

TRANSCRIPTION

Company: Telecom New Zealand
Title: Investors and Analysts Demerger Presentation
Date: 13 September 2011
Time: 11:00 NZT
Reservation ID: 4471696
Duration: 75 minutes
Chairperson: Paul Reynolds

Start of Transcript

Mark Watts: Thank you for dialling in to today's call, with me is Telecom Chairman Wayne Boyd, Telecom CEO Paul Reynolds and Telecom CFO Nick Olson. Also on line are CEO of Chorus Mark Ratcliffe and the Acting CFO of Chorus Brian Hall. Before we begin, a little bit of housekeeping. This call is for investors and analysts. If there are any media online you are welcome to listen in but can I ask that you save your questions for the dedicated media call at 1.00pm today. Thank you.

I would now like to introduce Wayne Boyd who will say a few words before passing over to Paul Reynolds to give the investor presentation.

Wayne Boyd: Thanks, Mark. Good morning everyone I'm shortly going to hand over to Paul but before that I thought I'd just take the opportunity to say a few words. Telecom's Board is unanimous that the demerger proposal, the details of which will be presented today, is in the best interests of shareholders and will maximise shareholder value over the long term. They also believe it's in the best interests of New Zealand as a whole. Today's full announcement also provides insight into our proposed new Board including the Board's recommendations for the new Chairman when I step down. The Board believes Mark Verbiest is the right man to lead the stewardship of the interests of shareholders as Telecom addresses the opportunities and challenges after demerger.

The combination of the proposed appointments and those directors who will be staying on the Board will give Telecom a very strong, diverse and highly skilled Board. It provides the

right balance of governance, strategy, understanding of technology and an exceptional depth and breadth of experience both in New Zealand and overseas. Now I'll pass over to Paul Reynolds who will take us through the demerger process in a bit more detail. Paul.

Paul Reynolds: Thank you, Wayne and good morning everybody and welcome. This is a big day for us that follows an immense amount of work on the proposed demerger which you will see reflected in the documents that we have released today. They include of course a Scheme Book, the Demerger Management Presentation which I am about to step through and several other documents including an Independent Expert's Report and indeed the Telecom Annual Report. I suggest over the coming days you read them all.

This call is going to be focused on the Scheme Booklet and the demerger so I am going to talk through that document Telecom NZ demerger presentation. I want to provide an overview of the UFB the Ultra-Fast Broadband initiative and the regulatory framework and discuss the proposed demerger including benefits. Look there's a huge amount of information presented and to take in and I am sure you will have lots of questions. We begin that process of dialogue today with a Q&A session at the end of this presentation. But I'll also towards the end set out our upcoming shareholder investor roadshow which will give you, I hope, the opportunity to discuss these matters directly with management and after you have had a good chance to read and digest the material.

So let's get started. The agenda is on slide 2, introduction and overview of the UFB initiative and overview of the proposed demerger. Slide 4 is our standard disclaimer which I would urge you to read later. Slide 5, by way of introduction, we in Telecom have had in the year just finished a strong FY11 Group result. I think we built up a lot of progress over the year and with a particular focus on free cash and I think it delivered some very encouraging trends in what is a pretty flat telecommunications market in New Zealand, So we feel strongly about that and I'm delighted that the company's ongoing focus on delivering value through getting it right for customers, our customer satisfaction has improved across the piece of virtually every customer segment.

So running the business has been a big challenge and has delivered some good results, but at the same time we have obviously had some extraordinarily other work to focus on. We won of course 70 per cent or so of the Government's Ultra-Fast Broadband initiative. I mean not in the slide we also won the partnership with Vodafone, the Governments' rural broadband initiative both of which were big, have been enormous projects. We have made and we've got on with it in advance of today's call clearly significant progress

towards the proposed demerger of Chorus, which is required to enable participation in the Government's Ultra-Fast Broadband initiative. As Wayne says, we are pleased that it is unanimous that Telecom's directors and the Independent Expert are of the view that the demerger is in the best interests of Telecom's shareholders.

You know there are many steps on the way to delivering this program, but pleased too that recently the asset allocation plan, the physical asset allocation plan that is part of the demerger has been approved by the Minister of Communications and Technology, Stephen Joyce.

So turning to page 7, you know the demerger is effectively a condition of the Ultra-Fast Broadband contracts and will result in regulatory changes. We believe it will maximise long term value for Telecom's shareholders. Now just an outline some of this is historically for many of you on the call. The New Zealand Government proposed quite some time ago and made a commitment to contribute NZD1.35 billion to roll-out Ultra-Fast Broadband, that is specifically fibre to the premises networks and Government suggested that it reaches 75% of New Zealanders by 2019. Early delivery will be prioritised deployment to schools, hospitals, health service providers and businesses but ultimately over the course of the roll out becoming wide ranging and being available to that 75% target.

On the basis of offering structural separation of our access network business Chorus from Telecom, Chorus was awarded 24 of the 33 candidate areas covering something like 830,000 premises across New Zealand. The chart on the right shows in blue the towns that are covered by Chorus and in other colours by other participants who make up the remaining approximately 30% of the candidate areas. You know therefore, Chorus has access to approximately NZD929 million of Government investment.

There is I should say the potential for Chorus to expand its role beyond the 24 candidate regions by partnering with those other companies selected and discussions are ongoing in respect of that. Overall the encouraging thing here is that winning the bulk of this contract means that Chorus' interests in building the network are aligned with the Government's objectives for Ultra-Fast Broadband which, as I will come to later, in the context of history that alignment I think is very, very important for the ongoing success of the businesses.

Turning to slide 9, and with an overview of the demerger. Chorus' cornerstone role in the initiative and the associated regulatory changes are conditional on Telecom demerging. You know the Government's specific requirement was and is that money would only be offered to organisations that had no retail service provider function. So it was therefore

attractive to businesses who never had such a function or to us if we were prepared to demerge the retail from the network business.

