



2014

# Chorus Annual Report



P1 Company overview

P9 Governance & Disclosures

P23 Management commentary

P41 Financial statements



# Report from Chairman Sue Sheldon and CEO Mark Ratcliffe



Chorus has produced a solid financial result underpinned by an increase of 51,000 broadband connections and relative stability in the number of fixed lines, while fibre connections more than doubled. Delivery of the UFB and RBI programmes is ahead of schedule, but this success has been overshadowed by the need to reshape Chorus operationally and financially to address the challenges posed by the ongoing uncertainty with the regulatory framework and revised copper pricing.

## HIGHLIGHTS

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EBITDA

\$649m

Earnings before interest, income tax,  
depreciation and amortisation

NPAT

\$148m

Net profit after tax

FIXED LINE CONNECTIONS

1,781,000

UFB PROGRAMME

31%

UFB completion

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## Dear shareholder

### There is no denying that the financial year ended 30 June 2014 has been a challenging one for Chorus and its shareholders.

Your Board is acutely aware of the loss in value experienced by shareholders during the period and is totally focused on reshaping the business to put Chorus back on a sustainable financial footing.

We wrote to shareholders in late 2013 to explain the background and challenges the business faces from the Commerce Commission's decision to substantially reduce the amount we can charge for two of the key services we provide to the telecommunications industry at a time of unprecedented capital investment. The most significant decline comes into effect on 1 December 2014.

Independent financial reviews have supported Chorus' financial analysis and the funding gap implied by a reduction in EBITDA of more than \$140 million per annum.

We are not waiting for any kind of regulatory relief from the Crown, and it is a clear expectation of many of our stakeholders that Chorus solves the very challenging funding gap created by the new regulated prices under its own steam.

By February 2014 we had completed a top to bottom review of our entire business, and we are now five months into a range of activities to help put Chorus back on a sustainable footing.

We have worked closely with Crown Fibre Holdings and negotiated amendments to our contract to roll out fibre that give us additional flexibility, as well as a funding backstop.

We have presented our banks with a credible plan and they have supported us with some important changes in our funding arrangements.

We have developed an innovative range of commercial products to enhance end-user choice and lift copper broadband beyond a best efforts service. We await regulatory guidance on their implementation.

At the same time we have reviewed our entire cost structure.

The funding gap implied by the regulated prices means we are cash constrained, so other than where we have contractual or regulatory obligations we are making decisions that prioritise short term cash. This may require us to sacrifice value enhancing capital expenditure to the detriment of our customers.

This is a regrettable but necessary position as we manage our way through a difficult set of circumstances. The extent to which we have to focus on costs in this way is related to any success we have with the ongoing regulatory processes and the development of new commercial products.

Naturally, we remain absolutely committed to delivering a successful roll out of fibre, and delivering and supporting innovation throughout the industry to benefit end-users.

The impact of the regulatory decision is all the more frustrating because operationally Chorus has delivered on all fronts.

We have delivered a solid financial result, which was underpinned by an increase of 51,000 broadband connections and relative stability in the number of fixed lines, while fibre connections more than doubled.

We are now comfortably into our stride on the massive Ultra-Fast Broadband and Rural Broadband Initiative infrastructure upgrades, with both build programmes ahead of schedule.

At our end of year results we were pleased to report cost per premises passed for the UFB rollout at the bottom of the guidance range, demonstrating the intense focus on the rollout during the year.

We have also successfully delivered some of the largest IT projects in New Zealand, as we complete the separation from Spark, and we have once again been recognised as one of the best employers in Australasia.

As we look to the future, it is the view of the Board that the regulatory environment that comes into effect post 2020 is critical, and in the meantime we remain focused on maximising outcomes from today's flawed framework which fails to accommodate the transition to fibre in the marketplace.

To that end, Chorus continues to engage transparently and professionally in a very arduous regulatory process on the pricing of the copper-based services. This has now moved into an entirely new phase known as the Final Pricing Principle (FPP), which is due for completion in April 2015.

The FPP processes will ultimately determine if a fair rate of return will be achieved for network investment in the short to medium term.

The FPP is very different from the prior benchmarking phase because it gives the opportunity to ground network prices in the reality of New Zealand's circumstances, rather than those of some benchmarked Scandinavian countries. A sustainable FPP outcome will give certainty to all industry participants through to the enactment of the new regulatory environment in 2020.


With around 80% of Chorus' revenues coming from regulated copper products, a regulated price that does not enable Chorus to make future investments will cause significant issues for everyone in the sector. To avoid this it is important that the choices the Commerce Commission makes during this phase accurately reflect the realities of building and operating a network in New Zealand which delivers the full current range of services.

In line with our previously stated position on capital management that no dividend would be paid until a greater level of certainty enabled a sustainable dividend policy, and as part of the revised funding agreements with the banks, no dividends will be paid until the later of the conclusion of the Commerce Commission's final pricing principle review processes or 30 June 2015.

In summary, Chorus has delivered a strong year operationally, significant progress has been made in reshaping the business to deliver a sustainable future, and we continue to engage in a regulatory environment that is not appropriate for the new industry structure or the effective delivery of the Government's policy.

We now have clarity on our strategies to address issues we face and the risks that remain. Our hope is that the regulatory outcomes we are pursuing will deliver fair returns to you as investors in Chorus.

This report is dated 24 August 2014 and is signed on behalf of the Board of Chorus Limited:



Sue Sheldon  
Chairman



Mark Ratcliffe  
Managing Director

# Reshaping Chorus

## The Commerce Commission's 5 November 2013 initial pricing principle benchmarking decision on Chorus' regulated broadband pricing placed new and additional demands on Chorus in relation to the viability of its business model.

The period since has seen intense Board and management focus on reshaping Chorus to secure a sustainable operating framework in the context of a substantial reduction in revenue from 1 December 2014. A significant number of special Board meetings have been held, often on a weekly basis, to navigate the company through this period. The Commerce Commission is currently scheduled to conclude its pricing review processes in April 2015, which means Chorus continues to face a lengthy period of pricing uncertainty.

Chorus has already implemented a number of initiatives, with an extensive range of revenue, operating cost and capital expenditure opportunities being pursued as part of an intense focus on cash management. The broad nature of these initiatives was outlined in Chorus' interim results in February 2014. Initiatives implemented to date include repricing a number of existing commercial services, reduced resourcing levels in support areas, a 50% reduction in FY15 short term incentive remuneration payments for all employees and interest rate swaps were reset in December to realise \$30 million of cash. Discretionary activities, including growth-related capital investment, have been reduced. In March 2014, Chorus and CFH agreed a range of amendments that will assist Chorus to continue to deliver the UFB programme. Chorus also announced plans to introduce innovative new commercial copper and fibre-based broadband products, in anticipation of increasing demand, that are expected to provide material benefits for end-users, enhance competition at a retail level, and potentially provide valuable additional new revenues. The copper based products remain under review by the Commission.

At a capital management level, Chorus has pursued multiple work streams. In November 2013, dividend guidance was withdrawn and in February 2014 Chorus indicated that a future dividend policy would be communicated when financially sustainable and there was sufficient certainty of outcome from the Chorus initiatives, Crown Fibre Holdings (CFH) discussions and regulatory reviews. Chorus has been proactively engaging with rating agencies and its lenders since November 2013. A new business

plan for the FY15 year was approved in June 2014, consistent with the initiatives outlined in February 2014. On 18 July 2014, Chorus entered into a conditional agreement with CFH, which gives Chorus the option of bringing forward the present value of CFH funding of up to \$178 million budgeted to be spent on Chorus' UFB programme in FY18 and FY19. The agreement is a useful funding backstop and does not have any ongoing financial cost unless drawn. Subsequent to that, on 25 July 2014 Chorus also announced that it had secured important amendments to its committed bank facilities, providing increased covenant levels and extending the maturity date for Chorus' November 2015 facility to 31 July 2016. While these initiatives provide significant additional financial flexibility and funding certainty, it does mean that Chorus cannot pay dividends until the later of either the conclusion of the Commerce Commission's pricing review or 30 June 2015, consistent with capital management guidance provided in February 2014. If Chorus chooses to draw upon the CFH facility, Chorus will be unable to pay a dividend before December 2019 without CFH approval, unless Chorus normalises the CFH funding profile.

Chorus has, therefore, made significant progress in protecting shareholder interests by pursuing multiple complementary work streams. Given that Chorus has a limited range of discretionary activity, Chorus has necessarily had to make fundamental changes to those areas and has a limited, if any, ability to do more if further adverse regulatory decisions occur in the future. In addition, with a strong focus on cash management, some of the initiatives that have been implemented, such as a reduction in discretionary growth investment, may result in a loss of longer term shareholder value as signalled in Chorus' interim results. In FY15 there will be a heavy focus on execution of planned initiatives as Chorus works hard to deliver on the plan to reshape Chorus.

Finally, the level of regulated pricing remains the most important value driver for Chorus, and is key to ensuring investors receive a fair rate of return so significant focus continues on all options, judicial and regulatory. Chorus has to protect shareholder value and advocate for a fit-for-purpose regulatory framework.

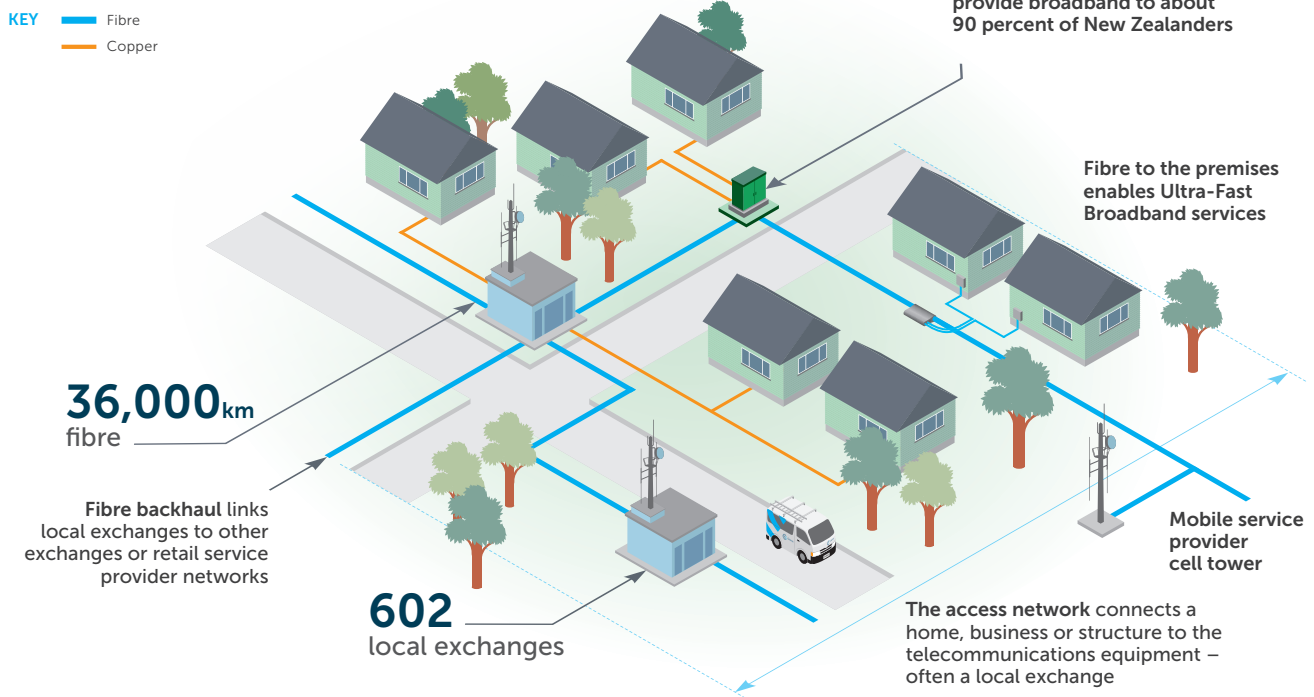
# Chorus and the New Zealand telecommunications market

Chorus is New Zealand's largest fixed line communications infrastructure services provider, supplying more than 90% of all fixed network connections to retail service providers.

