Chorus
Half Year Report

For the six months ended 31 December 2013

Chorus

Half Year Report
Summary

For the six months ended 31 December 2013

NPAT

$78m

Net profit after tax

Fixed line connections

1,776,000

EBITDA

$329m

Earnings before interest, tax, depreciation and amortisation

UFB Build

259,000

End-users within reach

Report from Chairman Sue Sheldon and CEO Mark Ratcliffe

MARK RATCLIFFE, CEO

SUE SHELDON, CHAIRMAN

Dear shareholders,

Chorus reports net profit after tax (NPAT) for the six months ended 31 December 2013 of $78 million. Revenues were $535 million and earnings before interest, tax, depreciation and amortisation (EBITDA) were $329 million. Chorus' business performance was pleasing, with fixed line connection numbers largely stable and ongoing growth in broadband connection numbers. Both the Ultra-Fast Broadband (UFB) and Rural Broadband Initiative (RBI) fibre rollouts are being delivered successfully, with more than 320,000 end-users within reach of better broadband. Chorus is also making steady progress on initiatives to reduce the cost of our UFB deployment.

However, this performance has been totally overshadowed by regulatory and political developments in the six months to 31 December 2013 which led to a dramatic fall in the value of Chorus shares. The Board is conscious that many shareholders have experienced significant losses and financial uncertainty as a consequence of these events.

These developments have placed new and additional demands on Chorus in relation to the viability of its business model. We noted in December that it is likely that Chorus will need to cut all discretionary activity, including growth-related capital investment, re-price most of its commercial services and generally manage for cash. Chorus is already reshaping its business to secure a sustainable operating framework in the context of a substantial reduction in revenue from 1 December 2014. A fundamental review of the entire business has identified an extensive range of revenue, operating cost and capital expenditure initiatives. Many of these initiatives are now in train for implementation from mid 2014 and some smaller initiatives have already been implemented.

Chorus has been proactively engaging with its lenders and ratings agencies to keep them informed in what is an extremely complex situation. The business is already being operated with an intense focus on cash management. Interest rate swaps have, for example, been reset, realising approximately $30 million of cash this financial year, with a consequential modest increase in financing costs on our 2020 sterling denominated debt. This focus will continue for the remainder of FY14 (twelve months ending 30 June 2014). In light of the above, Chorus has elected not to pay an interim dividend for FY14.

1. Regulatory update

The six months to 31 December 2013 saw significant regulatory and political developments.

1.1 UBA decision and political developments

On 5 November 2013 the Commerce Commission announced its final price for the copper broadband service (UBA), which will see a price reduction of around 50% from the current $21.46 monthly charge. Chorus currently charges retail service providers $44.98 per month for a copper line and copper broadband service which would reduce to $34.44 from 1 December 2014. Chorus advised the market that this could mean around $142 million per annum EBITDA impact and around $1 billion funding shortfall for the remainder of the UFB build period. Ratings agencies immediately placed Chorus on negative outlook and Moody's has subsequently downgraded Chorus from a Baa2 to a Baa3 rating with negative outlook. Chorus' BBB credit rating remains on negative watch with Standard & Poor's.

It is clear that the implementation of the 2011 legislative reforms has not delivered on the policy intent to transition to fibre. The UBA decision not only undermines the business cases of Chorus and other Local Fibre Companies, it also undermines the relativity between copper and fibre pricing.

Bringing coherence and removing as much uncertainty from the regulatory framework as possible remains in everyone's interests. We await next steps on whether the Government's policy reviews will continue in the absence of the pricing intervention considered in August.

1.2 Final pricing principle and an appeal of the Commerce Commission's UBA decision

Chorus and other parties have applied to the Commerce Commission for a final pricing review of its November UBA decision.
On 7 February 2014, the Commerce Commission released a process and issues paper with a draft determination scheduled for August 2014 and final determination scheduled before 30 November 2014. Chorus and other parties made an earlier request for a price review in February 2013 in respect of the Commerce Commission's December 2012 decision on Chorus' copper line (UCLL) pricing. The schedule for the UCLL process is yet to be confirmed. Being one year into the UCLL price review process, Chorus has requested that the Commission complete that earlier UCLL application contemporaneously and by 30 November 2014.

Essentially these review processes mean that the Commerce Commission will undertake economic cost modelling to determine the price for Chorus' services rather than simply benchmarking prices against services in other countries. Cost modelling is complex and highly technical. The outcomes of the Commerce Commission's further pricing reviews are uncertain.

In parallel with the Commerce Commission processes, Chorus is also asking the High Court to determine whether the Commerce Commission was correct to rely on pricing from just two countries when setting the initial UBA price and whether s18(2A) of the Telecommunications Act was considered as intended. The High Court hearing is scheduled for 17-21 March 2014.

1.3 EY review and CFH discussions

Following the Commerce Commission's UBA decision in November, the Government commissioned Ernst & Young Australia (EY) to conduct an independent assessment of Chorus' ability to meet its obligations under the UFB and Rural Broadband Initiative (RBI) contracts. The EY assessment was publicly released on 14 December 2013 and confirmed Chorus' view of a $1 billion funding gap by 2020. EY identified a range of potential revenue, cost and investment related initiatives that Chorus could undertake in order to partially address the funding gap, and they identified that those initiatives come with substantial trade-offs. The report also stated that EY's view is that following the initiatives Chorus could undertake alone, a significant funding gap would still remain.