Upon demerger we will create two independent listed entities, Chorus of course which will be the largest telecommunications infrastructure business in New Zealand with approximately 93% share of the fixed line market. Telecom, post demerger will be New Zealand's leading telecoms and IT services provider with number 1 or number 2 market positions across all key markets. The demerger proposal says that eligible shareholders and those eligible in the footnote here, would receive 1 Chorus share for every 5 Telecom shares and the demerger will be implemented by way of the court-approved Scheme Of Arrangement.

In respect of size and weight, Telecom is expected to remain in the NZX50, and the ASX200 and in the MSCI World Standard Index. We will of course continue to be listed in New York, Australia and New Zealand. It is anticipated that Chorus will qualify for inclusion in the NZX50.

Shareholders' votes on the demerger will be at the annual meeting on 26 October 2011, that is the schedule. We aim to complete the demerger by 30 November 2011 and the demerger distribution is expected to qualify for demerger tax relief in New Zealand, Australia and the US

The chart on page 10 is pretty simple and straightforward and just shows the structure, the US shareholders own Telecom New Zealand, operating businesses currently are AAPT in Australia, Chorus the network business in New Zealand and Gen-i our IT services' business in New Zealand and Australia. Our Telecom retail which provides, mobile, fixed and other services in New Zealand and the one with the stripe on it, the wholesale and international businesses which manage the other services to the wholesale market in New Zealand and international connectivity services both to New Zealand players and businesses overseas. The split colours show that that wholesale and international existing function will divide itself between the two new entities which we see on the right-hand side.

Telecom New Zealand shareholders immediately post demerger will have holdings in the two companies, Chorus and Telecom. Chorus itself will comprise the existing Chorus business and that part of wholesale it inherits and Telecom will continue to have wholesale and international, retail, Gen-i and AAPT. The wholesale and international is important,

there continues to be, as you'll see in a minute significant assets in both entities post demerger and those assets will be deployed for both retail and wholesale markets.

The next chart slide 11 is probably the key chart that we will discuss today. To emphasise all Telecom Directors and the Independent Expert are of the view that the benefits of demerger outweigh the disadvantages and the risks. There is a lot more detail about that in the documents' released. I would like to take a high level view. Telecom New Zealand's recent history is dominated by increasing Government actions and regulatory intervention, which we believe makes us one of the most regulated telcos in the world.

What have those actions sought to do? Well they've sought to constrain the commercial freedom of our retail businesses because of the perceived advantage of size and of owning the access network. Those interventions have required infrastructure and other service items to be built you know at shareholder cost ahead of any commercial imperatives to do so. They've sought amongst other things to provide open access to networks and services. So each of those items would be non-commercial in the broader sense of that term. Participation in the UFB project realigns things in a much more favourable way we believe for shareholders. It provides a great benefit of resetting the regulatory framework to something that is more normal. It enables our businesses and shareholders' funds to work and Chorus is much better aligned with Government policy and includes Government funding. It will enable Telecom's retail businesses much better freedom to compete in the market. So that is the elevator speech if you like.

Let me go through the eight points on this chart. Point 1, participation facilitates Chorus taking a leading role in the UFB. Now clearly consumers and businesses the world over are requiring more and more and faster broadband and data services. The overtime customer demand for much higher speed services than typically exists today are going to grow. I do not think there is any doubt about that. Participation here enables New Chorus to lead in that transition in New Zealand from copper to fibre and to take a forefront role in what we would regard as our natural business. Participation really has the financial advantage of Chorus being awarded NZD929 million in funding, which will help build the UFB network ahead of demand and help de-risk the transition to these new capital intensive high speed broadband networks. So it is a very positive advantage in taking part.

I think the alignment of interests of New Chorus with the Government bearing in mind recent history is also very important. You know the Government will have significant investment itself in the Ultra-Fast Broadband network and New Chorus is incentivised

through its agreements with the Government agency, the Crown Fibre Holdings, to drive deployment and uptake.

So point 3, yes participation has those advantages and it also avoids the counter-factual of Telecom having to compete with a Government funded and backed fibre competition. Clearly if the demerger does not proceed it is likely that other parties will be in receipt of NZD929 million of Government investment and will take forward the initiative in those candidate areas. If that occurs, Telecom's copper network and existing business will have to compete with fibre networks operated by other parties and underpinned by Government investment. Indeed not only that, Telecom would in this scenario continue to be bound by some onerous regulation based on the existing fibre network products and services. So we believe that would likely result in the loss of customers and earnings over time. Look we have, directors and management have compared the outcomes of participation including demerger to the alternative where Telecom would have to compete with local fibre companies funded by Government. We consider it clear that demerger is more likely to enhance shareholder value in the long run.

So Item 4 covers regulation, participation leads to the introduction of a simplified regulatory regime with greater certainty reduced further and less associated costs. Look it's summarised on the next page so perhaps you could turn to chart 12. There's a lot of stuff here. I'd like to say firstly that the regulatory changes set out in this chart were in fact enacted on 30 June this year but conditional of course on the successful demerger. Recent history and in particular operational separation and the undertakings that Telecom provided to the Government in 2008 have driven significant operating costs, capital investment and taken management focus away from normally commercial activities and customers towards the meaning of Government objectives. The opportunity cost of the regulation as well as the capital and operating cost has been enormous.

So going through this chart the first regulatory benefit is the abolition of the existing what we call 'three box' operational separation structure. By three box we mean in regulatory terms the division of our business into retail, wholesale and Chorus the access network business with the attendant Chinese walls prescriptions on the build of services and detailed prescriptions on the migration of customers to many new systems and processes. Clearly the abolition of operational separation will result in simplification of the operation and the administration of both companies.

You know I want to stress that the operational separation undertakings and their effective business both in terms of costs of activities and opportunity costs is enormous, and removing it is a big benefit. Already agreed is the whole migration plans driven by the undertakings will be terminated. So this avoids us investing in a non-commercial way on migrations to copper-based systems, you know which are not only costly but actually drive significant customer experience and challenges. So all good.

