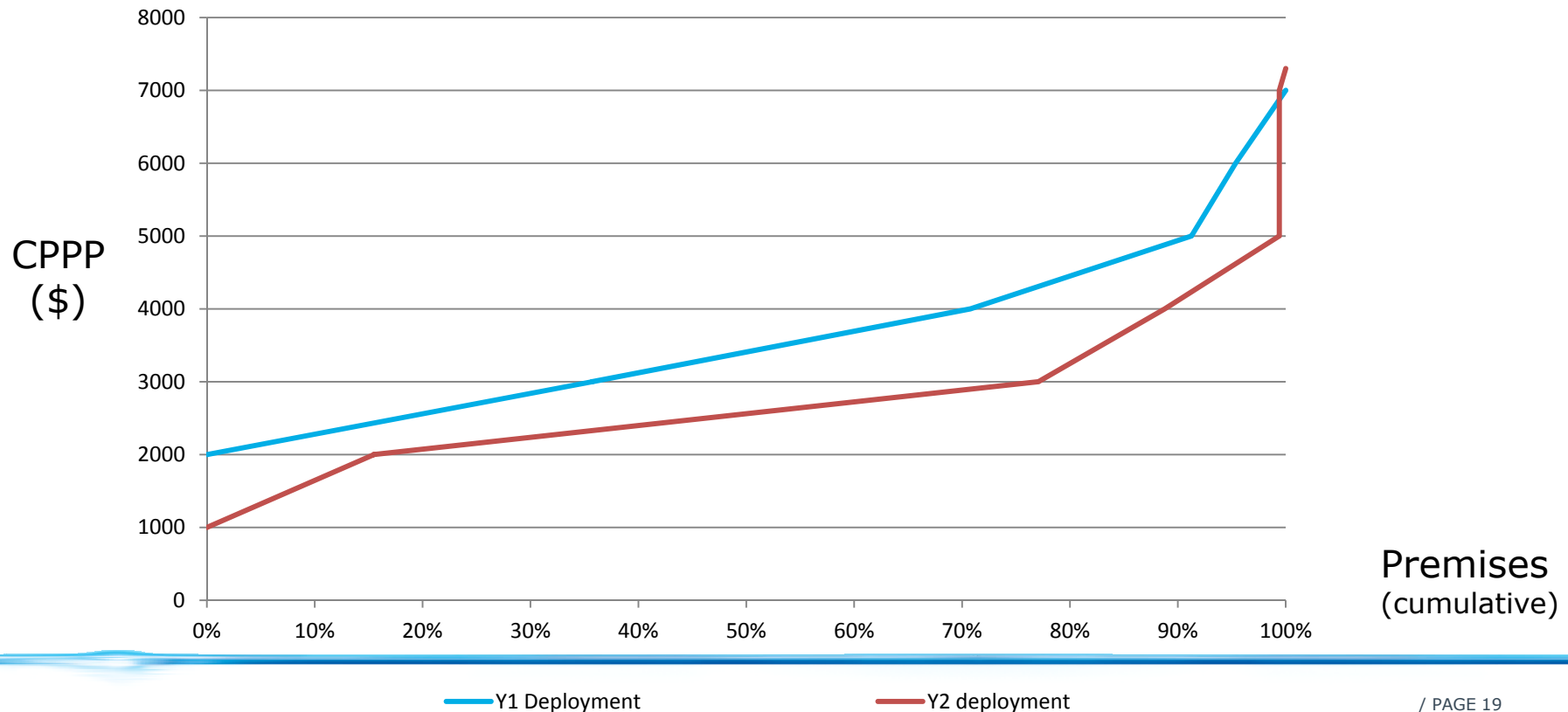


Copper capex	37
Network sustain	17
Copper connections	11
Copper layer 2	4
Product	5
<b>Common capex</b>	<b>14</b>
Information technology	7
Building & engineering services	6
Other	1

**Note:** capex amounts should not necessarily be doubled to develop an annual FY13 capex estimate because of seasonal, market and scheduling factors, particularly for UFB