As requested by the Minister, Chorus has engaged with Crown Fibre Holdings (CFH) to discuss changes that might be made to the UFB contract, alongside changes to Chorus' own business model, to assist in closing the funding gap.

2. Capital expenditure

Gross capital expenditure for the six months ended 31 December 2013 was $332 million. About 87% of the gross capital expenditure spend was fibre related, principally for the rollout of fibre for the UFB and RBI projects.

Build work is on track and was completed for 199,000 UFB premises by 31 December 2013, with 259,000 end-users able to be connected to the UFB network. The increased pace of the rollout, with 46,000 premises passed during the six month period, meant UFB communal capital expenditure totalled $179 million.

Considerable focus continued to be placed on reducing UFB deployment costs, with initiatives including:

- Targeted cost contracts implemented with service companies which incentivise cost performance through benefit and risk sharing;
- Competitive tendering introduced for selected deployment areas;
- First deployment of aerial communal network began in December in Greymouth;
- Network technology evolution continued to deliver savings; and
- Chorus continued to work closely with Councils to address specific local requirements and trial deployment techniques such as micro-trenching.

Chorus has targeted an average cost per premises passed of $2,900 to $3,200 for UFB deployment to the year ended 30 June 2014. As at 31 December actual costs had been received for about 9,000 premises and these costs were approximately 4% below targeted cost. The targeted cost for all premises to be passed in FY14 is about $3,100 per premises, before any "pain" or "gain" share with service companies or any agreed contractual variation for exceptional circumstances.

UFB communal spend included $5 million of work completed on fibre network for greenfields subdivisions within Chorus' UFB areas that are yet to be counted as premises passed under the UFB contract. About $1 million was also spent on 'UFB synergy' work where elements of communal network build were brought forward to align with work being undertaken by other network or infrastructure owners.

UFB connections and layer 2 spend increased as the volume of non-business fibre connections grew. Layer 2 equipment, such as GPON ports and splitters, also continues to be installed ahead of demand as the UFB footprint expands.
The average cost of connection per standard residential premises was approximately $1,800 for the period inclusive of the long run average cost of Layer 2 equipment. Chorus is focused on reducing the average cost through a range of initiatives as UFB uptake grows, which will enable process and scale efficiencies. The expected average cost of connection for standard residential end-user premises is $900 to $1,100 (in real terms and inclusive of the long run average cost of Layer 2 equipment) across the UFB rollout.

Fibre products and systems spend was $23 million as Chorus builds new fibre inventory systems to improve the ordering and provisioning process for fibre connections.
Spend on other fibre connections and growth was $27 million, as demand drove ongoing investment for business grade fibre connections (both inside and outside Chorus' UFB areas), non-UFB subdivisions, and backhaul capacity.

RBI spend was $32 million as the programme has passed the halfway mark and the scale of rollout work required begins to reduce ahead of its completion in 2016.

Copper related capital expenditure was $28 million as investment to expand network capability and coverage, as well as proactive maintenance, was reduced or deferred.

Common capital expenditure was $17 million. A reduction in building and engineering spend during this period helped offset the increase in Information Technology (IT) spend occurring as part of Minister approved systems separation plans.

3. Operating results

3.1 Operating revenue

Revenues were up around 1% compared to revenue for the six months to 30 June 2013 despite total fixed line connections declining from 1,784,000 to 1,776,000. Some of the decline in connections from 30 June 2013 is attributable to seasonal variations in connections with, for example, university students exiting tenancies over the Christmas holiday period. Retail service providers continued to focus on input costs.

Fixed line connections

At 31 December 2013 there were approximately 1,497,000 baseband copper lines[1] , a decrease of 24,000 lines from 30 June 2013. 'Data service over copper' connections reduced by 6,000 lines as the classification of legacy connections was reviewed and retail service providers scrutinised input costs.

The reduction in these categories was offset by the increase in other fixed line connection products. 'Naked' connections (naked Basic UBA, naked Enhanced UBA and naked VDSL) grew by 13% to 103,000 lines, while fibre connections grew by 42% to 27,000 lines. Approximately 13,100 fibre connections were within the areas where Chorus had deployed UFB communal network at 31 December 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.

[1] 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.

The growth in fibre connections was driven by the continued expansion of Chorus' UFB coverage footprint and the entry of larger retail service providers into the residential fibre market. About 60% of Chorus' 27,000 fibre connections were residential UFB end-users (which includes UFB Bitstream 2 and 3 and education connections) or pre-UFB fibre subdivision end-users. These end-users had previously represented about 44% of Chorus' total fibre connections.

HSNS Premium fibre connections (also referred to as Bitstream 4 under the UFB agreement) continued to grow. When combined with Bandwidth Fibre connections, these high grade business fibre connections accounted for 27% of Chorus' total fibre connections at the end of the period. Direct Fibre Access accounted for the remaining 13% of total fibre connections at 31 December 2013.