The core of Chorus' business is the nationwide network of fibre optic cables (36,000km) and copper cables (130,000km) that connect homes and businesses to each other. These cables typically connect back to local telephone exchanges, of which Chorus has about 600 nationwide. Chorus fibre also connects

many mobile phone towers owned by mobile service providers. About 7,000 cabinets provide interconnection points for around 50% of the lines in the Chorus network. A large number of these cabinets are like mini telephone exchanges and have electronic broadband equipment installed in them.

Figure 1: Chorus' Network



Open access wholesale services are at the heart of the industry model established in late 2011, with Chorus prohibited from selling directly to end-users.

This new industry structure and the ongoing rollout of the Ultra-Fast Broadband (UFB) network, as part of a public-private partnership with the New Zealand Government, means that the retail service provider (RSP) environment is in a state of transition. Chorus has approximately 100 RSP customers, although consolidation of RSPs continues to be a feature of the new environment. On 20 June 2014, for example, the third and fourth largest RSPs announced they were combining with Callplus' acquisition of Orcon. Regional RSPs are also using the UFB rollout as an opportunity to expand their offerings to new areas.

Against this industry backdrop, the number of fixed line connections on Chorus' network continues to be relatively static at just

under 1.8 million. This has been assisted by the ongoing growth in connections to new subdivisions and demand for fixed line broadband connections. Statistics New Zealand estimated 75% of households had a broadband connection at June 2012, compared to 63% in 2009.

In July 2014 the OECD reported that New Zealand was the second fastest OECD market for annual growth in fibre broadband connections to December 2013. Broadband penetration per 100 inhabitants was 30.2%, ranking New Zealand at 15th in the OECD and ahead of the United States.<sup>1</sup>

The amount of data traffic used by end-users is also increasing rapidly, with Chorus estimating that average data usage is 41GB per month.

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## Other networks

Chorus' existing business fibre and fibre to the node (copper/fibre) networks compete with a range of other network operators across different areas around New Zealand, including:

- The local fibre companies (LFCs) – Northpower, Ultrafast Fibre and Enable Networks – building the UFB network past about 365,000 premises in nine of the 33 UFB areas. As at 30 June, they had passed approximately 170,000 end-users.
- Vodafone has a cable network in Wellington, Kapiti and Christchurch connecting about 60,000 broadband end-users. It also has business fibre networks in all major central business areas and a national transport and backhaul network.
- Vector, FX Networks (subject to a purchase offer by telecommunications company Vocus), Citylink and Unison operate fibre networks of varying sizes, typically focused on the backhaul and business markets.
- Some RSPs have chosen to 'unbundle' by installing their own broadband equipment in exchanges and pay Chorus just for the rental of the access line. The level of unbundling increased slightly during the year with about 7% of Chorus' lines unbundled as at 30 June 2014.
- Spark (formerly Telecom NZ), Vodafone and 2 Degrees operate mobile phone networks that are currently based on 3G technology and they are implementing, or planning, upgrades to 4G technology.
- Vodafone, Woosh, CallPlus and Now are among a range of fixed wireless network providers. It is estimated almost 50,000 end-users are served by wireless networks in New Zealand.

<sup>1</sup> OECD Broadband Statistics Update, 22 July 2014.

## Steady progress expanding the Ultra-Fast Broadband footprint

Chorus made great strides in its deployment of the UFB network through the year and the rollout is now at maximum pace. Approximately 31% of the planned 830,900 premises had been passed by 30 June 2014, bringing about 261,000 premises and 353,000 end-users within reach of a UFB connection. As Figure 2 shows the rollout is almost complete in Blenheim, Timaru, Oamaru and Ashburton. Chorus currently expects to complete its UFB rollout in these towns in FY15.

Each of Chorus' 24 contracted deployment areas is different in terms of local body requirements and geotypes, as well as the availability of existing infrastructure such as poles and ducts that can be re-used to extend the new network. The Auckland and Wellington regions represent more than 60% of Chorus' UFB premises and have very high density urban areas that have shaped deployment costs to date. Chorus is working with councils and other utility companies across its areas to further

reduce deployment costs, where feasible and permitted, through infrastructure sharing and the implementation of emerging deployment techniques, such as rapid trenching.

Fibre connections are growing as Chorus' fibre footprint expands and RSPs market it more widely. As Figure 3 shows, UFB uptake varies from area to area, largely reflecting the number of RSPs and their marketing focus in each area. Chorus has been promoting the availability and benefits of fibre through its Gigatown campaign, with local towns competing to win a sponsored Gigabit fibre service.

The UFB deployment is helping future-proof Chorus' network for the continuing growth in bandwidth demand. Bandwidth on Chorus' network has been growing at over 80% per year due to increased connection volume and increased bandwidth usage per connection. Fibre end-users are using twice as much data per month as copper end-users.

Figure 2: Progress by Chorus UFB Area as at 30 June 2014

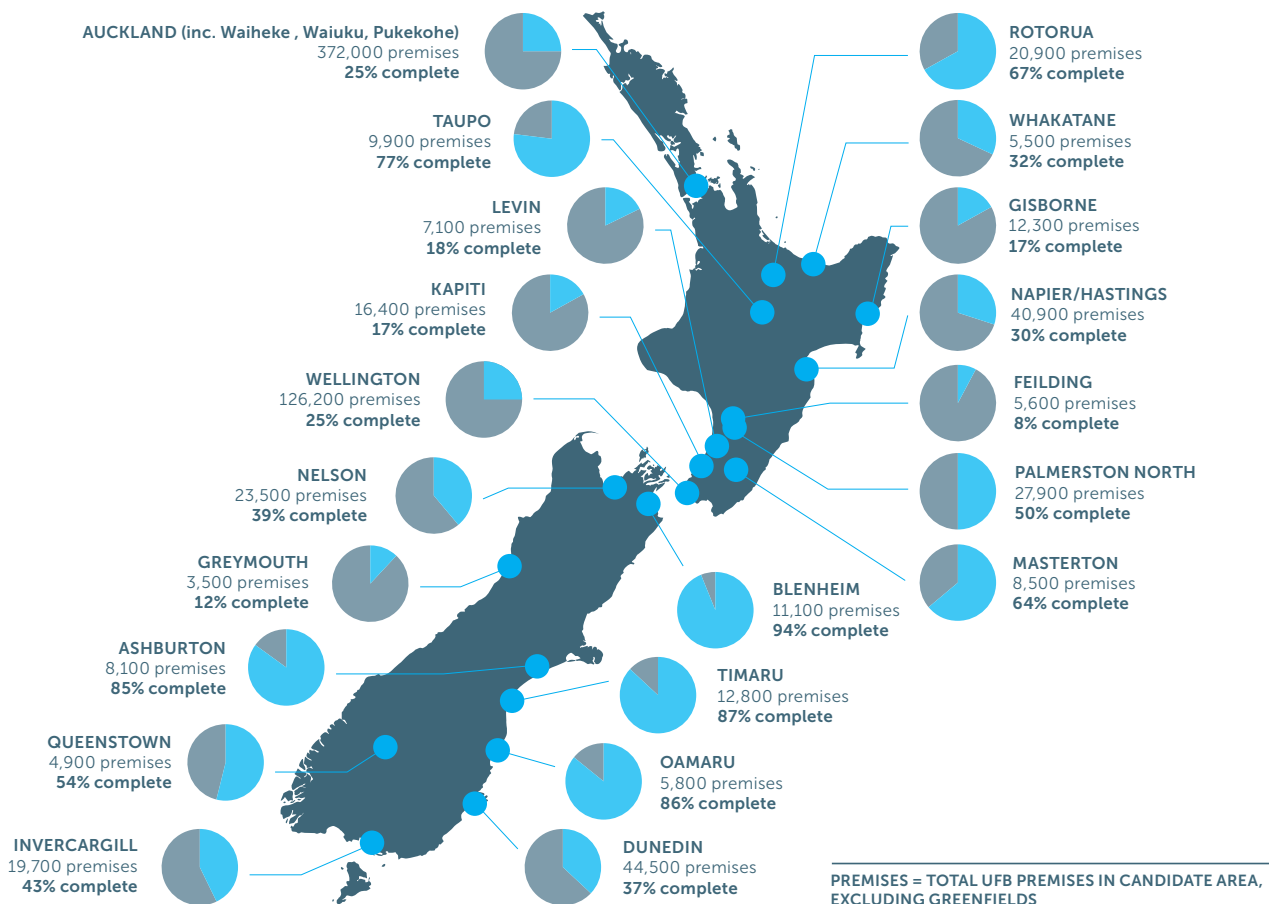
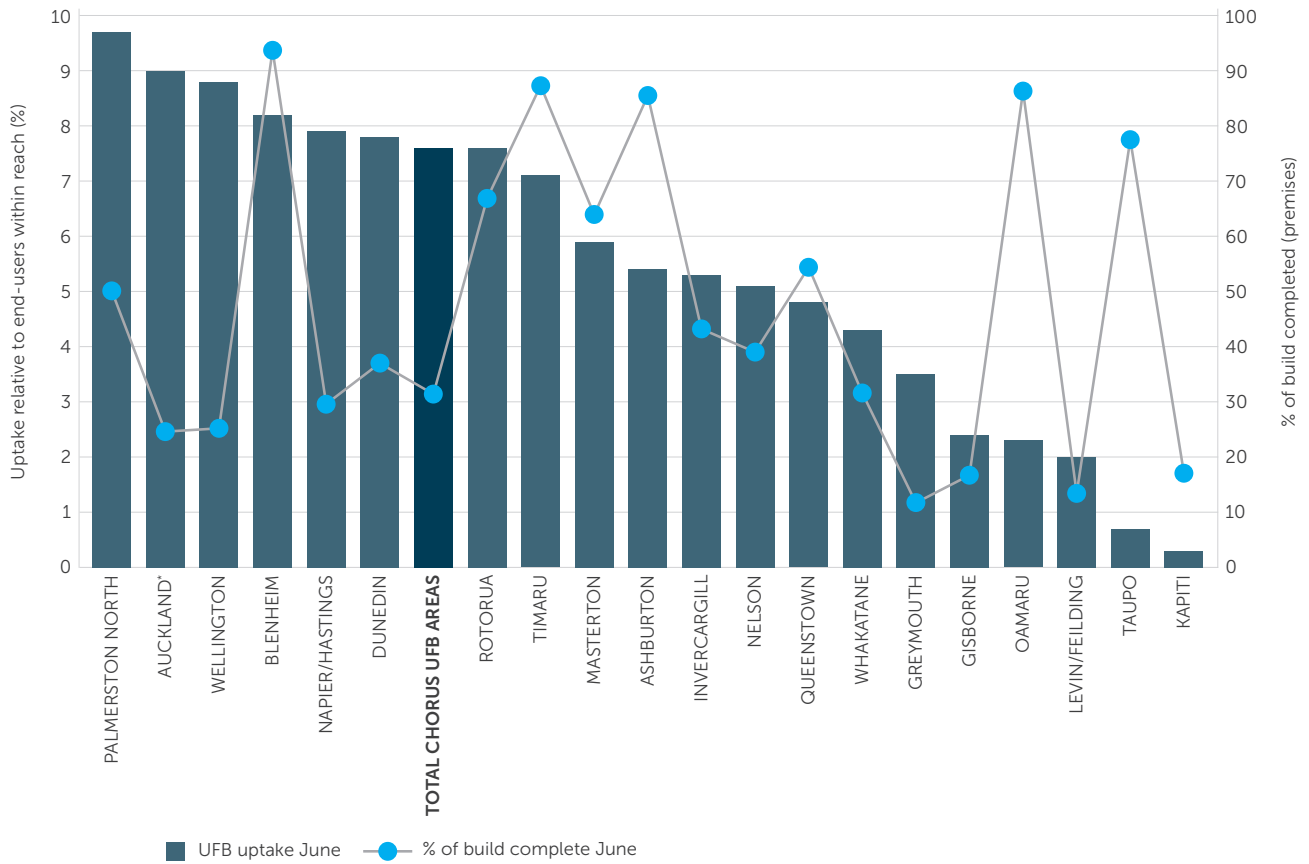


