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STOCK EXCHANGE ANNOUNCEMENT

26 March 2021

Chorus Initial Asset Value Model Overview

Chorus is submitting a comprehensive Initial Asset Value model to the Commerce Commission today as required under the Price-Quality process. This model is compliant with the Commission's Input Methodologies requirements and supports a solid, but conservative, starting Regulated Asset Base (RAB) of \$5.5 billion for Chorus' fixed line fibre access services at 1 January 2022.

In addition, Chorus has provided an alternative cost allocation approach that supports potential RAB outcomes between \$5.5 billion and \$6 billion. We believe the Commission could consider this approach because it better reflects the full costs of structural separation required by the public-private partnership with the Government.

Chorus CFO David Collins said it's important that initial regulatory settings deliver on the policy goal of a smooth transition for consumers and investors.

"The Commission has a number of mechanisms at its disposal to achieve this. The models we're submitting have required extensive work and were developed by international experts Analysys Mason who have undertaken similar network analysis for regulators and network operators overseas.

"This analysis should enable the Commission to move reasonably rapidly in progressing its draft Price-Quality Determination due in the coming months and we look forward to working constructively with them," he said.

Based on Chorus' indicative revenue modelling, the Initial Asset Value model of \$5.5 billion indicates an estimated maximum allowable revenue range of \$715 million to \$755 million per annum in the first regulatory period from January 2022 to December 2024.

"While the preliminary estimated revenue range broadly aligns with Chorus' forecast fibre revenues for this initial period, it leaves no room for unintended consequences. Poor outcomes for consumers and perverse incentives for Chorus could arise if the revenue cap ends up constraining our natural expected rate of growth.

"Consumers are currently benefitting from strong network investment, incentives to encourage fibre uptake and the ongoing development of new and higher-speed products. Chorus would have limited incentives to keep growing and enhancing fibre services if the cap is met when fibre uptake has only just reached 63%.

“The regulatory framework is being determined at a time when interest rates are at historic lows and potential WACC outcomes for Chorus of around 4.4% are significantly below the 5.8% WACC announced by Ofcom in the UK just last week for fibre networks,” Mr Collins said.

Following the finalisation of the initial asset value model, Chorus has applied consistent cost allocations methodology to expenditure for the first three-year regulatory period. The refinement of shared costs in the modelling means the allocation of operating expenditure to regulated fibre services has reduced from \$625 million to \$550 million and this is reflected in Chorus’ estimated maximum allowable revenue range.

A presentation overview of the Initial Asset Value model Chorus has submitted to the Commerce Commission is attached. An audio conference briefing to discuss the presentation will be held at 10am (NZ time) for investors and analysts.

To join the audio conference, please use one of the following numbers and the pin code: 21814790#

- New Zealand: 0800 452 257
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Initial Asset Value Model