The number of unbundled exchanges grew from 183 to 188 over the period, with approximately 130,000 access lines being used by retail service providers to deliver unbundled services to consumers. This total comprised 125,000 UCLL connections and 5,000 SLU lines (offered in conjunction with Chorus' commercial SLES product).

Baseband IP connections, used by retail service providers to deliver a voice over internet protocol service over copper, are increasing slowly off a small base, with a growing number of retail service providers developing the capability to offer this service. Baseband IP is currently available across about 10% of Chorus' lines.

Broadband connections

Total broadband connections continued to grow, with an increase of 20,000 connections to 1,132,000. Growth was driven by the continued uptake of 'naked' services, the doubling of fibre connections (Bitstream 2, 3 and fibre subdivision lines) to 16,000 lines, and the increase in demand for VDSL. The number of VDSL connections (including naked VDSL) increased from 4,000 to 25,000 connections during the period as retail service providers began marketing it more widely. The ongoing expansion of Chorus' fixed broadband coverage through the RBI also continued to contribute to connection growth.

Infrastructure

Infrastructure revenue increased slightly as new market entrants and network aggregators request commercial co-location space to interconnect with Chorus' UFB footprint.

Field services

Field services revenue has grown slightly with increases in provisioning and cable location revenue offsetting reductions in maintenance of retail service provider networks.

Chorus summary connection numbers

	31 DECEMBER 2013	30 JUNE 2013	31 DECEMBER 2012
Total fixed line connections	**1,776,000**	**1,784,000**	**1,793,000**
Baseband copper	1,497,000	1,521,000	1,559,000
UCLL	125,000	122,000	109,000
SLU/SLES	5,000	6,000	16,000
Naked Basic/Enhanced UBA/Naked VDSL	103,000	91,000	72,000
Data services over copper	19,000	25,000	22,000
Fibre	27,000	19,000	15,000
Total broadband connections	**1,132,000**	**1,112,000**	**1,076,000**
Basic UBA	246,000	331,000	474,000
Naked Basic UBA	11,000	11,000	9,500
Enhanced UBA	747,000	680,000	530,000
Naked Enhanced UBA	87,000	78,000	60,500
VDSL	20,000	2,000	NM
Naked VDSL	5,000	2,000	2,000
Fibre (Bitstream 2, 3 and fibre subdivisions)	16,000	8,000	NM

NM = not a meaningful comparison

3.2 Operating expenses

Operating expenditure has increased by around 3% compared to the six months ended 30 June 2013 and 6% compared to the six months ended 31 December 2012 largely reflecting ongoing growth in the labour force. Notable categories include:

Network maintenance costs of $49 million were slightly down on previous periods, despite higher weather-related fault volumes, reflecting lower levels of maintenance on retail service provider networks.

Labour costs of $41 million for the period represent staff costs that are not capitalised. At 31 December Chorus had 805 permanent and fixed term employees, up from 763 employees at 30 June 2013 and 710 at 31 December 2012. Additional people have been employed to support critical programmes, such as the UFB rollout and IT systems transition, and growing levels of operational activity, particularly for UFB provisioning work. The majority of costs relating to the additional people in the UFB rollout and IT teams are capitalised. In September 2013 the company implemented an employee equity building scheme to better align employee and shareholder interests. A total of 622 Chorus employees participated in the scheme. Under the scheme, 106,984 shares were purchased on market at an average price of $2.897 per share. The shares are held by a trustee and vest to participating employees after a three year period.

Provisioning costs of $27 million increased slightly relative to the previous periods, reflecting a change in the mix of overall provisioning activity, particularly with growth in demand for VDSL. A large proportion of provisioning costs are recovered from retail service providers as field services revenue.

Depreciation and amortisation, before the release of Crown Funding, have increased slightly compared to prior periods. The increase in amortisation reflects ongoing IT investment. The release of Crown Funding against depreciation has also increased.

3.3 Finance expenses

Finance expenses of $62 million have increased from $58 million in the six months ended 30 June 2013 and include the costs relating to a new syndicated bank facility and the reset of interest rate swaps.

4. Dividends and capital management

Following on from the withdrawal of dividend guidance on 18 November 2013, Chorus has elected not to pay an interim dividend.

Chorus is focussed on delivering on initiatives to manage for key debt metrics. Chorus' broader capital management objectives are:

- maintain an investment grade rating with headroom. In the longer term, the Board continues to consider a "BBB" rating appropriate for a business like Chorus; and
- setting a financially sustainable dividend policy once sufficient certainty is achieved.

Capital management decisions will be communicated when there is sufficient certainty around the outcome of Chorus initiatives, CFH discussions, and regulatory reviews.

5. Outlook

Chorus now expects to be at the top end of our FY14 guidance range of flat to low single digit percentage decline in EBITDA, relative to underlying FY13 EBITDA of $654 million[2]. Chorus' FY14 gross capital expenditure guidance of $660–$690 million is unchanged.