Figure 3: UFB uptake relative to end-users within reach as at 30 June 2014



\* Includes Auckland North, Auckland South, Pukekohe, Waiuku & Waiheke Island.

## Rural Broadband Initiative extends broadband benefits

Chorus is now well past the halfway mark in its rollout of fibre and high speed broadband cabinets for the Rural Broadband Initiative (RBI). At 30 June 2014, a total of about 3,100km of fibre had been laid for the programme, with fibre extended to 951 schools. The rollout had also brought new or upgraded broadband coverage within reach of 72,000 rural lines and broadband uptake was approximately 80%.

Chorus' overall fixed line broadband footprint at 30 June 2014 extended to 97% of lines nationwide. When the RBI rollout is completed in 2016, Chorus will have upgraded or installed about 1,200 broadband cabinets, making high-speed broadband available to more than 90% of lines nationwide. The Government is funding the majority of the rollout through an industry levy, which Chorus is a significant contributor to, with Chorus also directly providing approximately 15-20% of the investment required to fund its fixed line portion of the rollout.



## Regulatory environment

Regulatory developments had a significant impact on Chorus and its shareholders during FY14.

On 5 November 2013, the Commerce Commission (Commission) released its final benchmarking decision on the price Chorus can charge for its regulated copper broadband services or Unbundled Bitstream Access (UBA). The Commission's decision relied on pricing from just two countries – Denmark and Sweden – and stipulated that from 1 December 2014 Chorus' UBA price reduces from \$21.46 per month per connection to \$10.92 per month. 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. Subsequent to this decision it also became clear that there was no longer political support for the Government proposal, as detailed in the Government discussion paper of 7 August 2013, to review the telecommunications regulatory framework with an immediate focus on copper pricing. The Government hasn't continued or closed its review and legislation requires a review of the regulatory framework to commence by 2016.

The Commission is now undertaking final pricing principle reviews of its benchmarking decisions on UBA and copper line, or Unbundled Copper Local Loop (UCLL) pricing. These reviews

have been requested by Chorus and other industry parties and involve using Total Service Long Run Incremental Cost (TSLRIC) methodology to model the cost of building a network to deliver services in New Zealand. Cost modelling is complex and highly technical, as opposed to simply benchmarking prices against services in other countries.

The Commission has indicated that draft pricing from the reviews will be released on 1 December 2014, with final pricing to be released on 1 April 2015. The outcomes of these reviews are uncertain and will shape the answer to the critical question of whether a fair rate of return can be achieved for network investment in New Zealand.

In parallel with the Commission's processes, Chorus also asked the High Court to consider legal aspects of the Commission's UBA benchmarking decision. The High Court dismissed Chorus' appeal, although the judge acknowledged benchmarking is a "quick and cheap" process. The Court of Appeal has since heard Chorus' appeal on this matter and a decision is pending.

For a complete overview of Chorus' regulatory environment, please see the *competition and regulation* section in the Management Commentary.

## Corporate sustainability

Chorus is building a sustainable operating model to efficiently deliver its needs of today without compromising its needs of tomorrow. Chorus continues to provide carbon footprint data to the Carbon Disclosure Project, a leading global carbon benchmark, but is no longer eligible for the FTSE4Good index because of market capitalisation criteria.

Chorus commenced a number of carbon-related initiatives, including a programme to remove the remaining ozone depleting substances from air conditioners in the network, shifting to a cloud-based desktop system, and an exchange battery and fuel

tank replacement programme. During the year, approximately 3,400 fibre cable drums, 22 kilometres of duct, 640 tonnes of copper and 232 tonnes of electronic equipment were recycled. As part of Chorus' art programme to combat graffiti, 112 cabinets and two radio huts were painted by artists.

About 430 Chorus people spent a day helping others in their local community through its volunteer day programme and employees also donated to local charities through the payroll giving programme. Chorus also donated \$25,000 to Wellington Free Ambulance, along with volunteer time.

## Health and safety

Chorus undertook an extensive review of its health and safety management processes during the year as part of its ongoing commitment to ensuring effective health and safety management. Chorus is improving the health and safety management system to ensure Chorus can achieve ACC Workplace Safety Management

Practices accreditation and meet the AS/NZ 4801 standard for health and safety management systems.

The principal objective for Chorus is that everyone working within Chorus and on the network will go home safe and free from 'harm' and will have a 'safe & secure' environment in which to work.

## Chronology of significant events

<b>9 July 2013</b>	The Government releases a Telecommunications Service Obligation (TSO) discussion document.
<b>7 August 2013</b>	The Government releases a wider discussion document, announced in February, outlining potential changes to the regulatory framework, including copper pricing options below existing pricing.
<b>17 September 2013</b>	Chorus makes its submission on the wider discussion document.
<b>23 October 2013</b>	Chorus announces that it is consulting industry on a range of new UFB products to provide enhanced entry level speeds.
<b>5 November 2013</b>	The Commission announces that the final benchmarked UBA price to apply from 1 December 2014 is \$10.92, around a 50% reduction. Chorus estimates this will have around a \$142 million annualised EBITDA impact and implies around a \$1 billion funding shortfall by 2020.
<b>6 November 2013</b>	Moody's places Chorus on review for possible downgrade.
<b>15 November 2013</b>	ICT Minister Amy Adams announces that Ernst & Young Australia will undertake an independent assessment of Chorus' financial position and its capability to deliver on its contractual commitments with the Government.
<b>18 November 2013</b>	Chorus announces it has withdrawn its FY14 dividend guidance in light of the ongoing regulatory uncertainty.
<b>2 December 2013</b>	Chorus applies to the Commission for a final pricing principle review of the UBA benchmarking decision and also says it is filing a High Court appeal of the same decision to determine whether the Commission has applied the law correctly.
<b>5 December 2013</b>	ICT Minister Amy Adams says the Government expects Chorus to approach Crown Fibre Holdings (CFH) to discuss specific provisions within the UFB contract and notes that Chorus is expected to meet a significant part of the funding shortfall through its own actions.
<b>11 December 2013</b>	Chorus sends a letter to shareholders to update them on what the Chorus Board and management team is doing to preserve and restore value in Chorus. The Commission initiates a review of UCLFS connection charges.
<b>14 December 2013</b>	Ernst & Young's 'Independent Assessment of Chorus' Financial Position' confirms Chorus' assessment of a \$1 billion funding gap by 2020 and that initiatives to partially address the gap come with substantial trade-offs.
<b>21 January 2014</b>	Moody's downgrades Chorus from 'Baa2' to 'Baa3'.
<b>5 February 2014</b>	Standard and Poor's maintains 'BBB' Creditwatch negative for Chorus.
<b>7 February 2014</b>	The Commission schedules its UBA final pricing principle draft determination for 19 August 2014 and final determination before 30 November 2014.
<b>24 February 2014</b>	Chorus' interim FY14 result outlines 'new reality' of reshaping the business to be sustainable with an extensive range of revenue, operating cost and capital expenditure initiatives. No interim dividend paid.
<b>11 March 2014</b>	Chorus and CFH agree an initial package of UFB improvements to help deliver UFB faster, smother and more cost effectively.
<b>13 March 2014</b>	NZX announces Chorus is to be removed from the NZX 15 Index.
<b>28 March 2014</b>	The Commission indicates it intends to also complete its UCLL final pricing principle review by 30 November 2014.
<b>8 April 2014</b>	The High Court dismisses Chorus' appeal of the UBA determination.
<b>24 April 2014</b>	The Commission announces its decision to align UCLFS connection charges with benchmarked UCLL charges. This is estimated to impact Chorus' EBITDA by around \$6 million annually.
<b>14 May 2014</b>	Chorus announces it will consult on new commercial copper and fibre products intended to deliver greater speeds, enhanced High Definition video capability and more choice to industry.
<b>22 May 2014</b>	The Commission announces a delay in its final pricing principle timetable with UCLL and UBA draft decisions now due by 1 December 2014 and final decisions due by 1 April 2015.
<b>23 May 2014</b>	Standard and Poor's affirms Chorus 'BBB' rating – outlook negative.
<b>12 June 2014</b>	NZX announces Chorus is to be removed from the NZX 20 Index.
<b>18 July 2014</b>	Chorus announces an agreement with CFH that provides the option of bringing forward UFB funding subject to various conditions.
<b>22 July 2014</b>	The Commission announces an investigation relating to proposed changes to the regulated UBA service. This is in parallel to considering Chorus' proposed Boost services.
<b>25 July 2014</b>	Chorus announces it has agreed amendments to its committed bank facilities to provide significant additional financial flexibility and funding certainty. This includes agreeing no dividends will be paid until the later of the conclusion of the Commission's review processes or 30 June 2015.