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- Should be read in conjunction with Chorus' audited consolidated financial statements for the year to 30 June 2020 and NZX and ASX market releases.
- Includes non-GAAP financial measures such as "EBITDA". These measures do not have a standardised meaning prescribed by GAAP and therefore may not be comparable to similar financial information presented by other entities. They should not be used in substitution for, or isolation of, Chorus' audited consolidated financial statements. We monitor EBITDA as a key performance indicator and we believe it assists investors in assessing the performance of the core operations of our business.
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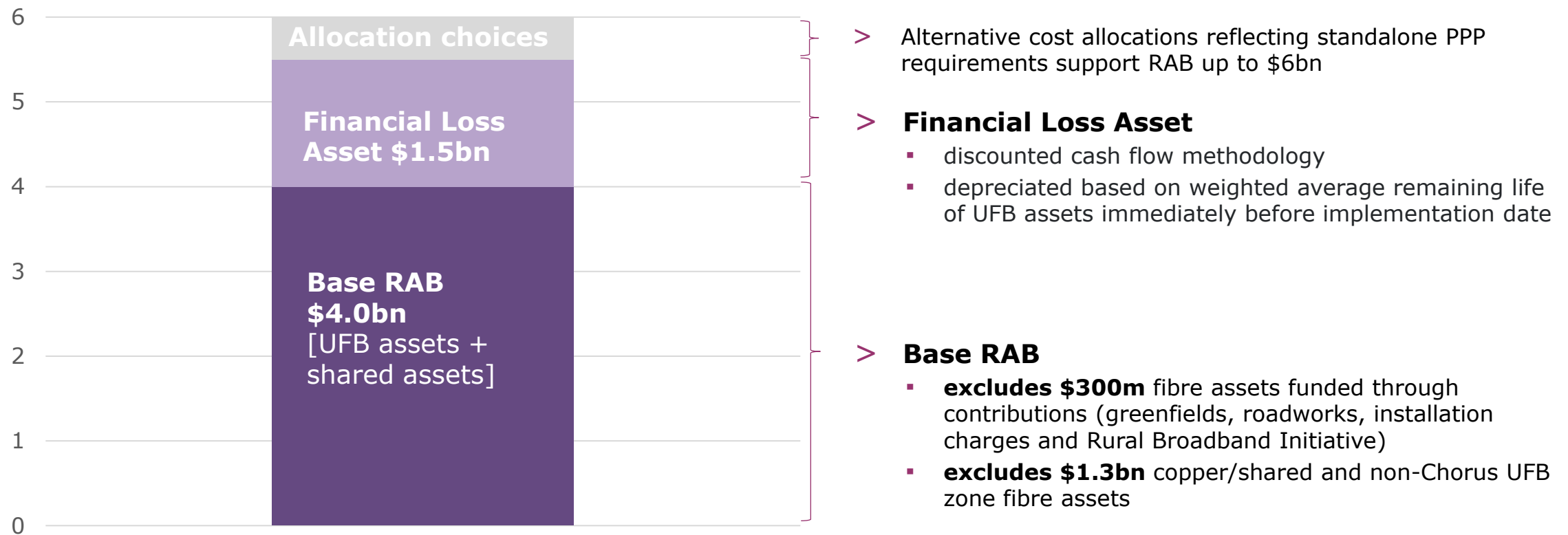
IAV model supports solid, conservative RAB of \$5.5bn

Alternative cost allocation approaches that reflect the full costs of Chorus' standalone participation in the fibre PPP support a range of \$5.5 to \$6 billion

- > **Initial Asset Value (IAV) model is compliant with the Commerce Commission's Input Methodologies requirements**
 - independently audited for accuracy and compliance, approved by the Chorus Board
 - extensive work by international experts Analysys Mason who supported Chorus' copper services review in 2014/2015
 - should enable the Commission to move reasonably rapidly in progressing its draft Price-Quality Determination
- > **IAV model indicates an estimated maximum allowable revenue range of \$715 million to \$755 million p.a. for RP1**
 - this range broadly aligns with Chorus' forecast fibre revenues for RP1 but leaves little room for unintended consequences
 - poor outcomes for consumers and perverse incentives for Chorus could arise if the revenue cap constrains Chorus' natural expected rate of growth
 - MAR estimate is subject to finalisation of 3-year risk free rate
 - MAR model to be provided to Commerce Commission in April
- > **Expenditure views updated following finalisation of IAV model**
 - consistent cost allocation methodology has been applied to expenditure for RP1 previously presented on 17 December
 - allocation of operating expenditure to regulated fibre services has reduced from \$625 million to \$550 million from December
 - the update results in non-material changes to capital expenditure

Base RAB of \$4.0bn, plus Financial Loss Asset \$1.5bn

Conservative base case RAB of \$5.5 billion at 1 January 2022



\$5.5bn RAB composition: balance sheet view

Asset type	Unallocated Asset Value*	Price-Quality Fibre RAB*	Proportion allocated to Fibre RAB
Copper cable	\$0.3bn	\$0	0%
Fibre cable	\$1.8bn	\$1.6bn	90%
Ducts, manholes, poles	\$2.3bn	\$1.8bn	86%
Property	\$0.3bn	\$0.1bn	37%
Cabinets, Transport, Layer 2, IT and miscellaneous	\$0.6bn	\$0.5bn	78%
Base Asset Value	\$5.3bn	\$4.0bn	75%
Add Financial Loss Asset	\$1.5bn	\$1.5bn	100%
TOTAL ASSET VALUE	\$6.8bn	\$5.5bn**	84%

*Gross asset values are rounded to nearest \$100m and represent written down values per the statutory accounts as at 30 June 2020, plus forecast capex to 31 December 2021, less forecast depreciation (straight-line depreciation as contemplated by Input Methodologies).