Susan Sheldon

SUE SHELDON
Chairman

MARK RATCLIFFE
CEO and
Managing Director

24 February 2014

[2] EBITDA of $663 million for the year ended 30 June 2013 was adjusted by $8 million for the impact of the price reduction in 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) and for $1 million of insurance proceeds, to derive underlying EBITDA of $654 million.

Half Year Report

Highlights and Challenges

Highlights

UFB build on track with 259,000 end-users within reach.	Total fixed line connections largely stable at 1,776,000.
Gigatown competition increasing UFB awareness.	Broadband connections grew by 20,000 over the last six months to 1,132,000.

Challenges

Regulatory decisions undermining funding of and efficient transition to fibre.	Developing and implementing options to address funding shortfall from the UBA decision.
Industry changes driving continued retail service provider focus on costs.	Moody's credit downgrade following the UBA decision and continued negative outlook.

Condensed consolidated income statement

FOR THE SIX MONTHS ENDED 31 DECEMBER 2013

		GROUP		
(DOLLARS IN MILLIONS)	NOTE	SIX MONTHS ENDED 31 DEC 2013 UNAUDITED $M	SIX MONTHS ENDED 31 DEC 2012 UNAUDITED $M	YEAR ENDED 30 JUNE 2013 AUDITED $M
Basic copper		279	329	631
Enhanced copper		143	94	215
Fibre		34	26	60
Value added network services		19	19	37
Infrastructure		10	9	17
Field services		43	41	85
Other		7	7	12
Total operating revenue		**535**	**525**	**1,057**
Labour costs		(41)	(33)	(67)
Provisioning		(27)	(26)	(51)
Network maintenance		(49)	(50)	(100)
Other network costs		(20)	(17)	(37)
Information technology costs		(25)	(24)	(52)
Rent and rates		(6)	(5)	(12)
Property maintenance		(6)	(6)	(12)
Electricity		(6)	(6)	(13)
Insurance		(2)	(2)	(4)
Consultants		(3)	(3)	(6)
Other		(21)	(22)	(40)
Total operating expenses		**(206)**	**(194)**	**(394)**
Earnings before interest, income tax, depreciation and amortisation		**329**	**331**	**663**
Depreciation		(129)	(128)	(258)
Amortisation		(33)	(32)	(61)
Earnings before interest and income tax		**167**	**171**	**344**
Finance income		3	3	7
Finance expense	8	(62)	(57)	(115)
Net earnings before income tax		**108**	**117**	**236**
Income tax expense		(30)	(33)	(65)
Net earnings for the period		**78**	**84**	**171**
Earnings per share				
Basic earnings per share (dollars)		**0.20**	**0.22**	**0.44**
Diluted earnings per share (dollars)		**0.17**	**0.21**	**0.42**

Condensed consolidated
Statement of comprehensive income

FOR THE SIX MONTHS ENDED 31 DECEMBER 2013

	GROUP		
(DOLLARS IN MILLIONS)	SIX MONTHS ENDED 31 DEC 2013 UNAUDITED $M	SIX MONTHS ENDED 31 DEC 2012 UNAUDITED $M	YEAR ENDED 30 JUNE 2013 AUDITED $M
Net earnings for the period	**78**	**84**	**171**
Other comprehensive income			
Items that will be reclassified subsequently to profit and loss when specific conditions are met			
Effective portion of changes in fair value of cash flow hedges (pre-tax)	18	-	13
Tax benefit on cash flow hedge	(5)	-	(4)
Other comprehensive income net of tax	**13**	**-**	**9**
Total comprehensive income for the period net of tax	**91**	**84**	**180**

The financial statements are approved and signed on behalf of the Board.

SUE SHELDON
Chairman

MARK RATCLIFFE
Chief Executive Officer and Managing Director

Authorised for issue on 24 February 2014.

Condensed consolidated **statement of financial position**

AS AT 31 DECEMBER 2013

		GROUP		
(DOLLARS IN MILLIONS)	NOTES	31 DEC 2013 UNAUDITED $M	31 DEC 2012 UNAUDITED $M	30 JUNE 2013 AUDITED $M
Current assets				
Cash and call deposits		170	46	80
Trade and other receivables		210	285	294
Finance lease recievable		3	3	3
Total current assets		**383**	**334**	**377**
Non-current assets				
Derivative financial instruments		4	2	7
Software and other intangibles	2	161	158	153
Network assets	1	2,960	2,618	2,796
Total non-current assets		**3,125**	**2,778**	**2,956**
Total assets		**3,508**	**3,112**	**3,333**
Current liabilities				
Trade and other payables		344	392	328
Income tax payable		14	16	5
Total current liabilities excluding Crown funding		**358**	**408**	**333**
Current portion of Crown funding	5	9	6	6
Total current liabilities		**367**	**414**	**339**
Non-current liabilities				
Trade and other payables		-	7	2
Derivative financial instruments		104	111	106
Finance lease payable		125	122	123
Debt	3	1,706	1,618	1,697
Deferred tax payable		184	164	190
Total non-current liabilities excluding CFH and Crown funding		**2,119**	**2,022**	**2,118**
CFH securities	4	42	11	30
Crown funding	5	307	110	222
Total non-current liabilities		**2,468**	**2,143**	**2,370**
Total liabilities		**2,835**	**2,557**	**2,709**
Equity				
Share capital		465	435	447
Hedge reserves		12	(10)	(1)
Retained earnings		196	130	178
Total equity		**673**	**555**	**624**
Total liabilities and equity		**3,508**	**3,112**	**3,333**