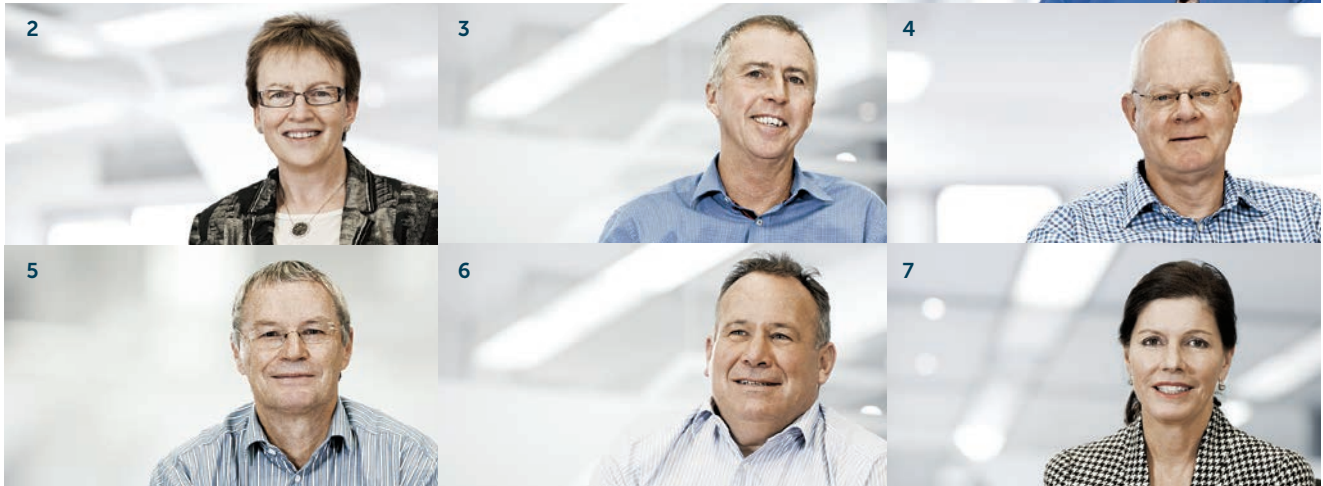
# Governance and Disclosures

## CONTENTS

Directors	10
Executive Team	11
Governance at Chorus	12
The Chorus Board	13
Diversity at Chorus	14
Remuneration at Chorus	16
Disclosures	19



## Directors



**1. Sue Sheldon, CNZM, BCom, FCA**  
Chairman; director since 1 July 2011; independent

Sue is a professional company director. She is chairman of Freightways and Paymark, a director of Contact Energy and the independent chair of the Audit and Risk Management Committee of the Christchurch City Council. Sue is a former deputy chairman of the Reserve Bank of New Zealand and a former director of Telecom, Smiths City Group and Meridian Energy, among others. She has extensive experience as both a chairman and member of audit and risk committees and is a former president of the New Zealand Institute of Chartered Accountants. Sue was made a Companion of the New Zealand Order of Merit for services to business in 2007.

**2. Anne Urlwin,**  
BCom, CA, F InstD, FNZIM, ACIS  
Director since 1 December 2011; independent

Anne has more than 20 years' directorship experience across many sectors, including energy, health, construction, regulatory services, internet infrastructure, research, banking, forestry and the primary sector, as well as education, sports administration and the arts. She is chairman of Naylor Love Enterprises and a director of Southern Response Earthquake Services, Steel & Tube Holdings and OnePath Life (NZ). Anne is also chairman of the Ngāi Tahu Te Rūnanga Audit and Risk Committee, the former chairman of Lakes Environmental, the New Zealand Blood Service, the New Zealand Domain Name Registry and a former director of Meridian Energy.

**3. Clayton Wakefield,**  
BSc (Computer Science), GradDip Mgmt  
Director since 1 December 2011; independent

Clayton has over 30 years' experience in the banking, financial services, telecommunications and technology industries. He is an executive director and owner of Techspace, a leading New Zealand independent IT advisory company working with New Zealand's major corporates. Clayton is currently a director of Fisher & Paykel Finance and its subsidiaries, a former chairman of Electronic Transactions Services and Visa New Zealand and a former director of Endace. From 2001 to 2007 Clayton was Head of Technology and Operations at ASB Bank.

**4. Jon Hartley, BA Econ Accounting (Hons),  
Fellow ICA (England & Wales),  
Associate ICA (Australia), Fellow AICD**  
Director since 1 December 2011; independent

Jon is a Chartered Accountant and Fellow of the Australian Institute of Company Directors. He has held senior roles across a diverse range of commercial and not for profit organisations in several countries, including as chairman of SkyCity, director of Mighty River Power, CEO of Brierley New Zealand and Solid Energy, and CFO of Lend Lease in Australia. Jon is currently deputy chairman of ASB Bank and Sovereign Assurance Company, chairman of VisionFund International and the Wellington City Mission and a trustee of World Vision New Zealand.

**5. Keith Turner, BE (Hons), ME, PhD**  
Director since 1 December 2011; independent

Dr Keith Turner was CEO of New Zealand electricity generator and retailer Meridian Energy for nine years from its establishment in 1999. He is currently chairman of Fisher and Paykel Appliances and Emirates Team New Zealand, deputy chairman of Auckland International Airport and a director of Spark Infrastructure, an Australian listed company. Keith has had an extensive career in electricity, taking part in much of its reform, including the separation of Transpower from Electricity Corporation of New Zealand (ECNZ) in 1992, the separation of Contact Energy from ECNZ in 1996 and the eventual break up of ECNZ into three companies in 1999.

**6. Mark Ratcliffe, BA Accounting**  
Director since 9 December 2011; non-independent

Mark has been CEO of Chorus since it was established in 2007 as an operationally separate business unit within Telecom and was appointed as its first CEO when it became a separately listed entity in 2011. In a 20 year career with Telecom, Mark held finance, marketing, product development, product management and IT roles. Mark was promoted to the executive team in 1999 where he was CIO (including a period as joint CEO of AAPT in Australia) and then COO Technology and Wholesale before becoming CEO of Chorus. From May 2010, he led the team that secured Chorus' participation in the Government's UFB initiative and the demerger of Chorus and Telecom.

**7. Prue Flacks, LLB, LLM**  
Director since 1 December 2011; independent

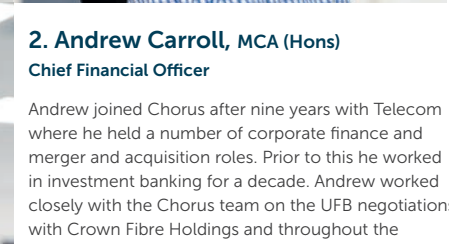
Prue is a director of Bank of New Zealand and Mighty River Power, and a trustee of the Victoria University Foundation. She is a barrister and solicitor with extensive experience in commercial law and, in particular, banking, finance and securities law. Her areas of expertise include corporate and regulatory matters, corporate finance, capital markets, securitisation and business restructuring. Prue is a consultant to Russell McVeagh, where she was previously a partner for 20 years.



# Executive Team

**1. Mark Ratcliffe**  
Chief Executive Officer

See previous page.



**2. Andrew Carroll, MCA (Hons)**  
Chief Financial Officer

Andrew joined Chorus after nine years with Telecom where he held a number of corporate finance and merger and acquisition roles. Prior to this he worked in investment banking for a decade. Andrew worked closely with the Chorus team on the UFB negotiations with Crown Fibre Holdings and throughout the demerger process.

**3. Deborah Sinclair\***  
Acting General Manager, Human Resources

Deborah has been intimately involved in developing Chorus' HR strategy and the engagement work that has seen Chorus recognised as an AON Hewitt's Best Employer Australia and New Zealand in 2012, 2013 and 2014. Deborah has previously held roles at Telecom, Toyota Finance, ENZA, Blue Star Shipping and Exxon Mobil.

**4. Ed Beattie**  
General Manager, Infrastructure

Ed has more than 30 years' experience in building and maintaining fixed line and mobile telecommunications networks in New Zealand. Most recently, he managed the delivery of the successful Fibre to the Node programme and played a lead role in the Christchurch crisis response and restoration activities.

**5. Ewen Powell, BE**  
Chief Technology Officer

Ewen has over 20 years' experience in managing the technology, services and partnerships that operate a national communications network. He has spent time in both the supplier and operator communities with much of his career spent at Telecom where he was at the forefront of a wide range of technology changes. Ewen's focus post establishment of Chorus has been to deploy the core enterprise systems to run the business and developing the technology capabilities to provision and manage the new fibre network.

**6. Mark Tod\*\***  
Joint Acting General Manager, Marketing & Sales

In addition to Joint Acting GM Marketing and Sales, Mark is also Chorus' Head of Sales. He has more than 10 years sales and sales management experience followed by another 10 years developing performance cultures with national and global organisations. Mark's previous experience includes roles at Telecom, APN, ANZ, Telstra and Unisys.

**7. Mike Lott\*\***  
Joint Acting General Manager, Marketing & Sales

Mike has extensive experience in the telecommunications industry and had key roles in the successful UFB bid, as well as the demerger negotiations that led to the formation of Chorus. In addition to Joint Acting GM Marketing and Sales, Mike is also responsible for developing new services that meet the needs of our customers, end-users and Chorus itself.

**8. Nick Woodward**  
General Manager, Customer Service

Nick's career combines a wide range of IT, sales, customer and project management experience in the financial and telecommunications industries. His roles have seen him work across the United States and Europe for Hutchison 3G UK and Household Bank in the United Kingdom. Nick has been a member of the Senior Leadership Team since Chorus' inception in 2008.

**9. Vanessa Oakley, LLB (Hons),  
PGCert (MgtSt), PGCert (CompPolicy) (UK),  
GAICD, MInstD**

**General Counsel & Company Secretary**

Vanessa has extensive experience in law and policy, especially in relation to regulated infrastructure businesses. A qualified lawyer in New Zealand and England and Wales, Vanessa joined Chorus after playing a key role in the UFB contract, legislative and demerger processes. Prior to that she has held roles in the public and private sectors including as a key adviser to United Kingdom and New Zealand regulators and across the Telecom group.

**10. Irene Lovejoy\*\*\***  
Executive Assistant

Irene has worked with Chorus CEO Mark Ratcliffe for more than 14 years, bringing a unique insight that adds value to the development of the Chorus executive team. Before joining Chorus, Irene spent 22 years with Telecom where she held roles in the marketing, technology and corporate teams.

\* Deborah Sinclair became Acting General Manager, Human Resources following the departure of Sara Broadhurst in August 2013.

\*\* Mark Tod and Mike Lott assumed joint responsibility for Acting General Manager, Marketing & Sales following the departure of Victoria Crone in April 2014.

\*\*\* Irene is not an "officer" for the purposes of the Securities Markets Act 1988 or NZX Listing Rules.

## Governance at Chorus

**Chorus' Board and management are committed to ensuring that our people act ethically, with integrity and in accordance with our policies and values.**

### Framework

Chorus is incorporated in New Zealand and listed on the New Zealand and Australian stock exchanges.

The governance practices and policies we have adopted therefore reflect, and are consistent with, the:

- NZX Listing Rules and Corporate Governance Best Practice Code;
- New Zealand Securities Commission's (now Financial Markets Authority (FMA)) 'Corporate Governance in New Zealand Principles'; and
- ASX Listing Rules and the recommendations set out in the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations.