The second line on the chart is accounting separation. You know we as part of those previous Government undertakings have to publish two sets of accounts. Those normal IFRS and others prescribed on methodologies set by the regulator. You know taking that away is going to reduce costs [unclear] time and present a much more straightforward view of the operations of the company into the market. The accounting separation requirements are relatively unusual in our industry.

Number 3 you know the regulatory regime and the rather onerous regulatory regime in New Zealand has multiple levels of oversight. The Minister for Communications sits at the top, the Ministry of Economic Development works on policy. There is a regulator as you would see in other markets, the Commerce Commission, and we also have this additional layer called the Independent Oversight Group, which would be abolished in these measures. Again reduces costs, time and attention and simplifies the operation of the business.

The fourth line on the chart is ownership restrictions. There are prescriptions in current legislation on the share of Telecom that overseas investors can hold. It is sometimes called the Kiwi Share. Clearly those sorts of Government ownership restrictions present a dampening effect and especially a dampening effect on the stock price of the business and those restrictions will be lifted on the Telecom business under these proposals although it will still exist for the Chorus business.

If we turn to line 5 on the chart, the subsequent points are points for clarification. I think they are all comparatively neutral but let me explain. Number 5 is open access undertakings. Chorus business has significant open access undertakings as existing and under the existing operational separation rules. A new set of open access undertakings which require Chorus [unclear] itself and all access [unclear] is the same, will apply in the new regime.

The TSO is the Telecommunications Services' Obligation, this is a universal term, this obligation that exists in most markets and under these changes that TSO obligation is split

between the two entities. The Chorus business will retain the requirement by connections and the Telecom business, the retail business, will continue to be required to provide free local calling and a light charging regime that is constrained by inflation. Again relatively neutral but there is provision for a review of the TSO in 2013.

Now number 7 is a line of business restrictions. I guess in working through this we were, the Government's requirement was that the winner of the bid did not operate in retail marketplaces and in separating Telecom between its 'retail businesses and network businesses' we've sought to have in the legislation the requirement that Chorus works has a line of business restriction that will prohibit New Chorus from providing services to retail customers. This clearly helps manage the threat of future value erosion for shareholders.

Number 8, there is the introduction in these measures of oversight arrangements on the transitional and sharing agreements that will be set up between New Telecom and New Chorus. You know in order to ensure a smooth and cost effective transition we will share some assets and some services for defined periods of time. The regulator has the ability to oversee those arrangements to ensure that fair play is maintained and we are comfortable with that.

Finally the simplified regulatory regime we believe provide for greater certainty on pricing, on regulated pricing for copper products. UCLL will move now to a nationwide price and the price of UBA will be frozen, unbundled access will be frozen for three years. Certainty is provided over fibre pricing which has been agreed with CFH, Crown Fibre Holdings out to 2019.

So forgive me for going through that I think these are important parts of the package. Let's turn back to slide 11 and I'll move on to point 5. Another key benefit has allowed Telecom and Chorus to further focus on their independent strategies and core competencies. Clearly the demerged entities will have somewhat different business models, certainly different customer bases and industry dynamics and demerger will allow the entities to focus in an unfettered way on their individual strategies and core competencies to a greater extent than they can today. New Telecom will focus on retaining and growing its position in fixed mobile and IT services and New Chorus will focus on building, operating and selling wholesale services on existing and new open access fixed networks.

Number 6 we can tailor the capital structure and financial policies as appropriate between these new entities. You know Chorus will have a capital structure of policies appropriate

for a business in the telco sector that has relatively stable cashflow. It will for example have proportionately greater leverage than has been the case for Telecom. I should say that we believe New Chorus is expected to retain an investment grade rating and that New Telecom will adopt a capital structure consistent with maintaining an A band credit rating.

Turning to point 7 you know with separation and two separately listed entities, we think that a benefit will be that management incentives at Telecom and Chorus can be tailored and aligned to their owners and to their shareholders. Incentives can be more focused on respective shareholders' interests and individual profiles than is currently the case in the integrated Telecom.

Finally point 8, clearly we are presenting to you two entities that have far greater transparency and flexibility for you as investors. The operating risk and the financial characteristics of each will be different and we think may appeal to different investors. The demerger allows investors to choose which entity, if they wish to choose there is more in line with their investment objectives. The reduced complexity and increased transparency will I think give greater insight for investors into the dynamics and to understand each business better. So those eight points and the regulatory resets we believe are the key benefits of the demerger.

So let's turn now to slide 13 and perhaps I could ask our Chairman, Wayne Boyd, to talk through the Boards of each of the entities. Wayne.

Wayne Boyd: Thanks, Paul. We have already announced a couple of weeks ago the Chorus Board. I just might say from a clarification point of view some may be asking why Mark Ratcliffe isn't an Executive Director. That is a decision that the new Board will make when they come into existence. From the Telecom side and the same with Chorus we started a process to appoint directors by developing a capability wheel, which we got buy-in from industry, Board and management. Some of the key capabilities that we were looking for, for this Board were deep telecommunications' industry knowledge, innovation and partnering, customer intelligence and marketing. Financial transformation, process and operations excellence, consumer product development and marketing and telecommunications operations. Then we had another quadrant which related to how the people worked as a team.

The process started off with a long list, I think of about 156 people so it certainly was a challenge to get ourselves down to a working list. But I think the process yielded excellent

results and the identification of what I think everybody should agree is a pool of very strong candidates. The process deliberately sought a mixture of established governance experience and high potential candidates who are earlier in their careers but bring critical skills experience and diversity of thought. Now I think the Boards reflect that because they do bring a wealth of proven, hands-on executive governance or business expertise with an ability to drive financial and business transformation. More importantly all the appointees are able to commit the time that would be required, particularly during the next 12 months. We had that deep telco and technology expertise on T2 and deep utility infrastructure expertise and start up experience on C2. So I think we are delivering a Board with a diverse range of skills and personalities, but that essential diversity of perspective that's necessary in boards these days.