Condensed consolidated **statement of changes in equity**

FOR THE SIX MONTHS ENDED 31 DECEMBER 2013

	GROUP			
(DOLLARS IN MILLIONS)	SHARE CAPITAL $M	RETAINED EARNINGS $M	CASH FLOW HEDGE RESERVE $M	TOTAL $M
Balance at 1 July 2013	**447**	**178**	**(1)**	**624**
Comprehensive income				
Net earnings for the period	-	78	-	**78**
Other comprehensive income				
Net effective portion of changes in fair value of cash flow hedges	-	-	13	**13**
Total comprehensive income	-	**78**	**13**	**91**
Contributions by and distributions to owners:				
Dividends	-	(60)	-	**(60)**
Supplementary dividends	-	(5)	-	**(5)**
Tax credit on supplementary dividends	-	5	-	**5**
Dividend reinvestment plan	18	-	-	**18**
Total transactions with owners	**18**	**(60)**	**-**	**(42)**
Balance at 31 December 2013 (UNAUDITED)	**465**	**196**	**12**	**673**

	GROUP			
(DOLLARS IN MILLIONS)	SHARE CAPITAL $M	RETAINED EARNINGS $M	CASH FLOW HEDGE RESERVE $M	TOTAL $M
Balance at 1 July 2012	**435**	**102**	**(10)**	**527**
Comprehensive income				
Net earnings for the period	-	84	-	**84**
Other comprehensive income				
Net effective portion of changes in fair value of cash flow hedges	-	-	-	**-**
Total comprehensive income	**-**	**84**	**-**	**8 4**
Contributions by and distributions to owners:				
Dividends	-	(56)	-	**(56)**
Supplementary dividends	-	(5)	-	**(5)**
Tax credit on supplementary dividends	-	5	-	**5**
Total transactions with owners	**-**	**(56)**	**-**	**(56)**
Balance at 31 December 2012 (UNAUDITED)	**435**	**130**	**(10)**	**555**

Condensed consolidated statement of changes in equity

FOR THE SIX MONTHS ENDED 31 DECEMBER 2013

	GROUP			
(DOLLARS IN MILLIONS)	SHARE CAPITAL $M	RETAINED EARNINGS $M	CASH FLOW HEDGE RESERVE $M	TOTAL $M
Balance at 1 July 2012	**435**	**102**	**(10)**	**527**
Comprehensive income				
Net earnings for the period	-	171	-	**171**
Other comprehensive income				
Net effective portion of changes in fair value of cash flow hedges	-	-	9	**9**
Total comprehensive income	**-**	**171**	**9**	**180**
Contributions by and distributions to owners:				
Dividends	-	(95)	-	**(95)**
Supplementary dividends	-	(8)	-	**(8)**
Tax credit on supplementary dividends	-	8	-	**8**
Dividend reinvestment plan	12	-	-	**12**
Total transactions with owners	**12**	**(95)**	**-**	**(83)**
Balance at 30 June 2013 (AUDITED)	**447**	**178**	**(1)**	**624**

Condensed consolidated **statement of cash flows**

FOR THE SIX MONTHS ENDED 31 DECEMBER 2013

		GROUP		
(DOLLARS IN MILLIONS)	NOTES	SIX MONTHS ENDED 31 DEC 2013 UNAUDITED $M	SIX MONTHS ENDED 31 DEC 2012 UNAUDITED $M	YEAR ENDED 30 JUNE 2013 AUDITED $M
Cash flows from operating activities				
Cash was provided from/(applied to):				
Cash received from customers		645	464	967
Finance income		2	3	7
Payment to suppliers and employees		(218)	(186)	(378)
Income tax paid		(30)	(42)	(65)
Interest paid on debt and derivatives		(59)	(55)	(108)
Net cash flows from operating activities		**340**	**184**	**423**
Cash flows applied to investing activities				
Cash was provided from/(applied to):				
Purchase of network assets and software and intangibles		(353)	(309)	(681)
Sale of network assets and software and intangibles		1	-	-
Capitalised interest paid		(3)	(3)	(6)
Net cash flows applied to investing activities		**(355)**	**(312)**	**(687)**
Cash flows from financing activities				
Cash was provided from/(applied to):				
Net proceeds from/(repayment of) finance leases		(1)	(1)	(1)
Crown funding (including CFH securities)		123	81	198
Proceeds from debt and derivatives	8	480	60	190
Repayment of debt		(455)	(50)	(100)
Dividends paid		(42)	(56)	(83)
Net cash flows from financing activities		**105**	**34**	**204**
Net cash flow		**90**	**(94)**	**(60)**
Cash at the beginning of the period		80	140	140
Cash at the end of the period		**170**	**46**	**80**