The Board regularly reviews and assesses Chorus' governance policies, processes and practices to identify opportunities for enhancement and to ensure they reflect Chorus' operations and culture.

### Compliance with corporate governance codes, principles and recommendations

Chorus considers that during the year ended 30 June 2014:

- the corporate governance principles adopted and followed by it did not materially differ from NZX's Corporate Governance Best Practice Code; and
- it followed each of the recommendations set by the ASX Corporate Governance Council.

### Managing risk

Chorus has a Managing Risk Policy that mandates one framework for the management of risk in Chorus to:

- ensure the Board sets the risk appetite and reviews principal risks annually;
- integrate risk management in line with the Board's risk appetite into structures, policies, processes and procedures; and
- deliver regular principal risk reviews and monitoring.

A copy of Chorus' Managing Risk Policy is available at [www.chorus.co.nz/governance](http://www.chorus.co.nz/governance).

As part of its role, the Audit and Risk Management Committee (ARMC) is responsible for assisting the Board to ensure that a risk management framework has been established and for monitoring compliance with that framework. The ARMC and the Board

regularly receive reports on risk management and the effectiveness of Chorus' management of its material business risks.

Chorus requires its CEO and CFO to make an annual declaration in relation to Chorus' financial statements relating to the matters set out in s295A of the Australian Corporations Act 2001, namely that in their opinion:

- the financial records of Chorus have been properly maintained;
- the financial statements of Chorus and accompanying notes set out in this annual report comply with generally accepted accounting practice in New Zealand and International Financial Reporting Standards; and
- the financial statements of Chorus and accompanying notes set out in this annual report give a true and fair view of the financial position and performance of Chorus.

The CEO and CFO also provide the Board with an assurance that the above declaration is founded on a sound system of risk management and internal control and that system is operating effectively in all material respects in relation to financial reporting risks.

The non-audit related fees paid to the auditor during the financial period (as detailed in Note 8 to the Financial Statements) were permitted non-audit services under Chorus' External Auditor Independence Policy.

### Codes of ethics

Chorus expects its directors and employees to conduct themselves in accordance with the highest ethical standards. Chorus has Codes of Ethics for its directors and employees that set the expected standards for their professional conduct. These codes are intended to facilitate decisions that are consistent with Chorus' values, business goals and legal and policy obligations. The director Code of Ethics is available at [www.chorus.co.nz/governance](http://www.chorus.co.nz/governance).

Chorus has communicated the Codes of Ethics to directors and employees and has provided training to its employees. Chorus encourages its people to report any unethical behaviour through a compliance function that investigates any such reports.

A whistle blowing policy allows for confidential reporting of serious misconduct or wrongdoing and a fraud policy for the reporting of suspected fraud or corruption.

Chorus has not received any reports of serious instances of unethical behaviour during the year.

# The Chorus Board

## Role of the Board and delegation of authority

The Board is appointed by Chorus' shareholders and has statutory responsibility for the business and affairs of Chorus. The Board has overall responsibility for the strategy, culture, governance and performance of Chorus working with, and through, the CEO.

As described in the Board Charter, to allow for the effective day-to-day management and leadership of Chorus, the Board has delegated its authority, in part, to the CEO. The CEO may, in turn, sub-delegate authority to other Chorus people. Formal policies and procedures govern the parameters and operation of these delegations.

The Board has also appointed three standing Board Committees to assist it in carrying out its responsibilities and has delegated some of its responsibilities, powers and authorities to those Board Committees. Those Committees are described below. The Board may also establish other ad-hoc or standing committees and delegate specific responsibilities, powers and authorities to those committees and to particular directors.

The Board and Board Committee Charters and other key governance documents are available on Chorus' website at [www.chorus.co.nz/governance](http://www.chorus.co.nz/governance). The annex to the Board Charter contains a diagram that illustrates the key governance documents and the roles and responsibilities of the Board and Board Committees.

## Board membership

The Board seeks to ensure that through its skills mix and composition it is positioned to add value to Chorus, as outlined in the Board Charter.

The Board currently has seven directors (six independent directors and a managing director) with a broad range of managerial, financial, accounting and industry experience. See page 10 for more information on the skills and experience of the directors.

The independence status of each director is noted in their biographies on page 10. For a director to be considered independent, the Board must affirmatively determine that the director does not have a disqualifying relationship (other than solely as a consequence of being a director). The disqualifying relationships are set out in the Board Charter. While the Board has not set financial materiality thresholds for determining independence, it considers the materiality basis of all relationships having regard to the materiality to Chorus, the director and the relevant person or organisation (e.g. customer, supplier or adviser) with which the director is related. Materiality is assessed in the context of each relationship and from the perspective of both parties to that relationship.

## Board Committees

Each standing Board Committee has a Board approved Charter and a chairman. The Board Committees assist the Board by focusing on specific responsibilities in greater detail than is possible for the Board as a whole.

### Audit and Risk Management Committee (ARMC)

The ARMC assists the Board in ensuring oversight of all matters relating to risk management, financial management and controls and the financial accounting, audit and reporting of Chorus.

All Committee members are non-executive directors. For information on Committee members' qualifications, see page 10.

Members: Anne Urlwin (chairman), Jon Hartley and Sue Sheldon.

### Human Resources and Compensation Committee (HRCC)

The HRCC assists the Board in overseeing people policies and strategies, including:

- Chorus' remuneration frameworks; and
- reviewing candidates for, and the performance and remuneration of, the CEO.

Members: Clayton Wakefield (chairman), Prue Flacks and Keith Turner.

### Nominations and Corporate Governance Committee (NCGC)

The NCGC assists the Board in promoting and overseeing continuous improvement of good corporate governance. The NCGC's role includes identifying and recommending suitable candidates for nomination to be members of the Board and Board Committees, and establishing, developing and overseeing a process for the Board to annually review and evaluate the performance of the Board, its Committees and individual directors.

Members: Sue Sheldon (chairman), Prue Flacks and Jon Hartley.

## Director restrictions

The Chorus Constitution provides that no person who is an 'associated person' of a person that provides telecommunications services in New Zealand (other than the services provided by Chorus) shall be appointed or hold office as a director. NZX has granted Chorus a waiver to allow the Chorus Constitution to include this restriction on the persons who may hold office as director.

## Board and Board Committee meeting attendance

The table below sets out attendance at the Board and Board Committee meetings in the year ended 30 June 2014.

	BOARD MEETINGS	SPECIAL BOARD MEETINGS	ARMC	HRCC	NCGC
<b>Total number of meetings held</b>	12	21	7	5	2
Sue Sheldon (chairman)	11	21	7	5*	2
Anne Urlwin	12	17	7	5*	2*
Clayton Wakefield	12	20	5*	5	1*
Jon Hartley	11	19	6	3*	1
Keith Turner	11	14	3*	5	-
Mark Ratcliffe	10	20	7**	5**	2**
Prue Flacks	12	19	6*	5	2

\* Attended meetings as an observer and not as a Committee member.

\*\* Mark Ratcliffe is not a member of any Board Committees but attends all Board Committee meetings as CEO and as an observer, and may be asked to leave at any time.

### Trading in Chorus shares

All non-executive directors are encouraged to hold Chorus ordinary shares (Chorus Shares).

Directors are subject to limitations on their ability to deal in Chorus Shares and other relevant Chorus securities (Chorus Securities) by Chorus' Insider Trading Policy, the New Zealand Securities Markets Act 1988 and the Australian Corporations Act 2001. These limitations prohibit directors from dealing in Chorus Securities while in possession of inside information.

As a matter of policy, Chorus also requires that directors, prior to dealing in Chorus Securities, notify and obtain consent from the chairman and that trading may only occur in accordance with Chorus' Insider Trading Policy.

All changes in any interests in Chorus Securities held by directors are required to be reported to the Board, the NZX and the ASX.

### Director induction and education

The Board seeks to ensure new directors are appropriately introduced to management and the Chorus business, that all directors are acquainted with relevant industry knowledge and economics and that they receive a copy of the Board and Board Committee Charters and the key governance documents.

It is expected that all directors continuously educate themselves to ensure they have appropriate expertise to effectively perform their duties.

In addition, visits to Chorus operations, briefings from key management, industry experts and key advisers to Chorus, together with educational and stakeholder visits, briefings or meetings are arranged for the Board.

### Independent advice

A director may, with the chairman's prior approval, take independent professional advice (including legal advice).

A director may request the attendance of such an adviser at a Board or Board Committee meeting where this is necessary to fulfil their role and responsibilities for Chorus. The costs of any such adviser is paid for by Chorus.

### Review and evaluation of Board performance

The chairman meets regularly with directors to discuss individual performance.

The Board has carried out, in the reporting period, an annual review of the Board's performance, that of individual directors and Board Committees utilising the Board evaluation process developed and overseen by the NCGC.

### Market disclosures

Chorus is committed to providing timely, orderly, consistent and credible information consistent with legal and regulatory requirements, to enable orderly behaviour in the market and to promote investor confidence. Chorus believes it is imperative that disclosure be evenly balanced during good times and bad and that all parties in the investment community have fair access to this information.

## Diversity at Chorus

### Diversity and inclusiveness at Chorus

Chorus has a Board approved Diversity and Inclusiveness Policy. Chorus believes that having a team of individuals working together who all have different experiences, views and self-reflections makes it stronger and better as an organisation. Chorus defines diversity as the characteristics that make one individual similar to or different from another. It defines inclusiveness as the recognition that diverse backgrounds, experiences and perspectives lead to a better experience of work for its people, makes teams stronger, leads to greater creativity and performance, contributes to a more meaningful relationship with its retail service provider customers and stakeholders, and ultimately leads to increased value to shareholders.

Valuing diversity is more than a moral imperative; it is also sensible business practice.

The focus of the policy is to leverage differences as a competitive advantage through its attraction and development practices, develop inclusiveness as a core capability for its people leaders



and as a channel to its people, and to continue to recognise individual contribution and performance.

The HRCC recommends measurable objectives to the Board that are set and assessed annually.

Chorus is a funder of DiverseNZ Inc. DiverseNZ Inc is a collaboration project with support from the New Zealand public and private sectors to harness the economic benefit, business gain and Gross Domestic Product uplift that results from diverse leadership and diversity of thought.