** Excludes \$0.3bn of fibre assets part or wholly funded with capital contributions or government funding after allocation.

Financial Loss Asset calculation

Financial Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Post-tax WACC	6.66%	6.10%	7.05%	6.55%	6.02%	5.86%	5.54%	5.35%	4.73%	4.29%	4.61%
UFB closing asset value*	\$0.2bn	\$0.6bn	\$1bn	\$1.3bn	\$1.6bn	\$2bn	\$2.4bn	\$2.9bn	\$3.3bn	\$3.7bn	\$3.8bn
PV of UFB revenue <i>Compounding factor (revenue date)</i>	\$-bn 1.87	\$0.1bn 1.69	\$0.1bn 1.71	\$0.1bn 1.55	\$0.1bn 1.41	\$0.2bn 1.32	\$0.3bn 1.23	\$0.4bn 1.16	\$0.5bn 1.09	\$0.5bn 1.04	\$0.3bn 1.01
PV of UFB capex, opex and tax** <i>Compounding factor (mid-year date)</i>	\$0.3bn 1.88	\$0.9bn 1.70	\$0.9bn 1.72	\$0.9bn 1.56	\$0.7bn 1.42	\$0.8bn 1.33	\$0.9bn 1.24	\$1bn 1.17	\$0.8bn 1.1	\$0.8bn 1.04	\$0.3bn 1.01
PV of annual net cash flows	-\$0.3bn	-\$0.8bn	-\$0.8bn	-\$0.8bn	-\$0.6bn	-\$0.6bn	-\$0.6bn	-\$0.6bn	-\$0.3bn	-\$0.3bn	\$0bn
PV of total net cash flows (1/1/2022)											-\$5.7bn
<u>Plus</u> UFB loss asset base closing value (1/1/2022)											\$3.8bn
<u>Plus</u> PV of Crown Financing benefit***											\$0.4bn
TOTAL FINANCIAL LOSSES											-\$1.5bn

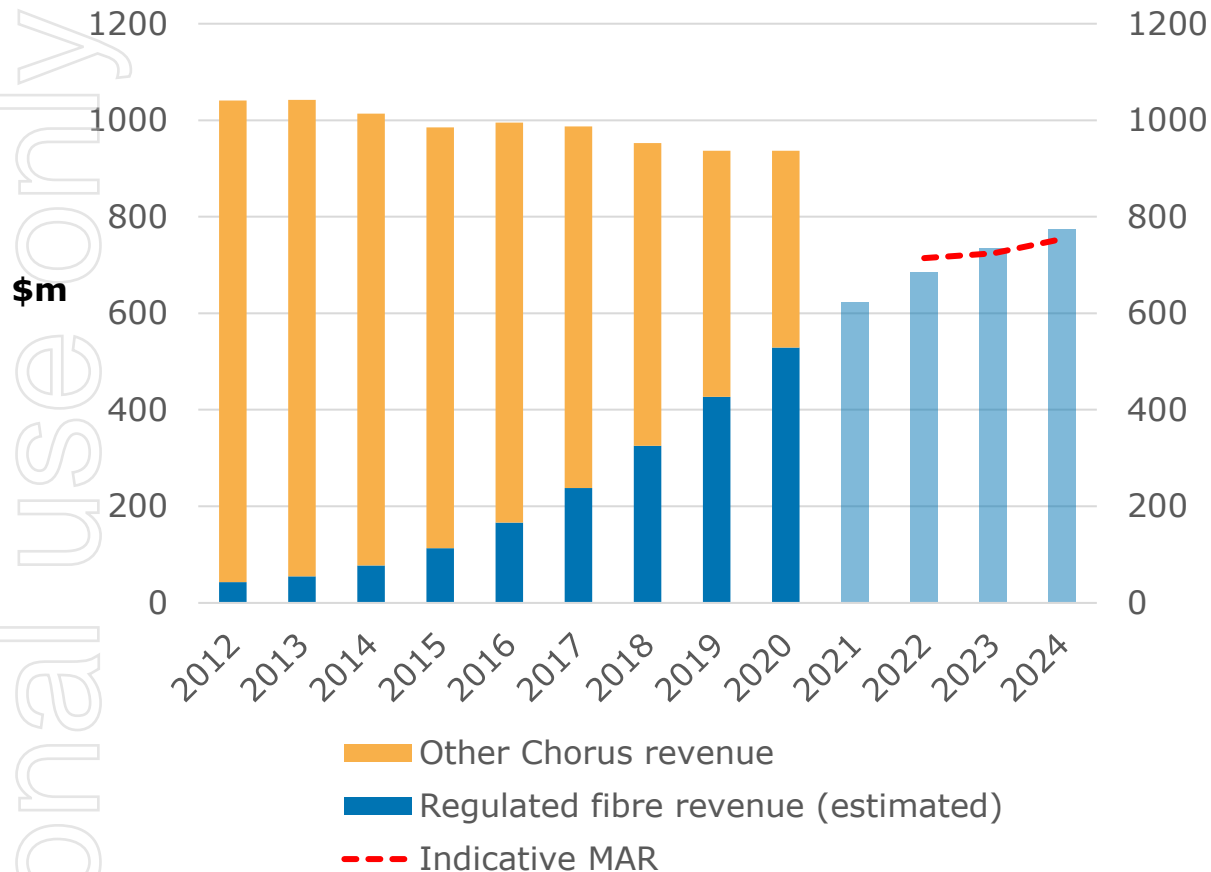
Note: table totals are rounded to nearest \$100m