Condensed consolidated statement of cash flows

FOR THE SIX MONTHS ENDED 31 DECEMBER 2013

Reconciliation of net earnings to net cash flows from operating activities

	GROUP		
(DOLLARS IN MILLIONS)	SIX MONTHS ENDED 31 DEC 2013 UNAUDITED $M	SIX MONTHS ENDED 31 DEC 2012 UNAUDITED $M	YEAR ENDED 30 JUNE 2013 AUDITED $M
Net earnings for the period	78	84	171
Adjustment for:			
Depreciation charged on network assets	133	130	262
Amortisation of Crown funding	(4)	(2)	(4)
Amortisation of software and other intangible assets	33	32	61
Change in deferred tax payable	(9)	(14)	9
Other	2	1	6
	233	**231**	**505**
Change in current assets and liabilities:			
Change in trade and other receivables	74	(72)	(70)
Change in trade and other payables	24	23	(3)
Change in income tax payable	9	2	(9)
	107	**(47)**	**(82)**
Net cash flows from operating activities	**340**	**184**	**423**

Notes to the
Financial Statements

Reporting entity and statutory base

Chorus Limited is a profit-oriented company registered in New Zealand under the Companies Act 1993 and is an issuer for the purposes of the Financial Reporting Act 1993.

The condensed consolidated interim 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) as at and for the six months ended 31 December 2013.

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.

Basis of preparation

The condensed consolidated interim financial statements have been prepared in accordance with the New Zealand equivalent to International Accounting Standard No. 34: "Interim Financial Reporting" and Generally Accepted Accounting Practice in New Zealand (NZ GAAP). These financial statements are prepared in New Zealand dollars, which is Chorus' functional currency. References in these financial statements to '$' and 'NZD' are to New Zealand dollars, references to 'GBP' are to pounds sterling. These condensed consolidated interim financial statements do not include all of the information required for the full annual financial statements and should be read in conjunction with the consolidated financial statements of Chorus as at and for the year ended 30 June 2013.

The condensed consolidated interim financial statements have been prepared using the same accounting policies and methods of computation as the financial statements for the year ended 30 June 2013, except for a change in the valuation methodology for derivative financial instruments which now reflects credit risk as required by New Zealand International Financial Reporting Standard Number 13 (NZ IFRS 13): Fair Measurement which is applicable for accounting periods beginning on or after 1 January 2013.

The condensed consolidated interim financial statements for the six months ended 31 December 2013, and comparative information for six months ended 31 December 2012 are unaudited. The comparative information for the year ended 30 June 2013 is audited. Comparative balances have been reclassified where appropriate to conform with the current period's presentation.

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 disclosed in the notes to the consolidated financial statements for the year ended 30 June 2013 and described in note 8 to these condensed consolidated interim financial statements.

Estimates

In preparing the condensed consolidated interim 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.

In preparing the condensed consolidated interim financial statements, the significant judgements made by management in applying Chorus' accounting policies and the key sources of uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended 30 June 2013 with the addition of judgements in relation to the carrying value of Chorus' assets. Specifically, NZ GAAP requires that the carrying values of assets in the statement of financial position are supported by an estimate of the future cash flows those assets are expected to generate.

On 5 November 2013 the Commerce Commission (the Commission) announced its final benchmarked price for the copper broadband service (UBA) substantially below existing price levels. This determination applies from 1 December 2014. The impact of this determination on the estimate of Chorus' future cash flows is uncertain for a number of reasons including:

- Chorus has applied to the Commission for a final pricing principle review of its 5 November 2013 UBA decision which means the Commission will undertake economic cost modelling to determine the price for Chorus' services rather than benchmarking prices against services in other countries. The outcome of this review is unknown;
- Chorus has appealed the Commission's 5 November decision, asking the High Court to determine whether the Commission was correct to rely on pricing from just two countries when setting the initial price and whether s18(2A) of the Telecommunications Act was considered as intended. The High Court hearing is scheduled for 17-21 March 2014;
- Chorus continues to develop options available to it, and within its own control, to mitigate the impact of the Commission's 5 November decision;
- As requested by the Minister of Communications and Information Technology Chorus has engaged with Crown Fibre Holdings Limited to discuss changes that might be made to the Ultra-Fast Broadband (UFB) contract, alongside changes to Chorus' own business model. These discussions are ongoing and the outcomes are unknown; and
- In February 2013 the Government announced a review of telecommunications regulatory policy. The outcome and timing of this review is unknown.

While the Directors believe that the carrying value of Chorus' assets remain appropriate, adverse outcomes in relation to any of these uncertainties could have a significant impact on the carrying value of Chorus' assets.

Note 1 – Network assets

	GROUP		
(DOLLARS IN MILLIONS)	31 DEC 2013 UNAUDITED $M	31 DEC 2012 UNAUDITED $M	30 JUNE 2013 AUDITED $M
Cost			
Opening balance	6,774	6,219	6,219
Additions	297	337	646
Other	1	-	2
Disposals	(6)	-	(93)
Closing balance	7,066	6,556	6,774
Accumulated depreciation			
Opening balance	(3,978)	(3,808)	(3,808)
Depreciation	(133)	(130)	(262)
Disposals	5	-	92
Closing balance	(4,106)	(3,938)	(3,978)
Net carrying amount	**2,960**	**2,618**	**2,796**

Capital commitments

As at 31 December 2013 Chorus had entered into contracts to purchase network assets for $30 million (30 June 2013: $28 million; 31 December 2012: $32 million).