## Diversity metrics as at 30 June 2014

The Board has set the following measurable objectives for achieving greater diversity at Chorus:

MEASURE	DESCRIPTION	ACTUAL AS AT 30 JUNE 2014	ACTUAL AS AT 30 JUNE 2013	BENCHMARK																														
Age profiles	Median age	41.5 years	41.4 years	42 years. Statistics New Zealand National Labour Force Projections updated August 2012																														
Employee satisfaction	Response to the diversity question "The work environment is very open and accepting of individual differences"	85%	84%	85% Aon Hewitt Best Employer																														
Ethnicity by role	Organisational groupings by ethnicity <sup>1</sup>	<table border="1"> <thead> <tr> <th></th> <th>Total Pop'n</th> <th>People Leaders</th> </tr> </thead> <tbody> <tr> <td>Africa</td> <td>1%</td> <td>0%</td> </tr> <tr> <td>Asia</td> <td>15%</td> <td>2%</td> </tr> <tr> <td>Australia</td> <td>1%</td> <td>0%</td> </tr> <tr> <td>Europe</td> <td>8%</td> <td>13%</td> </tr> <tr> <td>Maori</td> <td>4%</td> <td>4%</td> </tr> <tr> <td>New Zealand</td> <td>66%</td> <td>79%</td> </tr> <tr> <td>Pacific Island</td> <td>5%</td> <td>1%</td> </tr> <tr> <td>South America</td> <td>0%</td> <td>1%</td> </tr> <tr> <td>Unknown/not disclosed</td> <td>1%</td> <td>0%</td> </tr> </tbody> </table>		Total Pop'n	People Leaders	Africa	1%	0%	Asia	15%	2%	Australia	1%	0%	Europe	8%	13%	Maori	4%	4%	New Zealand	66%	79%	Pacific Island	5%	1%	South America	0%	1%	Unknown/not disclosed	1%	0%	<i>Was not available</i>	People leader population distribution = total company population distribution
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Unknown/not disclosed	1%	0%																																
Flexible working arrangements	Percentage of the population utilising flexible working arrangements	3.9% working part-time hours	4.3% working part-time hours	>4% working part-time hours																														
Gender by role	Organisational groupings by gender	<table border="1"> <tbody> <tr> <td>39% ♀</td> <td>61% ♂</td> <td>All</td> </tr> <tr> <td>29% ♀</td> <td>71% ♂</td> <td>People Leaders<sup>2</sup></td> </tr> <tr> <td>22% ♀</td> <td>78% ♂</td> <td>Officers/Senior Executives<sup>3</sup></td> </tr> <tr> <td>43% ♀</td> <td>57% ♂</td> <td>Board<sup>4</sup></td> </tr> <tr> <td>50% ♀</td> <td>50% ♂</td> <td>Non-executive Board<sup>5</sup></td> </tr> </tbody> </table>	39% ♀	61% ♂	All	29% ♀	71% ♂	People Leaders <sup>2</sup>	22% ♀	78% ♂	Officers/Senior Executives <sup>3</sup>	43% ♀	57% ♂	Board <sup>4</sup>	50% ♀	50% ♂	Non-executive Board <sup>5</sup>	<table border="1"> <tbody> <tr> <td>38% ♀</td> <td>62% ♂</td> <td>All</td> </tr> <tr> <td>33% ♀</td> <td>67% ♂</td> <td>People Leaders</td> </tr> <tr> <td>38% ♀</td> <td>62% ♂</td> <td>Officers/Senior Executives</td> </tr> <tr> <td>43% ♀</td> <td>57% ♂</td> <td>Board</td> </tr> <tr> <td>50% ♀</td> <td>50% ♂</td> <td>Non-executive Board</td> </tr> </tbody> </table>	38% ♀	62% ♂	All	33% ♀	67% ♂	People Leaders	38% ♀	62% ♂	Officers/Senior Executives	43% ♀	57% ♂	Board	50% ♀	50% ♂	Non-executive Board	People leader population distribution = total company population distribution
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Rookie ratio	The previous year's intake by age, ethnicity and gender	Average age 36.4 years Gender 45% ♀ 55% ♂ <table border="1"> <tbody> <tr> <td>Africa</td> <td>1%</td> </tr> <tr> <td>Asia</td> <td>27%</td> </tr> <tr> <td>Australia</td> <td>2%</td> </tr> <tr> <td>Europe</td> <td>11%</td> </tr> <tr> <td>Maori</td> <td>1%</td> </tr> <tr> <td>New Zealand</td> <td>53%</td> </tr> <tr> <td>Pacific Island</td> <td>5%</td> </tr> <tr> <td>Unknown/not disclosed</td> <td>2%</td> </tr> </tbody> </table>	Africa	1%	Asia	27%	Australia	2%	Europe	11%	Maori	1%	New Zealand	53%	Pacific Island	5%	Unknown/not disclosed	2%	Average age 37.2 years. Gender 41% ♀ 59% ♂ <i>Ethnicity not available</i>	No measure – for information														
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Internal hire rate	The previous year's appointments identifying internal vs external hire rate	45% of all appointments have been internal 88% of roles in layers 1-3 were recruited internally	39% of all appointments were internal. 61% of roles in layers 1-3 were recruited internally	66% of roles in layers 1-3																														

1 Ethnicity is self-reported by Chorus people.

2 People Leaders have management and leadership roles within Chorus and other Chorus people formally reporting to them.

3 Chorus' Senior Executives are its Officers under the Securities Markets Act 1988 (i.e. the CEO's direct reports who take part in the management of Chorus' business). As at 30 June, Chorus had 2 female and 7 male Officers/Senior Executives (30 June 2013, 3 female, 5 male).

4 As at 30 June, Chorus had 3 female and 4 male directors (no change from 30 June 2013).

5 As at 30 June, Chorus had 3 female and 3 male non-executive directors (no change from 30 June 2013).

Based on the annual review of the effectiveness of Chorus' Diversity and Inclusiveness Policy and Chorus' measurable diversity objectives, the Board considers that overall Chorus is making good

progress towards achieving its diversity and inclusiveness objectives and has performed well against the policy generally.

Chorus' Diversity and Inclusiveness Policy can be found at [www.chorus.co.nz/governance](http://www.chorus.co.nz/governance).

## Remuneration at Chorus

### Directors' fees

The total remuneration available to non-executive directors in the year ended 30 June 2014 was fixed at Chorus' 2012 AGM at \$980,000.

During the year ended 30 June 2014, the total remuneration earned by the directors of Chorus (in their capacity as such) was as follows:

DIRECTOR	TOTAL FEES \$
Sue Sheldon (chairman)	214,000
Anne Urlwin	139,000
Clayton Wakefield	128,500
Jon Hartley	131,500
Keith Turner	150,000
Mark Ratcliffe	-
Prue Flacks	126,500
<b>Total</b>	<b>889,500</b>

#### Notes:

- (i) The figures shown are gross amounts and exclude GST where applicable.
- (ii) Directors are entitled to be paid or reimbursed for reasonable travelling, accommodation and other expenses without requiring authorisation of shareholders. Any such expenses are not included in the table above.
- (iii) All non-executive directors receive a base fee.
- (iv) Board Committee fees are not paid to the chairman of the Board.
- (v) A fee is paid to other non-executive directors for being a member of a Board Committee or the UFB Steering Committee in addition to the base fees.
- (vi) Directors (other than the CEO) do not receive any other benefits.
- (vii) Mark Ratcliffe, as CEO, does not receive any remuneration in his capacity as a director of Chorus. The remuneration of the CEO is summarised below.

The HRCC reviews the remuneration of directors based on criteria developed by that Committee.

Based on advice from independent consultants the Board adopted the fee structure below for the year ended 30 June 2014. The same fee structure applies from 1 July 2014.

	ANNUAL FEE STRUCTURE YEAR TO 30 JUNE 2014 \$	ANNUAL FEE STRUCTURE FROM 1 JULY 2014 \$
<b>Base fees:</b>		
Chairman of the Board	214,000	214,000
Non-executive director	107,000	107,000
<b>Board Committee fees:</b>		
<b>Audit and Risk Management Committee</b>		
Chairman	32,000	32,000
Member	16,000	16,000
<b>Human Resources and Compensation Committee</b>		
Chairman	21,500	21,500
Member	11,000	11,000
<b>Nominations and Corporate Governance Committee</b>		
Chairman	16,000	16,000
Member	8,500	8,500
<b>UFB Steering Committee</b>		
Member	32,000	32,000

#### Notes:

- (i) With the exception of the chairman of the Board, directors receive a fee for each Board Committee of which the director is the chairman or a member.
- (ii) Directors may be paid an additional daily rate of \$2,400 for additional work as determined and approved by the chairman of the Board and where the payment is within the total fee pool available for the relevant financial year based on advice of the General Counsel & Company Secretary. No such fees were paid in the year ended 30 June 2014.

No director receives compensation in share options. No director (except the CEO) participates in a bonus or profit-sharing plan.

No superannuation was paid to, or other scheme for retirement benefits exist for, any director (except for the CEO) in the year ended 30 June 2014.

## CEO remuneration

### Remuneration package for the financial period

Mark Ratcliffe's remuneration as CEO consists of a mixture of fixed remuneration, short term incentives (STI) and long term incentives (LTI). The actual remuneration paid to Mark Ratcliffe in the financial period is as follows:

Fixed remuneration (1 July 2013–30 June 2014)	\$837,308.64 (gross)
Short term incentive (1 July 2013–30 June 2014)	\$423,648.23 (gross)*
Short term incentive extension and non-taxable accommodation payments	\$103,885.00
<b>Total remuneration received</b>	<b>\$1,364,841.87 (gross)</b>

\* FY13 STI paid in August 2013.

In addition, in the year to 30 June 2014, payments totalling \$51,446.58 with regard to KiwiSaver and medical insurance were made on behalf of Mark Ratcliffe.

The following LTI payments were made, or liabilities are due to be calculated and paid, in the following manner. They are all cash payments:

GRANT YEAR	VESTING YEAR	DETAIL	POTENTIAL VALUE
2011	2014	A cash LTI grant was made by Telecom in September 2011. Chorus carried across a liability for the value of \$250,000 (gross). The cash value was converted into Equity Equivalent Units (EEUs) based on dividing the target value by the volume weighted average price (VWAP) of Chorus Shares for the first 20 days of trading, following demerger. A number of post-allocation performance hurdles have been introduced by the Board for this grant. Performance against these measures is considered annually but for the purposes of the grant it is the collated three year performance that determines the vesting multiplier on the grant.	A maximum of 82,281 EEUs converted back into a cash value at vesting based on share price performance at that time.
2012	2015	A cash LTI grant was made by Chorus in September 2012 for the value of \$349,779 (gross). The cash value was converted into EEUs based on dividing the target value by the VWAP of Chorus Shares for a defined 20 day trading period. A number of post-allocation performance hurdles have been introduced by the Board for this grant. Performance against these measures is considered annually but for the purposes of the grant it is the collated three year performance that determines the vesting multiplier on the grant.	A maximum of 104,853 EEUs converted back into a cash value at vesting based on share price performance at that time.

The CEO remuneration package is reviewed annually by the HRCC and Board, after seeking advice from external remuneration specialists and reviewing CEO and Chorus' performance. In future years, the target values may be revised as a result of future adjustments to the CEO remuneration package and components.

### Chorus remuneration model

The Board reviews the remuneration model for Chorus and has established principles of alignment to shareholder outcomes, simplicity, clarity and fairness, and remuneration outcomes which are based on performance.

All Chorus employees have a fixed remuneration and STI component in their remuneration packages. A limited number of employees also have an LTI component.

#### Fixed remuneration

The fixed remuneration model is informed and adjusted each year based on data from multiple independent remuneration specialists. Employees' fixed remuneration is based on a matrix of their own performances and their current remuneration position in the market range.

