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MEDIA RELEASE

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Regulatory black hole puts Chorus funding at risk

The Commerce Commission has today released its final decision on the pricing for Chorus' copper broadband (UBA) service.

The Commission's final benchmarked UBA price of \$10.92 is around a 50% reduction from the current \$21.46 monthly charge. This means that the \$44.98 per month Chorus currently charges retail service providers for a copper line and copper broadband service would reduce to \$34.44.

Under current legislation this pricing will apply from 1 December 2014 and Chorus estimates that this will have around a \$142 million annualised EBITDA impact, based on connection numbers at 30 September 2013. This is in addition to the around annual \$20m EBITDA reduction from the December 2012 UCLL benchmarked decision. Chorus' NPAT for the year ended 30 June 2013 was \$171 million.

The UBA price announced today would imply around a \$1 billion funding shortfall by 2020, reflecting a combination of loss of operating cash flows, reduced borrowing capacity and increased interest and funding costs.

"Without the proposed Government intervention, the loss of these revenues would have two very negative consequences for Chorus' funding ability," said Mark Ratcliffe, Chorus CEO. "We would have much less cash every year to invest and we simply will not be able to borrow the sums of money we need to make up to a \$3 billion investment in UFB."

"The ability to finance the business cases of both Chorus and other LFCs, which were agreed when the UFB contracts were awarded, is missing from today's decision. This decision also undermines the intention to incentivise an efficient transition onto that network by attractive entry level fibre pricing. There is no guarantee this proposed reduction in wholesale prices would be passed through to consumers."

Consequences of today's regulatory decision

At the time of the Commission's draft UBA decision on 3 December 2012, Chorus said that it may need to fundamentally rethink its business model, capital structure and approach to dividends.

Following today's final UBA decision, and absent timely intervention by the Government to realign the policy settings to support the investment in and transition to fibre, Chorus will need to do the following:

- Discuss today's decision with existing lenders as well as the rating agencies who analyse Chorus' credit worthiness. Chorus was placed on "outlook negative" by Moody's in March this year following a review initiated when the draft UBA decision was released;
- Notify its bank lenders that absent the anticipated Government intervention in Chorus' view this price change is likely to have a material adverse effect on 1 December 2014 under the terms of Chorus' borrowing arrangement. If this did occur lenders would be entitled to trigger an event of default;
- Evaluate the appropriateness of Chorus' business model and the nature of its existing commitments. The combination of significantly reduced operating cash flows, reduced borrowing capacity and increased cost of capital fundamentally changes the business model envisaged prior to demerger;
- Discuss with the Crown whether Chorus is still a credible UFB partner in the way intended at demerger and how Chorus might deliver the balance of its programme despite the very material funding gap in Chorus' business implied by this decision;
- Review Chorus' current capital management settings, including capital structure, dividend policy and the potential need for a large future equity raising; and
- Conduct a detailed evaluation of other options to minimise financial downside for Chorus.

"We are intensely disappointed with today's decision. We are proud of our role as a cornerstone partner in delivering the Government's vision to build a fibre future for New Zealand. Chorus is ahead in its UFB build programme, is leading an industry transition to fibre and making other investment to improve broadband in New Zealand. But unless the Government intervenes, it is likely that the benefits for New Zealand will be significantly compromised," Mr Ratcliffe said.

Today's benchmarking decision is once again below the cost of providing the service, and Chorus is now set to take up its option to move to a full economic cost model for the UBA price. Together with UCLL this process may take around two years, leading to ongoing uncertainty for the entire industry. There is a vast range of evidence that supports today's aggregate price of \$44.98.

ENDS

Notes:

Chorus will not be providing any additional comment at this stage.

Key regulatory submissions made by Chorus on Commission regulatory proceedings, the parallel pending Government policy reviews and the Chairman's recent address to the Annual Meeting of shareholders on 30 October 2013 can be found on Chorus'

website at: <http://www.chorus.co.nz/investor-presentations#cs-57344> and are filed with the NZX and ASX.

Approximately 50% of Chorus is owned by New Zealanders currently comprising approximately 30,000 direct NZ shareholders and many thousands more via Kiwisaver funds. Chorus currently employs around 5,000 people (directly or indirectly) throughout NZ.

The Commission's release and determination is attached.

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