# CPPP: Good progress offset by a few

- > Large variance in build costs area by area from \$1,000 to \$8,000
- > Small number of areas (~10%) driving excessive costs (e.g. Ponsonby, Queenstown, Wellington CBD)
- > This is outweighing CPPP reduction from \$3,000 (Year 1) to \$2,700 (Year 2) in other areas



# Cost per premises connected (CPPC)

- > Prior guidance of \$900 to \$1,100 (real)
- > 1,400 connections to date too few to evaluate trends or change guidance
- > UFB connections capex for FY13 includes:
  - marketing initiatives (e.g. trial offers)
  - training and programme establishment costs
  - non-standard installs



# Changes to FY13 fibre capex

- > Service company billing for UFB work started in FY12 but completed in FY13 added **\$12m**. This increases Year 1 CPPP to \$3,500 from \$3,300.
- > Higher than expected cost per premises passed (CPPP) of \$2,900 at half year, **expect \$2,900 to \$3,200** for all Year 2 build, adding **~\$40-\$50m**
- > Expected school UFB capex of around **\$12m-\$15m** represents a bring forward of 'out of zone' schools previously planned for UFB in later years
- > Expected new school connection capex of around **\$10m** that is fully funded
- > RBI capex of around **\$12m-\$15m** expected to be brought forward and grant funded

	Total capex at 31 Dec (\$m)	CPPP
Cost to complete work commenced in Year 1	34	\$3,500 (all Y1)
Year 2 out of zone schools (incl WIP)	5	N/A
Year 2 work completed	72	\$2,900
Year 2 work in progress	76	N/A
<b>UFB communal spend for H1 FY13</b>	<b>187</b>	N/A

# FY13 revised capex guidance

	Previous FY13 guidance \$m	Updated FY13 guidance (at 25 February 2013) \$m
Fibre capex	450 – 480	540 – 590
Copper capex	75 – 85	70 – 75
Common capex	35 – 45	30 – 35
<b>Gross capex</b>	<b>560 – 610</b>	<b>640 – 690</b>

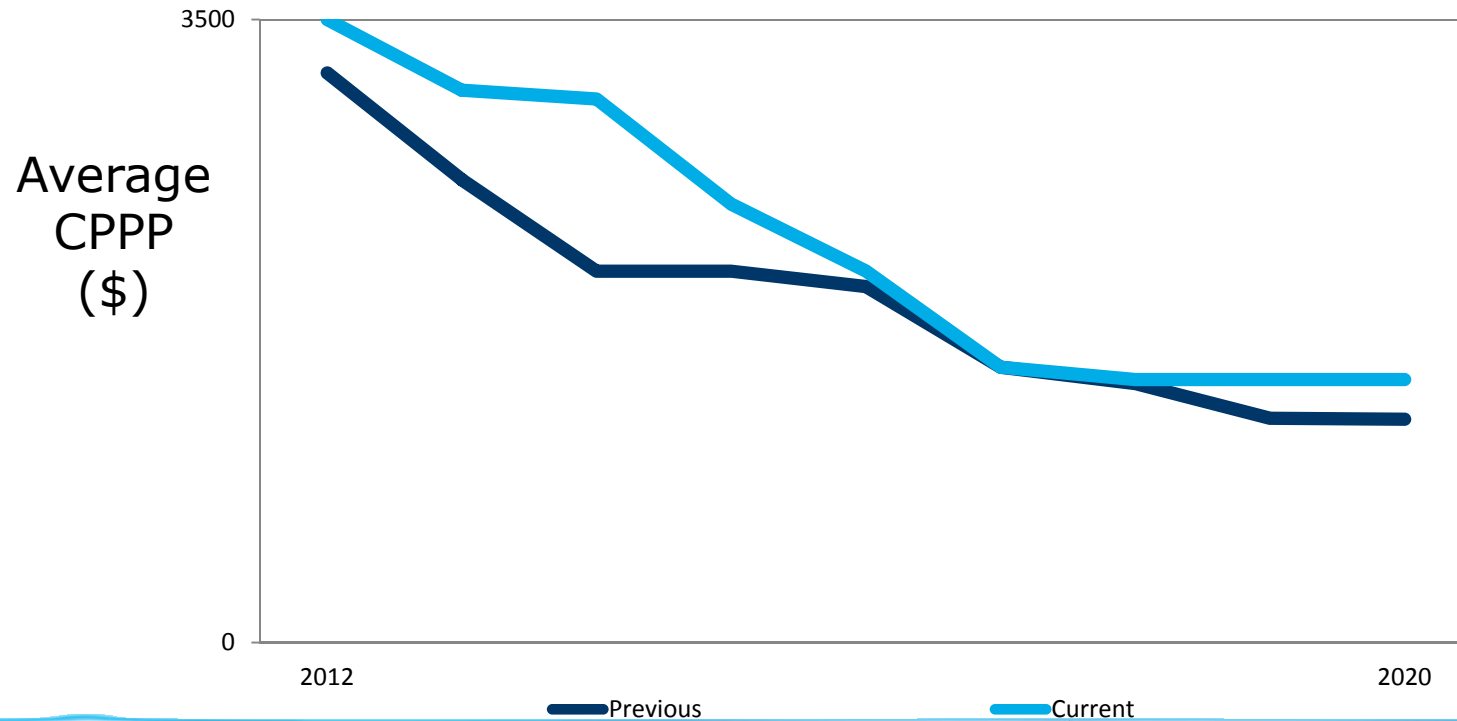
Revised capex guidance reflects:

- fibre capex trends as per previous slide
- modest efficiencies in other copper and common programmes

Note: The individual ranges presented above are not necessarily additive

# Cost per premises passed

- > Update largely reflects cost impact of outlier areas (greater in first half of rollout)
- > Average CPPP by end of programme now forecast to be **\$1,300 to \$1,500**



# UFB build metrics: updated view

	Current assessment	Previous assessment
Estimated cost of communal network (guidance)	\$1.7 to \$1.9 billion	\$1.4 to \$1.6 billion
<u>Less</u> contribution from CFH	<u>\$929m</u>	<u>\$929m</u>
Estimated net Chorus contribution	\$771m to \$971m	\$471m to \$671m
Estimated average cost per premise passed (total programme)	\$2,046 to \$2,287	\$1,685 to \$1,926
FY13 average cost per premises passed (guidance)	\$2,900 to \$3,200	\$2,500 to \$2,700

# IT capex and opex outlook

- > FY13 IT capex spend currently \$55m-\$60m across fibre, copper and common capex categories
- > IT systems transition programme means capex and opex will grow in short term
- > Indicative planning suggests **additional combined capex and opex of \$50m to \$100m** over the next 4 years
- > This is incremental to the FY13 capex and opex 'base'
- > Total spend will be dependent on period over which two IT stacks are run in parallel and ability to extract savings from existing service providers
- > Pace of transition will also be influenced by customer choices and regulatory settings

# Dividends

- > FY13 interim dividend of 10.0 cents per share, fully imputed
- > Supplementary dividend of 1.7647 cents per share payable to non-resident shareholders
  - Record date: 28 March 2013
  - Payment date: 12 April 2013
- > Following the 8 February announcement from the Minister, Chorus considers that it has sufficient near term certainty to announce its FY14 dividend guidance of a fully imputed dividend of 25.5 cents per share (subject to there being no material adverse change in circumstances, operating outlook or Chorus' guidance for expected total UFB communal build costs of \$1.7 to \$1.9 billion)
- > The Board currently expects to announce longer term dividend guidance when the outcomes from the Government's reviews have been announced. At that stage, Chorus will also have an updated view of how its capital expenditure programmes are performing



# Dividend Reinvestment Plan

- > Plan is intended to increase flexibility for shareholders and provide Chorus with enhanced capital management.
- > The Board has currently set a 3% discount to the prevailing market price
- > Shareholders are eligible to participate in the Plan if they are resident in New Zealand or Australia
- > Offer document to be sent to eligible shareholders in time to enrol in the Plan before the FY13 interim dividend record date