Paul Reynolds: Thank you, Wayne. Turning to slide 14 just a little bit more detail on the assets' split. As I said earlier there are very significant physical assets in each of the new entities. The diagram here is clearly simplified and it's set up to illustrate more the key assets that will be transferred to Chorus, it is certainly not exhaustive. But on the right, just expanding that a bit. Chorus assets will include, 130,000 km of copper network and 27,600 km of already existing fibre network. It will have the majority of the exchanges because clearly it is access focused and most of the exchanges are access network exchanges. It will have the regional but not the national backhaul network, the ability to backhaul within regions to significant points of presence. In order to - it is not just [unclear] connectivity, it includes the access to electronics including DSLAMs for DSL capability that fire up the access network and for data.

The Telecom assets includes, you know a plethora of systems that enable service provision and too many to list here. But at the big ticket level, the mobile networks, we have a nationwide 3G network. We have a CDMA nationwide network which is scheduled to close next year but the mobile networks will be under Telecom. The equipment and facilities to run phone service the PSTN. The core national transport network and international assets, including the AAPT business and the Gen-i business that operate in Australia. Our 50% ownership of the Southern Cross cable network system that provides a substantial part of Australasian connectivity to the Internet. So substantial assets in both entities is the message.

Having said that we don't think anyone has ever separated a telco in this way, this is a world's first and telcos are a very complex set of assets and systems and processes. Now we have made a clean split of the obviously major assets as set out in slide 14. Slide 15

sets out that we have established a series of transitional arrangements in order to reduce the complexity of demerger and certainly to reduce the cost. Some assets will be shared for a period and there will be some long term arrangements too that enable the unpicking of the integrated business in a successful way. These are the arrangements that will be overseen by the regulator for fair play, which is fair enough, I believe.

So Telecom the asset splits there are some transitional arrangements and some long term sharing arrangements. That asset allocation plan has already been approved after you know detailed submission and review with the Minister. The transitional arrangements facilitate the transition of Chorus to a standalone entity and some of these arrangements will be in place for up to 3 years post the demerger. You know in a management sense a working process is set up between Telecom and Chorus both to manage that transition and to manage the achievement of standalone basis over that period of time. It covers shared network equipment, shared office facilities for example. Some accounting and IT systems and support functions you know equipment and IT systems that support our Fulfil, Assure and Bill processes for our key products and services.

The longer term arrangements reduce the duplication of network assets required to deliver cost effective services. You know the last thing any party interested in this scheme wants is you know costs and investments to go up in an unnecessary way. So we can deliver cost effective services through these long term arrangements and ensure ongoing regulatory compliance. This keeps costs well under control. There will be arm's length commercial agreements that are likely to remain in place for the duration of the life of some key assets. For example, the transport radio antennae and feeders, and the big support network routers and longer term sharing and commercial arrangements to manage that sharing

Turning over to slide 16, let's talk about the capital structure and dividend policy and I'll hand over now to Nick Olson, the Finance Director who will cover this. Nick.

Nick Olson: Thank you, Paul. The next few slides as Paul said are going to cover capital structure and dividend policies for both entities and also the division of EBITDA between the two companies. You know a normal caveat the dividend policy for each entity is going to have to be confirmed by the new Boards. As always are subject to their being no material adverse changes in circumstances or operating in outlook. With that caveat aside, let's go on.

Page 16, let's start with the capital structure. New Telecom will target A band rating on a long run basis as it does today. S&P and Moody's expect Telecom to be rated A- and A3 respectively post demerger. Telecom will target a ratio of debt to EBITDA of 1.1 times excluding capitalisation of operating leases. As you are aware there is a debt restructuring process currently underway ahead of demerger. By demerger date we expect Telecom to have net debt between NZD750 million and NZD950 million. The proposed dividend policy for Telecom will continue to be 90% of adjusted net earnings and dividends will be imputed to the greatest extent possible.

Now moving to New Chorus, the liability structure of Chorus has been set up to target Baa2 and BBB ratings from Moody's and S&P respectively. Chorus expects to maintain a ratio of debt to EBITDA of less than 3.5 times on a long run basis. The opening debt for Chorus at demerger will be approximately NZD1.7 billion. Chorus has an interim bridge facility of NZD2 billion available for initial funding and working capital. It is noted there is a process underway to exchange Sterling bonds that were previously issued by Telecom some years ago to term debt obligations of Chorus with the maturity of 2020. That will underpin the long term nature of its liability structure.

In addition Chorus is seeking to arrange a NZD1 billion syndicated debt facility with a term of up to 5 years. Again subject to confirmation by the New Chorus Board and the normal caveats above, Chorus expects to pay a prorated FY12 dividend of NZD0.25 per share for the year ended 30 June 2012.

There are a number of issues that were considered when setting the Chorus dividend policy for FY12 and I'll just quickly run through them. CapEx of working capital commitments under the UFB contract, maintenance of the existing copper network. I note that a number of analysts have aggressively reduced their spend on the copper network in their models. But we note that the copper network must continue to meet TSO obligations and to support a large rural network, so caution there. Continuing investment in wholesale equipment for copper-based broadband EGD plans and CapEx associated with separation of Chorus and the establishment of new fibre products and support systems. So all of those things were a consideration when we thought about the FY12 dividend policy.

Finally on this slide demerger transaction costs are expected to be in the range of NZD85 million to NZD120 million, and these are transaction costs. These include bank facility fees, legal, investment banking and accounting advisory fees. Independent Expert's report, communications costs, debt restructuring costs and as you can imagine there is a

plethora of small expenses that we incur when we are running a transaction of this scale. In addition, from 1 July to the demerger date Telecom expects to incur up to NZD30 million of costs as we prepare for demerger at an operational level. A reality of moving to a demerged state is that the combined corporate overheads for Chorus and Telecom will be higher than it is today. So you should just note that, it is not hugely material but it is a cost. Finally New Telecom and New Chorus are expected to incur additional costs over time as they set up independent systems and network equipment.