Depreciation

The Crown funding released against depreciation for the six months ended 31 December 2013 was $4 million (30 June 2013: $4 million; 31 December 2012: $2 million).

Note 2 – Software and other intangibles

	GROUP		
(DOLLARS IN MILLIONS)	31 DEC 2013 UNAUDITED $M	31 DEC 2012 UNAUDITED $M	30 JUNE 2013 AUDITED $M
Cost			
Opening balance	441	407	407
Additions	35	11	35
Other	6	-	-
Disposals	-	(1)	(1)
Closing balance	482	417	441
Accumulated amortisation			
Opening balance	(288)	(227)	(227)
Amortisation	(33)	(32)	(61)
Disposals	-	-	-
Closing balance	(321)	(259)	(288)
Net carrying amount	**161**	**158**	**153**

Other cost movement

Certain shared system assets owned by Chorus are required for continued use by Telecom post demerger and have been de-recognised based on the extent of Telecom use. The extent of Telecom use has been reassessed during the six months ended 31 December 2013 resulting in recognition of previously de-recognised assets.

Note 3 – Debt

	GROUP		
(DOLLARS IN MILLIONS)	31 DEC 2013 UNAUDITED $M	31 DEC 2012 UNAUDITED $M	30 JUNE 2013 AUDITED $M
Syndicated bank facility A - Nov 2015	500	675	675
Syndicated bank facility B - Nov 2017	440	440	520
Syndicated bank facility - May 2019	250	-	-
Euro medium term notes - Apr 2020	522	511	509
Less: syndicated loans facility fee	(6)	(8)	(7)
	1,706	**1,618**	**1,697**
Current	-	-	-
Non-current	**1,706**	**1,618**	**1,697**

Chorus continues to have in place a $1,350 million syndicated bank facility with tranches maturing in November 2015 and November 2017 and foreign currency EMTN debt. The maturity of each of syndicated bank facility A and B was extended by one year in May 2013. An additional $250 million syndicated bank facility was established in August 2013 maturing in May 2019. During the six month period to 31 December 2013 Chorus repaid $455 million of the syndicated bank facilities and drew $450 million.

As at 31 December 2013 the undrawn syndicated bank facility that is available for future operating activities is $410 million (30 June 2013: $155 million; 31 December 2012: $235 million)

The EMTN debt of 260 million GBP as at 31 December 2013 has been hedged at $677 million NZD (30 June 2013: $677 million NZD; 31 December 2012: $677 million NZD).

Note 4 – CFH Securities

	GROUP		
(DOLLARS IN MILLIONS)	31 DEC 2013 UNAUDITED $M	31 DEC 2012 UNAUDITED $M	30 JUNE 2013 AUDITED $M
CFH debt securities	27	7	20
CFH equity securities	15	4	10
Total CFH securities	**42**	**11**	**30**

Note 5 – Crown funding

(DOLLARS IN MILLIONS)	GROUP 31 DEC 2013 UNAUDITED $M	31 DEC 2012 UNAUDITED $M	30 JUNE 2013 AUDITED $M
Ultra-Fast Broadband	138	40	103
Rural Broadband Initiative	157	64	107
Other	21	12	18
	316	**116**	**228**
Current	**9**	**6**	**6**
Non-current	**307**	**110**	**222**

During the six months ended 31 December 2013, Chorus recognised $46 million funding from CFH for the UFB initiative (30 June 2013: $120 million; 31 December 2012: $30 million) which equated to 41,510 premises passed in areas where user acceptance testing was complete (30 June 2013: 107,806 premises; 31 December 2012: 33,729 premises). During the six months ended 31 December 2013 Chorus recognised $51 million in funding from the Ministry of Business, Innovation and Employment for expenditure relating to the Rural Broadband Initiative (30 June 2013: $90 million; 31 December 2012: $46 million).

Note 6 – 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 and the Board in assessing performance, allocating resources and making strategic decisions.

Note 7 – Equity

Dividends

On 11 October 2013 Chorus paid a fully imputed final dividend of 15.5 cents per ordinary share in respect of the year ended 30 June 2013. In addition, a supplementary dividend of 2.735 cents per ordinary share was paid to shareholders who are not resident in New Zealand. Of the total final dividend of $60 million, 7,070,718 shares with a total value of $18 million were issued under the Chorus Dividend Reinvestment Plan with the balance paid in cash.

On 12 April 2013 Chorus paid a fully imputed interim dividend of 10.0 cents per ordinary share in respect of the year ended 30 June 2013. In addition, a supplementary dividend of 1.765 cents per ordinary share was paid to shareholders who are not resident in New Zealand. Of the total interim dividend of $39 million, 4,216,926 shares with a total value of $12 million were issued under the Chorus Dividend Reinvestment Plan with the balance paid in cash.