#### STI plan

STI values are calculated as a percentage of fixed remuneration and determined based on the complexity of the roles. Employees'

STI payments are determined following review of company performance and individual performance and may be paid out at a multiplier of 0x to 2.8x. This model is focussed on articulating performance goals, driving for outcomes, differentiating high performance and rewarding delivery. Alignment with shareholder interests is maintained by annual review of company-wide performance targets and their relative weighting. In FY14 these performance targets were focused on EBITDA and capital efficiency (e.g. cost per premises passed, cost per premises connected) measures.

#### LTI plan

Chorus operates an LTI plan for its executives. The Board has reviewed this model, on the basis of independent advice, and intends to introduce a new model in 2015. This may involve the incorporation of a new subsidiary to act as trustee of the scheme.

#### STI Extension Programme

Chorus has a short term incentive extension programme in place for named executives that will run from December 2013 to March 2016 and replaces their LTI plan for 2013 and 2014. This is an extension of the current STI scheme and has been put in place while long term measures are subject to external uncertainties. As with all remuneration at Chorus, payment is subject to meeting performance criteria.

### Managing performance

Chorus' performance management process is based on all Chorus people having performance and development plans for the year, which are regularly reviewed with their people leaders. The performance plan is developed initially by the individual after participating in 'Line of Sight' sessions, which enable them to link Chorus' strategy with their day to day work and focus areas. The performance plan includes both outcome based objectives and behavioural measures, along with a development plan. End of year performance reviews are undertaken for all Chorus people. In these the people leader for the individual seeks additional feedback and participates in a peer review and moderation process, resulting in an overall rating and remuneration recommendation that impacts the individual's total reward (fixed remuneration and target STI).

This same process has been undertaken for the Chorus executive team, with the CEO making recommendations to the HRCC for the executive team and the chairman of the HRCC leading the performance review of the CEO and making recommendations to the Board. This process is consistent with that set out in the HRCC Charter and allows the Board to provide input into these individuals' performance outcomes, total reward approvals (fixed remuneration, target STI and LTI) and development plans.

### Employee remuneration range

The table alongside shows the number of employees and former employees who, in their capacity as employees, received remuneration and other benefits in excess of \$100,000 during the year to 30 June 2014.

In addition, certain employees elect to participate in Chorus' employee equity building scheme, receive contributions towards membership of the Marram Trust (a community healthcare and holiday accommodation provider), contributions to the Government Superannuation Fund (a legacy benefit provided to a small number of employees) and, if the individual is a KiwiSaver member, a contribution of 3% of gross earnings towards that individual's KiwiSaver scheme. These amounts are not included in these remuneration figures.

Any benefits received by employees that do not have an attributable value are not included.

REMUNERATION RANGE \$ (GROSS)	NUMBER OF EMPLOYEES IN THE YEAR ENDED 30 JUNE 2014 (BASED ON ACTUAL PAYMENTS)
1,360,001-1,370,000	1
660,001-670,000	1
550,001-560,000	1
520,001-530,000	1
500,001-510,000	1
460,001-470,000	1
440,001-450,000	1
410,001-420,000	1
360,001-370,000	1
310,001-320,000	2
300,001-310,000	3
280,001-290,000	1
270,001-280,000	2
260,001-270,000	4
250,001-260,000	3
240,001-250,000	6
230,001-240,000	3
220,001-230,000	3
210,001-220,000	16
200,001-210,000	6
190,001-200,000	11
180,001-190,000	11
170,001-180,000	15
160,001-170,000	18
150,001-160,000	19
140,001-150,000	35
130,001-140,000	53
120,001-130,000	45
110,001-120,000	49
100,000-110,000	55

### Employee Equity Building Scheme

Chorus implemented an employee equity building scheme in September 2013 to better align employee and shareholder interests. A total of 622 Chorus employees participated in the scheme. Chorus contributed up to \$499 per participating employee. A total of 106,984 shares were purchased on-market under the scheme 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.



# Disclosures

## Directors

### Directors during the year ended 30 June 2014

Current directors are listed on page 10. No directors resigned during the year ended 30 June 2014.

### Indemnities and insurance

As permitted by its Constitution, Chorus has entered into deeds of indemnity with each of the directors for potential liabilities or costs they may incur for acts or omissions in their capacity as directors.

Deeds of indemnity have also been given to certain senior staff for potential liabilities and costs they may incur for acts or omissions

in their capacity as employees of Chorus, directors of Chorus subsidiaries or as directors of non-Chorus companies in which Chorus holds interests.

Chorus has a directors' and officers' liability insurance policy in place. This provides insurance for the liabilities of the directors and employees of Chorus for acts or omissions in their capacity as directors or employees. It does not cover dishonest, fraudulent, malicious or wilful acts or omissions.

### Director interests in Chorus Shares

As at 30 June 2014, directors had a relevant interest (as defined in the Securities Markets Act 1988) in Chorus Shares as follows:

DIRECTOR	AS AT 30 JUNE 2014		TRANSACTIONS DURING THE REPORTING PERIOD		
	SHARES	INTEREST	NUMBER OF SHARES PURCHASED (SOLD)	CONSIDERATION	DATE OF TRANSACTION
Sue Sheldon	15,813	Registered holder as trustee of family trust	813*	\$2,612.58	11 October 2013
Clayton Wakefield	20,712	Beneficial interest	1,065*	\$2,832.90	11 October 2013
Keith Turner	5,994	Legal and beneficial interest	308*	\$819.28	11 October 2013
Anne Urlwin	10,000	Director and shareholder of registered holder	Nil		
Mark Ratcliffe	105,333	Beneficial interest	4,555*	\$12,116.30	11 October 2013
Prue Flacks	5,142	Legal and beneficial interest	264*	\$702.24	11 October 2013
	5,240	Trustee of family trusts	Nil		
<b>Total</b>	<b>168,234</b>				

\* Acquired under Chorus' Dividend Reinvestment Plan.

As at 30 June 2014, directors had a relevant interest representing approximately 0.042% of Chorus Shares.

### Interests Register

Directors disclosed, pursuant to section 140 of the Companies Act 1993, a change in, or cessation of, interest in the following entities during the year ended 30 June 2014:

**Sue Sheldon:** Changes in interests: Christchurch City Council Audit and Risk Management Committee (chairman). Cessation of interests: Reserve Bank of New Zealand (deputy chairman).

**Anne Urlwin:** Changes in interests: Summerset Group Holdings Limited (director), Naylor Love Properties Limited (director). Cessation of interests: SR 1 Limited (director).

**Clayton Wakefield:** Changes in interests: Fisher & Paykel Finance Holdings Limited (director), Consumer Finance Limited (director), Consumer Insurance Services Limited (director), Equipment Finance Limited (director), Fisher & Paykel Financial Services Limited (director), Retail Financial Services Limited (director), Fisher & Paykel Finance Limited (director). Cessation of interests: Nil.

**Jon Hartley:** Changes in interests: VisionFund International (chairman), Wellington City Mission (Anglican) Trust Board (chairman and trustee), GRIT Learning Limited (director). Cessation of interests: VisionFund Cambodia Limited (director), GRIT Learning Limited (director), Trango Capital Limited (director, shareholder, trustee of shareholder)\*.

**Keith Turner:** Changes in interests: Team New Zealand AC35 Challenge Limited (chairman). Cessation of interests: Solar City New Zealand Limited (chairman), Waitaki Wind Limited (director).

**Mark Ratcliffe:** Changes in interests: Nil. Cessation of interests: Nil.

**Prue Flacks:** Changes in interests: Nil. Cessation of interests: BNZ Life Insurance Limited (chairman), BNZ Insurance Services Limited (chairman).

\* Change in interest occurred after 30 June 2014.

## Shares and shareholders

### Stock exchange listings and American Depositary Receipts

Chorus Shares are quoted on the NZX Main Board and on the ASX. Chorus trades under the ticker 'CNU'.

American Depositary Shares (ADSs), each representing five ordinary shares and evidenced by American Depositary Receipts (ADRs), are not listed but are traded on the over-the-counter (OTC) market in the United States under the ticker symbol 'CHRY'. Chorus' depository is the Bank of New York Mellon.

Chorus has also issued GBP260 million foreign currency debt in the form of European medium term notes (EMTNs). Chorus is listed, and the EMTNs quoted, on the Luxembourg Stock Exchange.

### NZX waivers

A summary of all waivers granted and published by NZX in the 12 months ending on 30 June 2014 and relied on by Chorus is available on Chorus' website at [www.chorus.co.nz](http://www.chorus.co.nz). This summary will be available until Chorus' next annual report is published.

### ASX disclosures

Chorus has been admitted to the official list of the ASX. As a result, Chorus is required to make the following disclosures:

- Chorus' place of incorporation is New Zealand.
- Chorus is not subject to Chapters 6, 6A, 6B and 6C of the Australian Corporations Act 2001 dealing with the acquisition of shares (including substantial shareholdings and takeovers).
- Chorus' Constitution contains limitations on the acquisition of securities, as described below.

### Registration as a foreign company

Chorus has registered with the Australian Securities and Investments Commission (ASIC) as a foreign company. Chorus has been issued an Australian Registered Body Number (ARBN) of 152 485 848.

### Quoted securities

As at 30 June 2014 there were 396,369,767 Chorus Shares on issue.

Each Chorus Share confers on its holder the right to attend and vote at a meeting of Chorus, including the right to cast one vote on a poll on any resolution.

### Non-standard designation

NZX has attached a 'non-standard' designation to the listing of the Chorus Shares owing to the ownership restrictions in Chorus' Constitution, as described below.

### Chorus' constitutional ownership restrictions

Chorus' Constitution includes ownership restrictions that prohibit any person:

- from having a relevant interest in 10% or more of Chorus Shares, unless the prior written consent of the New Zealand Government is obtained; or
- other than a New Zealand national, from having a relevant interest in more than 49.9% of Chorus Shares, unless the prior written consent of the New Zealand Government is obtained.

If the Board or the New Zealand Government determines there are reasonable grounds for believing that a person has a relevant interest in voting shares in excess of the ownership restrictions, the Board may, after following certain procedures, prohibit the exercise of voting rights (in which case the voting rights shall vest in the chairman) and may force the sale of shares. The Board may also decline to register a transfer of shares if it reasonably believes the transfer would breach the ownership restrictions.

NZX has granted Chorus waivers allowing Chorus' Constitution to include the power of forfeiture, the restrictions on transferability of Chorus Shares and the Board's power to prohibit the exercise of voting rights relating to these ownership restrictions.

Chorus has been advised by the Crown that AMP Capital Holdings Ltd and its related companies have been granted approval, should they choose to exercise it in future, to acquire a relevant interest in 10% or more (but not exceeding 15%) of Chorus Shares.