Now moving to slide 17, the markets certainly had a snapshot of this because we have released quite a bit of this information as part of the debt restructuring exercise a few weeks back. But here we're aiming to provide high level EBITDA split between Chorus and Telecom. We have provided an EBITDA snapshot from the most recent adjusted results from 30 June. The special purpose financial statements, we call those carve out accounts and pro forma accounts, all for the year ended 30 June 2011, so it is historic.

Focusing on the left-hand column on page 17, at a business unit level under operational separation, Chorus EBITDA was NZD806 million and I'll use Chorus to anchor this slide. The carve out column in the middle is an intermediate step. Carve out accounts, by the way are a requirement of law and they hopefully provide some insight into the pro forma presentation. The carve out simply split our statutory accounts between Chorus and other business units as the business units operated in FY11.

Now moving to the right-hand column, the pro forma presentation provides additional insight by incorporating certain aspects of the demerger. The pro formas capture the impact of the demerger as if it had happened on 1 July 2010 for the [PML]. On the basis of the pro formas New Telecom's adjusted EBITDA for FY11 was NZD1.125 billion on an adjusted basis and New Chorus was NZD676 million. The material items that impacted Chorus' pro forma EBITDA relative to the Group result reported at 30 June are as follows. Regulated layer 2 revenue from costs from wholesale, marginally positive. Allocation of Corporate & TSS&S costs negative and new commercial arrangements for products and services between Chorus and Telecom accounts for the majority on the decline. This also reflects the burden of TSO costs now falling on Chorus.

With that I'll hand back to Paul.

Paul Reynolds: Thanks, Nick and moving quickly now to conclude turn to slide 18. We made the announcement in May 2011, we have been working pretty hard and here we are 13 September with the release of the Scheme Booklet. We expect to go to the shareholder

vote at the annual meeting on 26 October. The final court approval in November and the trading of Chorus shares on NZ and ASX late November. The demerger effective date of 30 November 2011. There is lots more communication to come. We have a very detailed investor engagement plan to be undertaken prior to the vote. We will, Nick and I and Mark Ratcliffe and Brian Hall are involved in institutional investor roadshows for Telecom and Chorus including meetings in NZ, Australia, US, Asia and the UK. With detailed retail roadshows in New Zealand and Telebond meetings in New Zealand too. So lots more to come and further opportunities to get under this and ask some questions.

So just to conclude, we are pleased to be able to release a pretty comprehensive set of information today. Our Directors all believe that demerger is in the best interests of the shareholders, facilitates participation our interests with Government, it avoids competition unnecessary competition and it creates a simplified regulatory regime. It will, we believe create long term value for shareholders and please read the material.

So thank you and perhaps we could now move to questions.

Operator: Thank you. Ladies and gentlemen if you have a question please press the * followed by the 1 on your touchtone phone. If you would like to withdraw your question, please press the * followed by the 2. If you are using speaker equipment you will need to lift the handset before making your selection. The first question comes from David Kaynes of Merrill Lynch. Please go ahead, David.

David Kaynes: (Merrill Lynch, Analyst) Thanks guys, David Kaynes here. Just a couple of questions.

Paul Reynolds: Hello.

David Kaynes: (Merrill Lynch, Analyst) Hi, just a couple of questions on your capital structure and then one on asset allocation. In your - just if I can confirm your, you have used different definitions of net debt for Telecom and Chorus. Is the difference there where you've got net interest bearing debt and for Chorus net debt, is that simply the treatment of lease capitalisation and the CFH securities? I'm just wanting to confirm you are - they are both net of cash and including all of your derivative liabilities?

Nick Olson: Okay, net debt gross debt less cash we do add in the Crown Fibre Holding's debt securities and depending on the treatment from the rating agencies, we also add a portion of the Crown Fibre equities' security and each of Moody's and S&P treat that slightly differently. I think that captures the whole question, doesn't it?

David Kaynes: (Merrill Lynch, Analyst) Yes it does, thanks. Just on the dividend, am I right in thinking Chorus will - there will be no dividend first half and it should be NZD0.125 paid in the second half?

Nick Olson: No.

David Kaynes: (Merrill Lynch, Analyst) No, okay.

Nick Olson: That's not quite right. Yes NZD0.25 is going to be prorated and - for seven months.

David Kaynes: (Merrill Lynch, Analyst) Your guidance is NZD0.25 for the full year, but I think from looking through your scheme documents there would be no dividend paid first half, is that not correct?

Nick Olson: That is correct.

David Kaynes: (Merrill Lynch, Analyst) That is correct, and then just on the your asset allocation. I'm wondering how much flexibility you have to change or to transfer assets between the two entities post demerger? Because I note that you've got, you know the 30 major exchanges staying with New Telecom but I assume that within those Chorus would still own the DSLAMS and the access equipment within those 30 exchanges, is that correct?

Paul Reynolds: DSLAMS and access equipment is owned by Chorus. I guess these sorts of assets work at multiple levels. You know there's the physical building and there's the network terminations and the service equipment that's in those buildings. The key notes are part of the Telecom assets that reflect New Telecom's need to have a major presence to run services. There's the points where we'll have Chorus items in them and they will be traded and the commercial arrangements as per normal. Post demerger could assets shift between the entities? Well possibly, I mean let me be clear, what we've set out here is what we think is a sensible, workable set up of two businesses. It's not based on any artificiality but you know if over time some better commercial arrangement seemed appropriate well in a normal commercial way one could negotiate it.

David Kaynes: (Merrill Lynch, Analyst) Yes, okay thank you.

Paul Reynolds: Okay. Another question please?

Operator: Yes the next question comes from Mark McDonnell of BBYT, please go ahead, Mark.