* Starting UFB asset of ~\$30m with depreciation based on statutory accounting rates. Only includes assets in Chorus UFB areas.

** Tax payments assumed at 0 due to existing tax losses

*** Reflects the Commission's treatment of avoided costs due to concessionary government funding for the UFB project.

MAR broadly in line with forecast fibre revenues



Note: Assessment of FFLAS revenue is based on final Input Methodologies. Subject to completion of Commerce Commission process.

> **Indicative MAR range of \$715m-\$755m per annum aligns with revenue forecast and is based on conservative base case RAB of \$5.5 billion**

- consistent with current FY21-25 Board approved 5-year plan
- reflects estimated 3-year risk-free rate of 0.30% at beginning of March: actual rate will be set based on 3-month average ending 31 May
- constrained by carry forward tax losses in RP1 resulting in zero tax building block
- MAR excludes capital contributions (e.g. greenfields, Rural Broadband Initiative) and FFLAS in LFC areas

> **MAR in first regulatory period (RP1) should be above forecast revenues to:**

- avoid constraining Chorus' natural expected rate of growth given uptake is only 63%
- retain incentives for Chorus to continue investing in better consumer outcomes (e.g. fibre uptake, new and higher-speed products)
- deliver on government policy goals of a smooth transition for consumers and investors

UPDATE: indicative FFLAS share of FY20 statutory opex

We estimate FFLAS opex was 47% of FY20 total opex

- > Reduction from 55% estimate in December reflects updated cost allocations to align with Initial Asset valuation Model
- > FFLAS proportion of opex is expected to increase significantly as fibre uptake grows and the copper network is retired
- > FY20 – FFLAS (indicative):
 - includes passthrough costs of \$10m
 - excludes IFRS 16 finance leases (treated as network fixed assets in FY20 statutory reporting)

	FY20 reported \$m	UPDATED: FY20 – FFLAS (indicative) \$m	Prior Dec 17 th FFLAS estimate (indicative) \$m
Labour	80	47	73
Network maintenance	64	13	13
Other network costs	29	7	7
IT	47	30	29
Rent, rates and property maintenance	25	8	8
Regulatory levies	7	5	6
Electricity	15	4	4
Provisioning	5	1	2
Consultants	9	8	6
Insurance	3	2	2
Other	27	21	20
Total	311	146	170

UPDATE: Opex regulatory template

Total proposed RP1 opex reduces from \$625.5m to \$549.6m

Opex categories	Sub-categories	2022	2023	2024	
Customer	▪ Customer operations	7.1	6.5	6.1	
	▪ Product, Sales & Marketing	23.9	24.5	25.0	
Network	▪ Maintenance	29.7	32.5	33.9	
	▪ Network operations	14.2	15.1	16.2	
	▪ Operating costs	18.2	20.0	22.2	
Support	▪ Asset management	13.3	13.3	13.7	
	▪ Corporate	52.9	50.6	50.8	
	▪ Technology	19.6	19.8	20.5	
TOTAL (\$m)		178.9	182.3	188.4	\$549.6m