# Net Debt / EBITDA

- > Net debt to EBITDA expected to increase through build period
- > Calculation below reflects Standard & Poor's treatment
- > PV of CFH debt securities uses 8.5% discount. This differs from accounting treatment that uses market rate on call notice date
- > Smaller December month end cash balance will influence ratio for H1 FY13

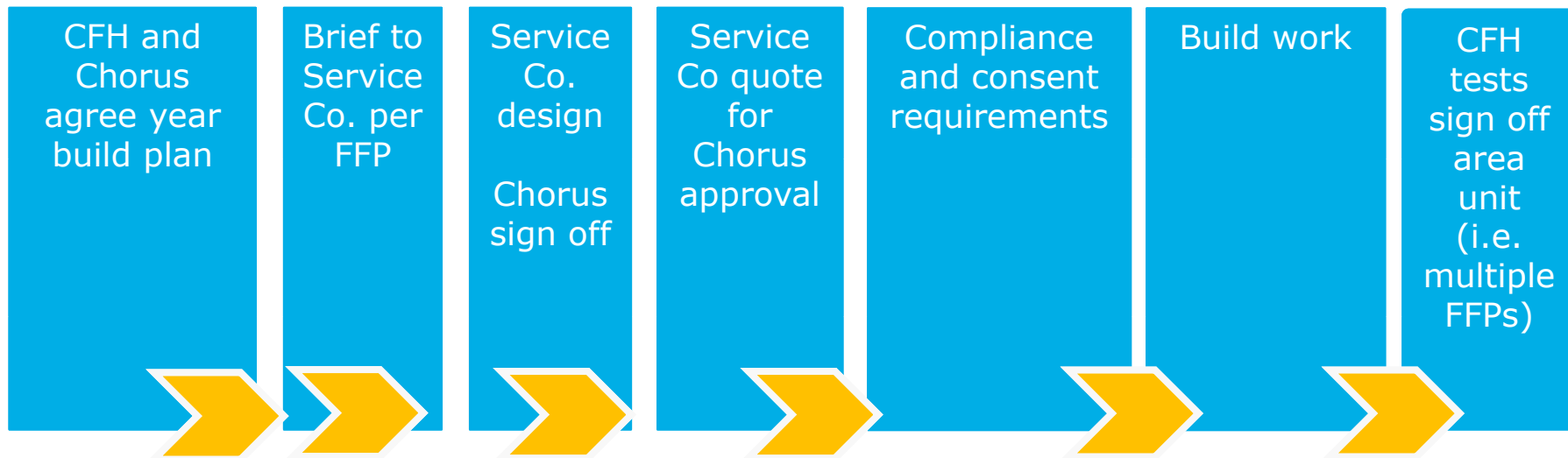
	As at 31 Dec 2012 \$m
Borrowings	1,792
+ PV of CFH debt securities (senior)	5
+ Net Finance leases	119
+ Operating leases	<u>17</u>
Sub total	1,933
- Cash	(46)
<b>Total net debt</b>	<b>1,887</b>
Net debt/EBITDA	2.8 times

# Mark Ratcliffe

Chorus CEO



# Moving to 'steady state' roll out



Roll out not yet optimal due to:

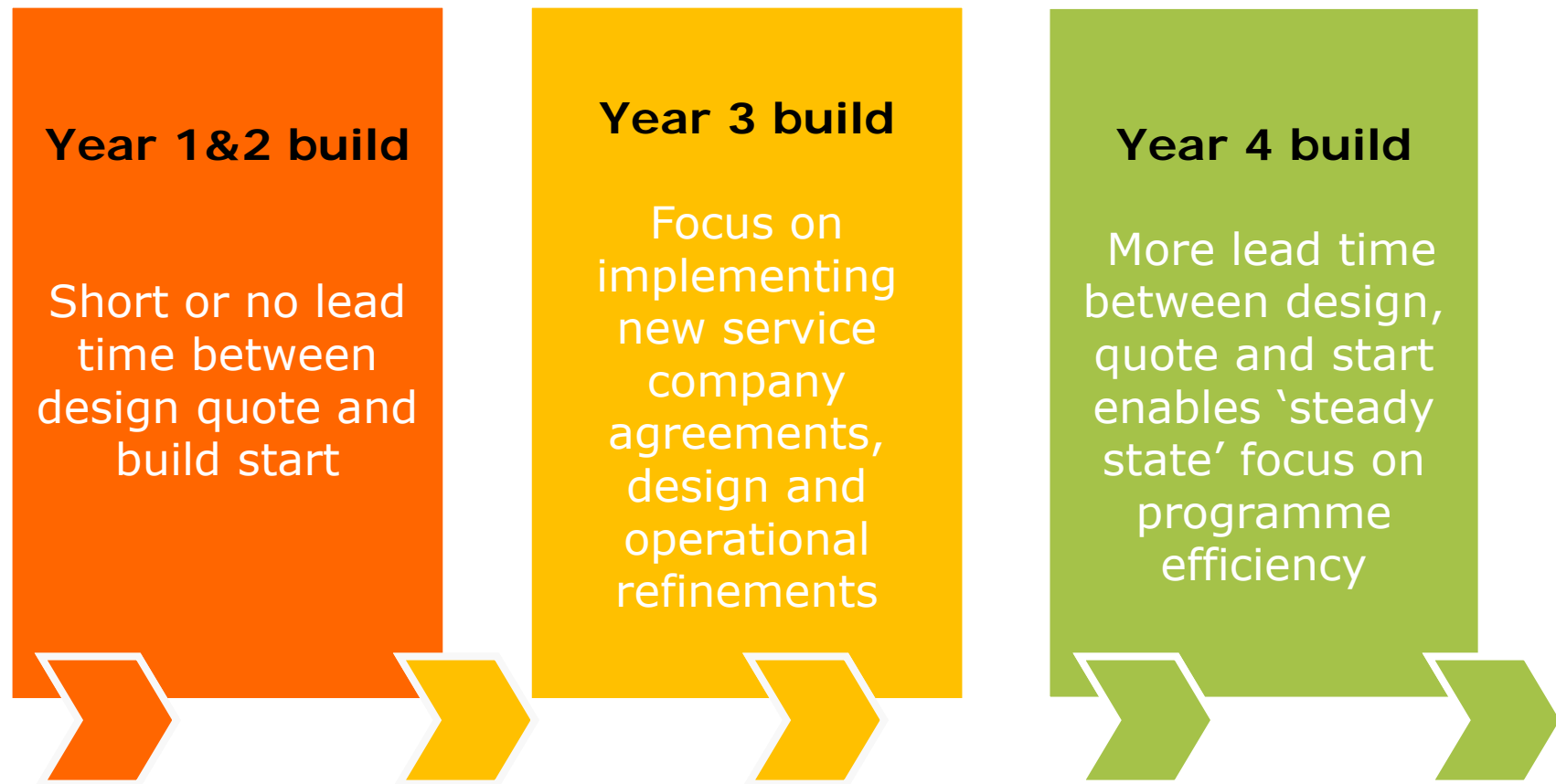
- > Condensed planning time
- > Service company contract models from previous framework
- > Variations in compliance requirements in outlier areas



## Our plan for operational cost reduction

- > Moving to new service company contracts with targeted cost incentives and shared risk
- > Seek regional consistency in Council requirements and utilities code interpretations
- > New deployment techniques, including micro trenching and aerial deployment where economic
- > Reassess upcoming deployment plans based on known challenges
- > Introduce new network technology innovations
- > Organisational changes to integrate fibre deployment and connection functions

# Moving to 'steady state' roll out





A scenic landscape photograph showing a paved road curving through a rural area. The sun is low on the horizon, creating a warm, golden glow over rolling hills and dense green trees. A white van is visible on the road in the distance. The overall atmosphere is peaceful and forward-looking.