Mark McDonnell: (BBYT, Analyst) Thank you.

Paul Reynolds: Hey, Mark.

Mark McDonnell: (BBYT, Analyst) Hi thanks guys and good morning.

Paul Reynolds: Good morning.

Mark McDonnell: (BBYT, Analyst) A couple from me, firstly on the operational side, just a couple of points of clarification. Paul, when you talk about the wholesale activities for New Telecom I'm just wondering does that mean that for example you'd be selling the national backhaul to Chorus or can you deal directly with your retail competitors at the wholesale level for those underlying assets?

Paul Reynolds: Yes we deal directly with other players in the market place. You know so for example we already offer an MV&O mobile virtual services so that's the sort of service that we would provide. We provide and sell managed backhaul services to other carriers in the industry. We continue to do so in much the same way as other players in the New Zealand industry do too. The major other players in New Zealand generally do not have detailed access networks. But they have certain networks and systems somewhat comparable to what would be in the G2 albeit in a smaller scale. Most of the big players wholesale them in some way too. So that, you know wholesale is a good normal business and you know will be pursued directly with other parties from Telecom.

Mark McDonnell: (BBYT, Analyst) Thank you. Related to that, I'm just wondering about the forward looking scope for operational flexibility particularly with respect to direct investment in your own networks and competition from mobile. Are there any restrictions placed on you in your dealings with Chorus? Is there an exclusivity provision or are you in anyway restricted from continuing to invest independently in your own network capacity going forward?

Paul Reynolds: No restrictions. Clearly Chorus will be our biggest supplier of access network and we will be their biggest customer, so that will be a very strong commercial relationship. But Telecom is free to invest and develop its products and services portfolio however it sees fit going forward.

Mark McDonnell: (BBYT, Analyst) Thank you, and just on that you also mentioned pricing had been agreed with Crown Fibre Holdings to 2019. I assume that's by Chorus? Is there an agreement between Telecom and Chorus in respect of the prices that Telecom will pay?

Paul Reynolds: Well the contracts with Crown Fibre Holdings which will be held by Chorus set out wholesale prices for defined products and services that will be offered to the whole market. So Telecom and for that matter, Vodafone, Telstra and other players in the New Zealand market will each get the same price for defined, regulated services going forward. A wholesale input price if you like, Mark. Each service provider will then add what they have to add to deliver a service and will make its own choice in terms of you know retail pricing.

Mark McDonnell: (BBYT, Analyst) Okay and just to be clear. Those prices are agreed out to 2019?

Paul Reynolds: Yes.

Mark McDonnell: (BBYT, Analyst) Thank you, and the last one from me. There was a footnote relating to a ban on Telecom using UCLL to 2013. I was just wondering if you could elaborate on the rationale for that? Its implications with respect to the services that you'd acquire in lieu of that and how that would play into your competitive position?

Paul Reynolds: Yes well first of all think about Telecom pre-demergers as an integrated entity. We are the biggest player in delivering broadband services in New Zealand and we do it on the back of assets that will post-demergers fall - a large part of which will fall into Chorus. I guess from Crown Fibre Holdings' point of view during negotiation one thing they were concerned with was that Telecom immediately post-demergers wasn't going to run off and undermine the Chorus business by building an alternate broadband network based on UCLL. So there's a three year transitional amnesty if you like on that one. After that period Telecom would in respect of those services would take whatever commercial decision it needed to.

To be frank, not an awfully difficult thing to agree to. You know we deliver good service and we are competitive in the market place. We think we can continue to be so using Chorus inputs in Telecom post-demergers.

Mark McDonnell: (BBYT, Analyst) Thanks very much.

Paul Reynolds: Thanks, Mark.

Operator: The next question comes from Laurent Horrut of J.P. Morgan, go ahead please, Laurent.

Laurent Horrut: (J.P. Morgan, Analyst) Good morning, guys, how are you?

Paul Reynolds: Okay, how are you?

Laurent Horrut: (J.P. Morgan, Analyst) Yes, good thank you. Two questions from me, just to follow up on an earlier point. Is there anything in the contract with CFH that sort of restricts your ability to compete by deploying new technology, different wireless technology? I am just thinking about that in the context of a similar sort of provision in the contract between Telstra and NBN Co on anti-sledding for example clauses. I'd be interested if you could clarify that. The second question, Nick mentioned some incremental costs going forward as a result of the demerger, which I would sort of qualify as operational inefficiencies. Just interested to maybe explore a bit that point and if there was any chance we could get some quantification on that number?

Paul Reynolds: Okay, so I'll ask Nick to comment on that in a moment. But with respect to your first question part, Mark Ratcliffe, CEO of Chorus is on the line. So Mark would you like to comment in respect of service development restrictions in Chorus?

Mark Ratcliffe: Yes there are no service restrictions, what we have agreed with CFH is that in areas where we are the chosen partner we won't make further investments in enhanced services on the copper network. We have already got a BDSL program that's well established. That program will continue to run out but we won't make investments in a sort of further generations of BDSL or DSL based equipment. We will focus on fibre both in the regions that we've won, in those regions where we are not the partner for Ultra-Fast Broadband we will be free to compete with whatever technology we've got, fibre and copper.

Laurent Horrut: (J.P. Morgan, Analyst) Okay.

Paul Reynolds: Thank you, Mark, look someone just whispered to me that perhaps Laurent you were also interested in Telecom's restrictions?

Laurent Horrut: (J.P. Morgan, Analyst) Absolutely, in fact that was the point of the question actually, are you...

Paul Reynolds: We don't have any.

Laurent Horrut: (J.P. Morgan, Analyst) So you can push any type of wireless services into UFB footprints as you see fit?

Paul Reynolds: Absolutely, there are none, nyet, none.

Laurent Horrut: (J.P. Morgan, Analyst) Okay, that's great, thank you.

Paul Reynolds: So Nick, you can talk about incremental costs?