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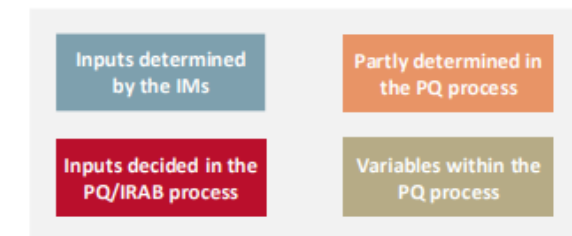
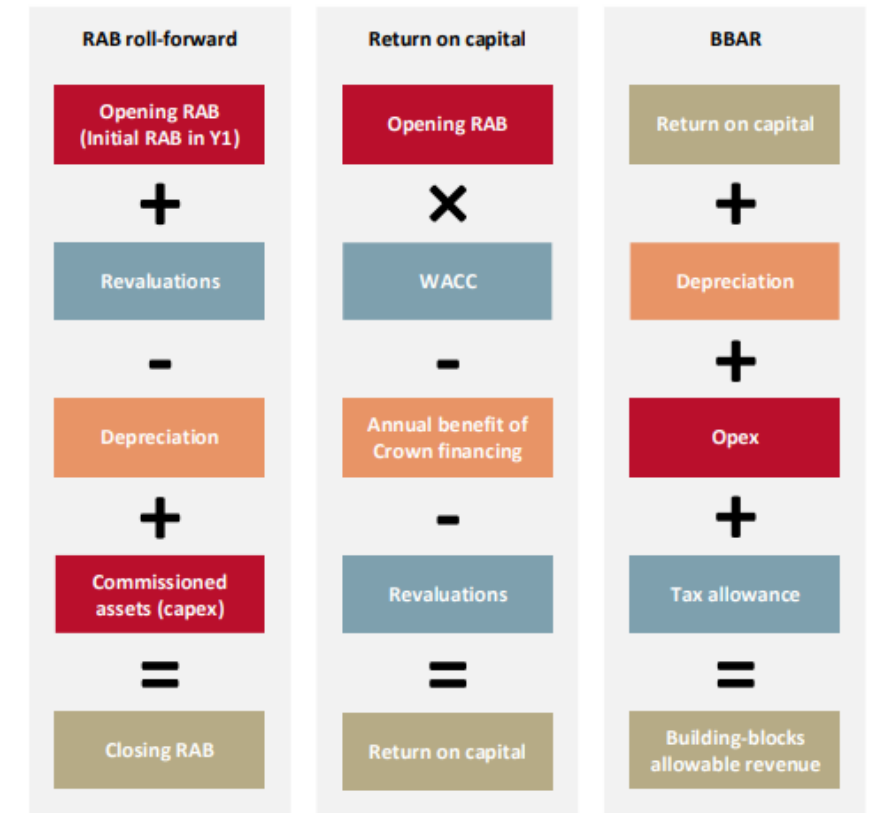
- includes IFRS 16 finance leases of ~\$41m (nominal) for presentational and comparative purposes
- excludes passthrough costs of ~\$45m (nominal)
- includes regulatory inflation

Input methodologies key parameters

	Pre January 2022 period (financial loss asset)	First regulatory period
Risk free rate	5-year rate, 1 month average, calculated as at middle of year, or mid each part year for 2012 and 2021	3-year rate, 3 months average, calculated as at 1 June 2021
TAMRP	7% until Oct 2020 then 7.5%	7.5%
Debt risk premium	BBB, 7-year term, 1 month average	BBB, 5-year term, 5-year trailing average
Leverage	29%	29%
Debt issuance cost	0.14%	0.33%
Asset beta	0.5	0.5
WACC uplift	none – 50 th percentile	none – 50 th percentile
Asymmetric stranding risk	no allowance	10 basis points
Crown financing	Financing rate reflecting Chorus' actual senior debt/subordinated debt/equity mix	Financing rate reflecting Chorus' actual senior debt/subordinated debt/equity mix

Regulatory timetable

Draft decisions	Q2 2021	ID draft decision Chorus transitional PQ initial RAB draft decision PQ draft decision Submissions on all draft decisions Cross-submissions on all draft decisions
Final decisions	Q3 to Q4 2021	PQ WACC determination Final decision on Chorus expenditure Final PQ decision Final ID decision
Post-final implementation	2022	Disclosure of the initial RABs Determination of the financial loss asset



Source: Commerce Commission