**Looking ahead:  
Investment demands  
underline the need for a  
clear and stable regulatory  
environment**



An aerial photograph of a coastal city at sunset. The city is built on a hillside overlooking a large body of water. The sky is a mix of orange and blue, and the water reflects the light. In the foreground, there are residential buildings and a large church with a prominent steeple. A marina with many boats is visible in the middle ground. The overall scene is peaceful and scenic.

# Any questions?



# Appendices

- > Appendix A: Indicative comparison of six months to 31 December 2012 results with six months to 30 June 2012 results
- > Appendix B: Revenue categories
- > Appendix C: Capex categories
- > Appendix D: Contributions to capex categories

## Appendix A: Indicative comparison of six months to 31 December 2012 results with six months to 30 June 2012 results

- > This analysis is indicative only and provides a comparison between the results for the two periods. This Appendix has not been audited.
- > Given Chorus' limited history as a stand-alone business, there isn't a previous comparable period for ready comparison. The Indicative Income statement creates a somewhat comparable six month result for information purposes by using the unaudited results for the immediately preceding six month period.
- > The two periods provide some indicative relativities, but also have some limitations, including, the seasonality implicit in network maintenance costs (the worst of the weather was experienced in July 2012 with another weather event in December). The six months to 31 December 2012 also include one month of reduced revenues following the Commission's 3 December 2012 final UCLL decision.
- > The 30 June 2012 results have been normalised for the one-off insurance proceeds received in that period.

# Indicative income statement

	31 December 2012 (six months)	30 June 2012 (six months)	Change
	\$m	\$m	%
Operating revenue	525	514	2.1
Operating expenses	(194)	(185)	4.9
<b>EBITDA</b>	<b>331</b>	<b>329</b>	<b>0.6</b>
Depreciation	(128)	(127)	
Amortisation	(32)	(34)	
<b>EBIT</b>	<b>171</b>	<b>168</b>	<b>1.8</b>
Finance costs (net)	(54)	(59)	
Income tax	(33)	(31)	
<b>NPAT</b>	<b>84</b>	<b>78</b>	<b>7.7</b>

# Operating revenue

	31 December 2012 (six months)	30 June 2012 (six months)	Change
	\$m	\$m	%
Basic copper	329	340	(3.2)
Enhanced copper	94	76	23.7
Fibre	28	24	16.7
Value added services	17	15	13.3
Infrastructure	9	13	(30.8)
Field services	41	40	2.5
Other	7	6	16.7
<b>Total operating revenues</b>	<b>525</b>	<b>514</b>	<b>2.1</b>

- > Total operating revenues have increased slightly on the previous six month period, with the trend of migration from basic copper to enhanced copper continuing. Fibre revenues have continued to grow along with carrier network services. Infrastructure revenues have reduced as one-off (up front fees) are charged when an exchange is unbundled, and the pace of exchange unbundling has reduced during the period.



# Operating expenses

	31 December 2012 (six months)	30 June 2012 (six months)	Change
	\$m	\$m	%
Labour costs	(33)	(27)	22.2
Provisioning	(26)	(20)	30.0
Network maintenance	(50)	(44)	13.6
Other network costs	(17)	(19)	(10.5)
Information technology costs	(24)	(26)	(7.7)
Rent and rates	(5)	(5)	-
Property maintenance	(6)	(7)	(14.3)
Electricity	(6)	(10)	(40.0)
Insurance	(2)	(3)	(33.3)
Consultants	(3)	(4)	(25.0)
Other	(22)	(20)	10.0
<b>Total operating expenses</b>	<b>(194)</b>	<b>(185)</b>	<b>4.9</b>

- > Total operating expenses have increased during the period as the business continued to grow, labour costs have increased as additional people have joined during the period, while provisioning and network maintenance costs have increased, partly as a result of the weather during the period and service company overheads. The majority of other costs have decreased period on period.