Nick Olson: No, Laurent, we are going to very carefully avoid making forward looking statements but I am going to kick to touch on that one. But we just want to signal that obviously as these organisations are split, each entity will at some point start building its own infrastructure. So you just have to form a view on what that might mean.

Laurent Horrut: (J.P. Morgan, Analyst) Okay.

Nick Olson: ... were off.

Laurent Horrut: (J.P. Morgan, Analyst) Thank you.

Paul Reynolds: Can we take another question please?

Operator: Yes the next question comes from Alan Stewart of RBS, please go ahead, Alan.

Alan Stewart: (RBS, Analyst) Hello, good morning. I have two questions, I guess firstly to start off with on the Chorus business if you look at your pro forma unaudited accounts I think your CapEx to sales is about 41% on that unaudited numbers. What do you see as an appropriate CapEx to sales target for that business excluding the actual UFB costs? Secondly, my second one was really around that separation costs. I know you've said you can't really make any forward looking statements, but I guess my understanding was your operational separation costs cost you around about NZD480 million? Is it in that kind of ballpark we should be considering these additional costs that you face? I guess lastly, one extra one is can you give us any idea of the incremental corporate costs that you're going to incur as well?

Paul Reynolds: Look Alan, to the last point, incremental corporate costs, I'm not going to give you a number. But you could calculate it yourself. You know just formulate a small corporate centre and add up the staff costs, you know it's fairly straightforward. In terms of separation costs look no I don't think you can take any indication from that number that you quoted and parley it into this equation. Offset was point 1 broke the back of separation, the back of the cost of separation for Telecom. It was enormously complex and expensive. I think the way you should, I'm not going to give you a figure clearly but I think the way you should think about it in your models is the job was mostly done so in comparative terms we're in the thin end of that program of work, okay?

As regards CapEx to sales, I'm not going to give you a forecast. You make a calculation and stuff, clearly you know there's a lot of predictability in the Chorus business and there's a deal of work to be done to continue to maintain, not build, but maintain the

copper network. We will build out the fibre network. You can do some sums here and there will be more information as we get going.

Alan Stewart: (RBS, Analyst) Okay, thanks.

Paul Reynolds: Thank you, another question please.

Operator: The next question comes from Guy Hallwright of Forsyth Barr, go ahead please, Guy.

Guy Hallwright: (Forsyth Barr, Analyst) Oh good morning.

Paul Reynolds: Morning Guy.

Guy Hallwright: (Forsyth Barr, Analyst) Hi.

Paul Reynolds: Morning.

Guy Hallwright: (Forsyth Barr, Analyst) A couple of things, firstly can you give us any idea, when you get to the end of financial year 12 how are you going to present all of this when you come to your sort of final end of year accounts? I mean Telecom presumably you'll have five months of consolidated figures and then you'll have seven months of New Telecom. Are you going to go back and pro forma the first five months? Likewise for Chorus are you just going to do a seven month figure or are you going to pro forma the first five months?

Nick Olson: Guy, actually I'll just give you a feel, Guy, but I think we could spend half an hour talking about this. It's not going to be easy for the analyst community, I can tell you that. But essentially Chorus will become a discontinued operation for the half year results.

Guy Hallwright: (Forsyth Barr, Analyst) Okay.

Nick Olson: And that will flow through to the full year result obviously. I'd actually prefer that we just pick through that offline, if that's okay?

Guy Hallwright: (Forsyth Barr, Analyst) Okay, all right. Secondly I know you are carefully avoiding any forward looking statements, but in the documents you've released there is of course the Grant Samuel Report which does have FY12 EBITDA figures for both entities. Now you are probably not going to confirm nor deny those, but can you just talk about the process? You know the process that you, I mean you've obviously worked with Grant Samuel on this or the kind of access they had to come up with those projections?

Paul Reynolds: So you are right, we are not going to confirm or deny, Guy. Look Grant Samuel are a reputable independent expert you know that. We've opened - we've been

very open with them given them all the information they needed. They've set out their views, which are their views and you know you take them at their merits and on their reputation. We should leave it at that.

Guy Hallwright: (Forsyth Barr, Analyst) Okay, but you, but they have had sort of a fairly full access?

Paul Reynolds: Oh very much so, very much so.

Guy Hallwright: (Forsyth Barr, Analyst) Okay, great, that's all I have at the moment, thank you.

Paul Reynolds: Thanks, Guy. Another question please?

Operator: Yes the next question comes from Mark Blackwell of Morgan Stanley, please go ahead, Mark.

Mark Stanley: (Morgan Stanley, Analyst) Yes, good morning guys.

Paul Reynolds: Morning, Mark.

Mark Stanley: (Morgan Stanley, Analyst) A few questions. Firstly I was wondering if you could give me a bit of colour on the decision to include the national core network in the New Telecom business? I guess given its infrastructure I'd kind of expected it might have been included in Chorus. But obviously you announced that a few weeks ago, I just wonder if you could give us a bit of colour on that decision?

Paul Reynolds: Yes, okay, well look, New Telecom is designed to be a competitive small retail service provider. You know as a competitive small retail service provider in markets across the world would typically have a national core network on which to build data and voice services and on which to innovate. So the decision - it's the natural organisation of the industry. It's the natural business model and operating model if you like for a substantial retail service provider. I think you can also look at it the other way around. You can say that the Chorus business is essentially a stable access network business mostly regulated. In structures again around the world if you like there is actually like a bottleneck is at the access network as defined in Chorus. So both sides of the equation this is the way you organise the industry.

Back to your point, what you don't do is throw assets from one entity or the other from a strictly financial viewpoint. You know you must take account of how the business operates and what's naturally, what falls naturally in each entity in order that the right decision

rights for innovation and customer service development are in place. That's what's driven it.

Mark Stanley: (Morgan Stanley, Analyst) Okay, so that means that any other access or retail access network will be required to either own its own backhaul or buy backhaul from someone else if that's correct, right?