On 5 October 2012 Chorus paid a fully imputed final dividend of 14.6 cents per ordinary share in respect of the seven months ended 30 June 2012. In addition, a supplementary dividend of 2.577 cents per ordinary share was paid to shareholders who are not resident in New Zealand. The total final dividend of $56 million was paid in cash.

Note 8 – 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. During the six months ended 31 December 2013 interest rate swaps with a face value of $676 million and fair value of $31 million were reset at the prevailing market interest rates at that time the reset transactions took place (4.89% compared to 3.99% prior to the transaction). These transactions realised $30 million of cash and generated a finance expense of $1 million being the difference between the calculated fair value of the swap and proceeds realised. The reset swaps hedge the same underlying exposure and risk profile, but at a higher effective borrowing cost.

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or amortised cost. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the reporting date. All financial instruments are categorised at Level 2: valuation techniques using observable inputs. The fair value is determined using 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. Fair values are determined as follows:

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.

Credit value adjustment

At 31 December 2013, valuations have been adjusted to reflect credit risk as required by NZ IFRS13: Fair Value Measurement. The effect of credit risk was quantified using an expected future exposure methodology using credit fault swap prices to represent the probability of default.

Note 9 – Related party transactions

Key management personnel compensation

The gross remuneration of directors and key management personnel during the period was $4.0 million (30 June 2013: $6.4 million; 31 December 2012: $3.9 million).

Note 10 – Contingent liabilities

On 11 December 2013, the Commission released a draft decision reviewing the connection charges retail service providers pay to connect end-users to Chorus' unbundled copper low frequency service (UCLFS connection charges). The Commission has proposed that UCLFS connection charges should be reduced to align with the UCLL benchmarking decision of 3 December 2012 and backdated to that date. Chorus submitted on the draft decision on 14 February 2014. The outcomes and timeline for a final determination are uncertain. The Commission's draft decision, if finalised in its current form, would result in a liability relating to backdating of around $6 million at 31 December 2013. It is also possible that UCLFS connection charges set in a final determination could subsequently be amended by a UCLL final pricing principle outcome. The timing and outcomes for the UCLL final pricing principle and any subsequent amendment of UCLFS connection charges are uncertain.

Note 11 – Post balance date events

Credit rating

On 21 January 2014, Moody's Investor Services Inc. downgraded Chorus' credit rating from a Baa2 to a Baa3 rating with negative outlook which will increase interest rates payable on Chorus' borrowing under its syndicated bank facilities by 0.15%. Chorus' BBB credit rating remains on a negative watch with Standard and Poor's.

Auditors' Review Report

To the shareholders of Chorus Limited

We have completed a review of the condensed consolidated interim financial statements on pages 9 to 23 in accordance with the Review Engagement Standard RS-1 issued by the External Reporting Board. The financial statements provide information about the past financial performance of Chorus Limited and its subsidiary ("the Group") and its financial position as at 31 December 2013.

Directors' responsibilities

The Directors of Chorus Limited are responsible for the preparation of condensed consolidated interim financial statements which give a true and fair view of the financial position of the Group as at 31 December 2013 and the results of its operations and cash flows for the six month period ended on that date.

Reviewers' responsibilities

It is our responsibility to express an independent opinion on the condensed consolidated interim financial statements presented by the Directors and report our opinion to you.

Basis of opinion

A review is limited primarily to enquiries of company personnel and analytical review procedures applied to the financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

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

Review opinion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated interim financial statements on pages 9 to 23 do not give a true and fair view of the financial position of Group as at 31 December 2013 and the results of its operations and cash flows for the six month period ended on that date in accordance with NZ IAS 34 Interim Financial Reporting.

Carrying value of assets

We draw your attention to page 17 of the condensed consolidated interim financial statements which explains that significant uncertainties exist in relation to future regulatory, legal and political outcomes that may impact the assessment of the carrying value of Chorus' assets. Our opinion is not qualified in respect of this matter.

Our review was completed on 24 February 2014 and our opinion is expressed as at that date.

KPMG

Wellington

Board of Directors

Sue Sheldon
Chairman, non-executive director
Director since 1 July 2011

Anne Urlwin
Non-executive director
Director since 1 December 2011

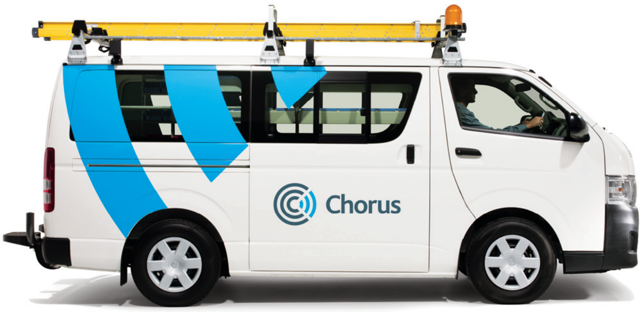
Clayton Wakefield
Non-executive director
Director since 1 December 2011

Jon Hartley
Non-executive director
Director since 1 December 2011

Keith Turner
Non-executive director
Director since 1 December 2011

Prue Flacks
Non-executive director
Director since 1 December 2011

Mark Ratcliffe
Executive director
Director since 9 December 2011


Chorus