# Depreciation and amortisation

	31 December 2012 (six months)	30 June 2012 (six months)	Change
	\$m	\$m	%
Depreciation	(128)	(127)	0.8
Amortisation	(32)	(34)	(5.9)
<b>Total depreciation and amortisation</b>	<b>(160)</b>	<b>(161)</b>	<b>(0.6)</b>

- > Total depreciation and amortisation have decreased slightly during the period. Depreciation expense has increased reflecting the significant capital expenditure programme, partially offset by a slightly larger credit of the government grant. Amortisation of software and other intangible assets is lower reflecting the short lives of this type of asset.

# Finance costs

	31 December 2012 (six months)	30 June 2012 (six months)	Change
	\$m	\$m	%
Finance income	3	4	(25.0)
Finance expense	(57)	(63)	(9.5)
<b>Finance costs (net)</b>	<b>(54)</b>	<b>(59)</b>	<b>(8.5)</b>

- > Finance income in the one month to 31 December 2011 included a gain on cross currency interest rate swaps which reversed prior to entering into a hedging relationship on 14 February 2012. Therefore, simply removing the one month December 2011 from the seven months to June 2012 does not create a comparable period to that ended 31 December 2012. When the \$11 million gain is excluded from the June 2012 comparison a reduction in finance expense is recorded, which reflects the largely fixed interest expense on debt.

# Appendix B: Revenue categories

Basic Copper	<ul style="list-style-type: none"><li>• core regulated products that are earlier technology or products with limited scope for further development e.g Baseband copper (UCLFS), Basic UBA, Naked UBA, UCLL, SLU, SLES</li></ul>
Enhanced Copper	<ul style="list-style-type: none"><li>• products enhanced to deliver higher speed capability and better customer experience e.g. Enhanced UBA, VDSL2, Baseband IP, HSNS Lite Copper</li></ul>
Fibre	<ul style="list-style-type: none"><li>• existing business fibre and new UFB services. Also includes UFB backhaul and direct, or 'dark', fibre</li></ul>
Value Added Network Services	<ul style="list-style-type: none"><li>• products and expertise for higher value or specialist services. Includes carrier network services which provide connectivity across backhaul links</li></ul>
Field Services	<ul style="list-style-type: none"><li>• field force in provisioning, maintaining and installing copper or fibre products</li></ul>
Infrastructure	<ul style="list-style-type: none"><li>• services that provide access to Chorus' network assets, principally exchange co-location space.</li></ul>

# Appendix C: Capex categories

## Fibre capex categories

<b>UFB communal</b>	<ul style="list-style-type: none"><li>• cost of building UFB network along street to pass premises</li></ul>
<b>UFB connections &amp; fibre layer 2</b>	<ul style="list-style-type: none"><li>• UFB connections are subject to demand via RSPs</li><li>• Layer 2 electronics</li></ul>
<b>Fibre products &amp; systems</b>	<ul style="list-style-type: none"><li>• Fibre- related product and system development</li></ul>
<b>Other fibre connections &amp; growth</b>	<ul style="list-style-type: none"><li>• Demand driven by greenfield &amp; business fibre growth.</li><li>• Regional backhaul to enable RSP traffic</li><li>• Fibre lifecycle investment</li></ul>
<b>RBI</b>	<ul style="list-style-type: none"><li>• Layers 0, 1 - network duct and fibre; Layer 2 cabinet electronics</li><li>• Expect total 5 year programme to cost around \$270 - 280 million. Spend weighted to front end of programme</li></ul>

## Copper capex categories

### Network sustain

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

### Copper connections

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

### Copper layer 2

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

### Product fixed

- Largely RSP driven investment in copper-related products



## Common capex categories

### **Information technology**

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

### **Building and engineering services**

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

### **Other**

- Items such as office accommodation and equipment

# Appendix D: Contributions to capex

## UFB

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

## RBI

- Government grant funding of ~\$225 million over 5 years to cover most layer 0 and 1 capex spend
- Layer 2 is not covered by the grant
- Grant is payable on completion of build work
- Annual grant around 80 - 85% of annual RBI capex spend

## Other

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