Paul Reynolds: So other, if you look at competitors in the New Zealand market or indeed the Australian market or anywhere in the world, but take New Zealand. You know Telstra, Vodafone, two of the biggest competitors have their own national backhaul networks. They compete with Telecom in this and they to some extent and varying degrees wholesale those backhaul networks as Telecom will do. There is nothing required here. This is going to be a competitive market place and these are the assets required to compete effectively.

Mark Stanley: (Morgan Stanley, Analyst) Okay, good thanks for that. Just a second question the last one was the 90% payout ratio on New Telecom is that an indication in a way of the sort of the growth possibilities of the growth outlook for that business. It sort of, it's a fairly high payout ratio I suppose in general terms, maybe not in telco terms but in general terms. Is that sort of indicative of what the growth opportunities for New Telecom are relatively modest or...

Paul Reynolds: Stop, I'm not going to sneak in a forward looking statement on the [unclear] derived figure from the dividend policy. Suffice it to say it is Telecom pre-demerger is our existing dividend policy. It's one that we can live with comfortably financially. Indeed if you look at our recent results we also paid a special dividend on top and then looking at our financials and moving into demerger we feel comfortable with it for FY12. The new Board of Telecom will take its own view in due course.

Mark Stanley: (Morgan Stanley, Analyst) Okay, Paul, thanks for your help, bye.

Paul Reynolds: Cheers. Another question please?

Operator: The next question comes from Lance Reynolds of UBS. Go ahead please, Lance.

Paul Reynolds: G'day Lance.

Lance Reynolds: (UBS, Analyst) G'day, mate a couple of questions. Two relate to the grant Samuels' report, which hopefully you can shed some light on. Just firstly on wireless penetration. I note that on page 70 it says if fixed to mobile substitution is high, Telecom will be better off under a compete scenario. Could you give us a feel for what base case

they were using, given that's kind of the only comment in the 500 pages which kind of flip that view? Also in relation to that if I could get some help on the sensitivity table on page 72. The way I read it is a 5% change in wireless generates a NZD170 million value change, which is quite significant. But if you look at that on a wireless penetration standpoint, it's only about 75 basis points. I just want to check whether that's actually penetration or actual absolute numbers? That's kind of my first question. Second question is the other kind of relatively strong swing factor here is obviously long run returns on New Chorus. Could you give us a guide on what Grant Samuels used as a kind of basis or terms of - some type of return on asset base, ROI? Thirdly if I could ask for a backward looking comment, if the demerger was to take place a year ago, could you backward look and tell me what the extra OpEx would have been.

[Laughter]

Paul Reynolds: Full marks for that one, that's a cracker. The answer is no I can't tell you because it would be a forward looking statement, so I'm sorry. Look I think that the IR team can help you with some of these things. You know Grant Samuels' work is Grant Samuels' but I don't want to avoid the thrust of your question, which is, is fixed mobile substitution a big sensitivity? Well it is, you know if one believed that people didn't need fixed line connections in the future. If one believed that you know substantial numbers of premises would not need them they would work off wireless only, it would make a difference to the economics from what we have assumed.

We have assumed continuing fixed mobile substitution but not, but certainly well short of if you like mobile replacement of fixed. Because the physics just don't enable it. You know mobile networks are shared. Every generation of technology is the same, it goes faster with every generation but the speeds drop as it's shared by multiple users. So there's a constraint on speed as take up is rolled into place. So our vision of the industry and I think it is shared widely around the world is that fixed, you know high speed fixed networks based on fibre to the premises and high speed mobile networks will co-exist. The way to think about it really is that at the end of every fibre in each premise there is likely to be a radio in the future. You know because people don't want to be tethered by a wire but services require both and the notion of fixed mobile substitution dramatically reducing the need for fixed lines is not one that we subscribe to. But it is a sensitivity.

Lance Reynolds: (UBS, Analyst) And the...

Paul Reynolds: [Over speaking]

Lance Reynolds: (UBS, Analyst) And the return on assets on Chorus 2?

Paul Reynolds: I'm not going to give a figure on that, but if you want to chat to Stefan and the guys who you can point to the pages you're looking at.

Lance Reynolds: (UBS, Analyst) Yes that would be great. I mean my final kind of comment would be, which I've had I guess for a year or so is, it says also on page 73 that you guys had a large degree of confidence or you know a large degree of confidence on the compete scenario assumptions. Did you consider telling us what those assumptions were at any point; were you restricted to - what was your process around not actually presenting the counter factual?

Paul Reynolds: Look what we've done is clearly to model in some detail to satisfy ourselves given everything we can see against the existing and future metrics what are the likely outcomes under compete and cooperate. The Board has come to a clear conclusion that cooperating or participation in UFB gives us the best outcome. But we are stopping short clearly and are not going to model these things or present models to the market. I mean, Lance, you are well capable of doing that yourself. We're telling you what our conclusion is you know I think my sense is that it's supported by most in the market place but you are obviously at liberty to make your own.

Lance Reynolds: (UBS, Analyst) Okay thanks for that.

Paul Reynolds: Thank you. Another question please?

Operator: I would like to advise there are no further questions at this time.

Paul Reynolds: Okay, well thank you very much ladies and gentlemen. A big day as I said and we will be coming around your way sometime soon and I hope to see you in person and take your more detailed questions once you have had time to digest the volume of information that's out there. Thank you for taking part today and good morning or good afternoon depending on where you are in the world. Bye bye.

Operator: Ladies and gentlemen, this concludes the Telecom New Zealand conference call. This conference will be available for replay after 1.30pm today New Zealand time through to midnight New Zealand time 13 September 2011. You may access the replay system at any time by dialling Australia international metered +61293740998, Australia local metered, 02937409998. Hong Kong, +852 30562777, Singapore toll free 8001012554 and entering the access code of 4471696. Thank you for your participation, you may now disconnect.

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