### Unquoted securities

SECURITY	NUMBER OF SECURITIES ISSUED IN YEAR ENDED 30 JUNE 2014	TOTAL NUMBER OF SECURITIES ON ISSUE AS AT 31 JULY 2014	HOLDER	PERCENTAGE HELD
CFH Equity Securities	71,503,708	146,210,731	Crown Fibre Holdings Ltd	100%
CFH Debt Securities	71,503,708	146,210,731	Crown Fibre Holdings Ltd	100%
CFH Warrants	4,423,340	8,182,505	Crown Fibre Holdings Ltd	100%

The CFH equity securities are a unique class of security that carry no right to vote at meetings of holders of Chorus Shares but entitle the holder to a right to a repayment preference on liquidation. Dividends become payable on a portion of the CFH equity securities from 2025, with the portion increasing over time. A greater portion of CFH equity securities attract dividends if a 20% fibre up-take threshold is not met by 30 June 2020. CFH equity securities can be redeemed by Chorus at any time by payment of the issue price or issue of new Chorus Shares (at a 5% discount to the 20-day volume weighted average price) to the holder. In limited circumstances the CFH equity securities may be converted by the holder into voting preference shares or Chorus Shares.

The CFH debt securities are unsecured, non-interest bearing and carry no voting rights at meetings of holders of Chorus Shares. Chorus is required to redeem the CFH debt securities in tranches from 2025 to 2036 (at the latest) by repaying the issue price to the holder. An accelerated repayment schedule applies if a 20% fibre up-take threshold is not met by 30 June 2020.

The CFH warrants are an option to acquire Chorus Shares on a specified exercise date at a set strike price and have been issued in two series, with different repayment schedules. On 30 June 2020 one series will be cancelled depending on whether a 20% fibre up-take threshold is met.

The terms of the issue for each of the CFH equity securities, CFH debt securities and the CFH warrants are set out in the subscription agreement with CFH and summarised on Chorus' website at [www.chorus.co.nz/financial-reports](http://www.chorus.co.nz/financial-reports).

### Distribution of shareholders and shareholdings of Chorus Shares as at 31 July 2014

SIZE OF SHAREHOLDING	NUMBER OF HOLDERS	NUMBER OF SHARES HELD	% OF CHORUS SHARES ISSUED
1 to 1,000	24,463	7,478,080	1.89
1,001 to 5,000	8,039	20,269,220	5.11
5,001 to 10,000	2,444	18,326,154	4.62
10,001 to 100,000	2,189	54,006,665	13.63
100,001 and over	145	296,289,648	74.75
<b>Total</b>	<b>37,280</b>	<b>396,369,767</b>	<b>100</b>

### Substantial security holders as at 31 July 2014

As at 31 July 2014 Chorus had received notices under Section 26 of the Securities Markets Act 1988 that the following shareholders were substantial security holders in respect of Chorus Shares:

SUBSTANTIAL SECURITY HOLDER	NUMBER OF VOTING SECURITIES	%	DATE OF NOTICE
Accident Compensation Corporation	32,581,123	8.22	22 July 2014
Schroder Investment Management Australia Limited	22,353,579	5.64	25 February 2014
Allan Gray Australia Pty Limited	19,839,411	5.00	29 July 2014

Chorus has also received notices from Jason Familton. Mr Familton is not himself a substantial security holder but has submitted separate notices on the basis of the aggregation of interests in securities held by him personally and held by Accident Compensation Corporation (ACC) given the qualified powers he may have to exercise voting rights and acquire or dispose of Chorus shares as an employee and portfolio manager or equity analyst for ACC.

### Twenty largest holders of Chorus Shares as at 31 July 2014

RANK	HOLDER NAME	HOLDING	%
1.	Accident Compensation Corporation*	32,458,159	8.18
2.	JP Morgan Nominees Australia Limited	28,359,188	7.15
3.	HSBC Nominees (New Zealand) Limited*	23,236,633	5.86
4.	National Nominees New Zealand Limited*	18,690,229	4.71
5.	National Nominees Limited	17,599,612	4.44
6.	HSBC Nominees (New Zealand) Limited A/C State Street*	17,536,840	4.42
7.	JP Morgan Chase Bank NA NZ Branch-Segregated Clients Acct*	15,837,187	3.99
8.	Citicorp Nominees Pty Limited	14,290,159	3.60
9.	Citibank Nominees (New Zealand) Limited*	10,163,674	2.56
10.	BNP Paribas Nominees (NZ) Limited*	9,971,163	2.51
11.	HSBC Custody Nominees (Australia) Limited	8,891,193	2.24
12.	RBC Investor Services Australia Nominees Pty Limited	8,661,582	2.18
13.	FNZ Custodians Limited	8,019,314	2.02
14.	Westpac NZ Shares 2002 Wholesale Trust*	7,162,983	1.80
15.	Forsyth Barr Custodians Limited	4,857,893	1.22
16.	New Zealand Superannuation Fund Nominees Limited*	4,686,043	1.18
17.	Ronald James Woodrow	4,662,281	1.17
18.	BNP Paribas Noms Pty Ltd	3,361,268	0.84
19.	Leveraged Equities Finance Limited	3,007,903	0.75
20.	Forsyth Barr Custodians Limited	2,731,931	0.68

\* Held through New Zealand Central Securities Depository Limited (NZCSD). NZCSD provides a custodial depository service which allows electronic trading of securities by its members. As at 31 July, 147,779,280 Chorus Shares (or 37.3% of the ordinary shares on issue) were held through NZCSD.

### Shareholders holding less than a marketable parcel

As at 31 July 2014, there were 11,300 shareholders holding between 1 and 199 Chorus Shares (less than a minimum holding under the NZX Listing Rules) and, based on the closing market price of A\$1.61, there were 14,935 holders that held less than a marketable parcel of A\$500 of Chorus Shares under the ASX Listing Rules.

On-market buy-back: There is no current on-market buy-back.

### Net tangible assets per security

As at 30 June 2014, the consolidated net tangible assets per share was \$1.43 (30 June 2013: \$1.21). Net tangible assets per share is a non-GAAP financial measure and is not prepared in accordance with NZ IFRS.

### Revenue from ordinary activities and net profit

In the year ended 30 June 2014 Chorus':

- revenue from ordinary activities increased 0.1% to \$1,058 million; and
- profit from ordinary activities after tax, and net profit, attributable to security holders decreased 13.5% to \$148 million.

### Company Secretary

Vanessa Oakley

### Donations

Chorus New Zealand Ltd made a donation of \$25,000 to Wellington Free Ambulance during the reporting period.

### Subsidiaries

#### Chorus New Zealand Ltd

Directors: Mark Ratcliffe (chairman), Andrew Carroll, Brian Hall, Vanessa Oakley and Lucy Riddiford (as alternate director for Vanessa Oakley).

No directors of Chorus New Zealand Ltd resigned during the reporting period.

#### Director Remuneration:

The directors of Chorus New Zealand Ltd are all employees and do not receive any remuneration in their capacity as directors.

#### Directors' interests:

Mark Ratcliffe: Changes in interests: Nil. Cessation of interests: Nil.

Andrew Carroll: Changes in interests: Nil. Cessation of interests: Nil.

Brian Hall: Changes in interests: Nil. Cessation of interests: Nil.

Lucy Riddiford: Changes in interests: Nil. Cessation of interests: Nil.

Vanessa Oakley: Changes in interests: Nil. Cessation of interests: Nil.

#### Indemnities and Insurance:

See Indemnities and Insurance on page 19 for further information.

#### Other subsidiaries

Chorus has no other subsidiaries. The Board intends to introduce a new long term incentive scheme for the CEO and Executive in 2015. A new subsidiary may be incorporated to act as a trustee of the scheme.





# Management Commentary

## CONTENTS

Challenges and highlights	25
In summary	26
Revenue commentary	27
Expenditure commentary	30
Capital expenditure commentary	33
Long term capital management	35
Competition and regulation	36
Litigation	37
Appendix one	38
Appendix two	39

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## Management commentary

	2014 \$M	2013 \$M
Operating revenue	1,058	1,057
Operating expenses	(409)	(394)
<b>Earnings before interest, income tax, depreciation and amortisation</b>	<b>649</b>	<b>663</b>
Depreciation and amortisation	(322)	(319)
<b>Earnings before interest and income tax</b>	<b>327</b>	<b>344</b>
Net interest expense	(121)	(108)
<b>Net earnings before income tax</b>	<b>206</b>	<b>236</b>
Income tax expense	(58)	(65)
<b>Net earnings for the year</b>	<b>148</b>	<b>171</b>
<b>Non statutory measure: underlying EBITDA</b>		
<b>EBITDA</b>	<b>649</b>	<b>663</b>
<i>Less: insurance proceeds</i>	(2)	(1)
<i>Add: UCLFS connection charge backdating</i>	9	-
<i>Less: UCLFS monthly charge price change</i>	-	(8)
<b>Underlying EBITDA</b>	<b>656</b>	<b>654</b>

Chorus reports earnings before interest, income tax, depreciation and amortisation (EBITDA) of \$649 million for the year ending 30 June 2014. After adjusting for \$2 million of insurance proceeds from the Canterbury earthquakes and \$9 million backdating of the UCLFS connection price change, underlying EBITDA is \$656 million (refer *appendix two*). Chief Executive Officer Mark Ratcliffe said it was “a solid financial result underpinned by an increase of 51,000 broadband connections and relative stability in the number of fixed lines, while fibre connections more than doubled. Delivery of the UFB and RBI programmes is ahead of schedule, but this success has been overshadowed by the need to reshape Chorus operationally and financially to address the challenges posed by the ongoing uncertainty with the regulatory framework and revised copper pricing.”

# Challenges and highlights

## Challenges

Chorus shareholders have had a very difficult year. Ongoing regulatory challenges resulted in very large capital losses and dividends being withdrawn until a dividend policy is financially sustainable and there is sufficient certainty around Chorus' outlook.

The Commerce Commission's (the Commission) 5 November 2013 initial pricing principle decision resulted in a very material funding gap in Chorus' business plan through to 2020 necessitating a fundamental review of the viability of Chorus' business model and a huge effort to reshape Chorus' business to secure a sustainable operating framework. In addition to the very material trade-offs the business has had to confront, impacting many stakeholders, this ongoing uncertainty continues to be a major distraction for Chorus and the wider industry, potentially slowing the migration to fibre.

It is difficult for Chorus to justify discretionary network investment in the absence of a fit for purpose regulatory framework that provides for a fair rate of return. This is further exacerbated by the lack of certainty as to the regulatory framework that will apply from 2020 once the Ultra-Fast Broadband (UFB) rollout is completed.

## Highlights

Good progress has been made in reshaping the business – operationally and financially – to manage in a situation where Chorus receives \$142 million less in EBITDA per annum as a result of the Commission's initial pricing principle decision. Chorus has a credible but demanding plan through to 2020 to manage this shortfall, has implemented a number of operational initiatives with more in train, and has secured important changes to its funding arrangements to provide materially more funding flexibility and certainty. Chorus is driving the bulk of the initiatives to manage through this shortfall, with Crown Fibre Holdings also providing some useful additional flexibility within existing contractual arrangements.

In addition to the substantial effort put into reshaping the business, Chorus has performed well operationally:

- Many very important network build milestones were achieved with the UFB and Rural Broadband Initiative (RBI) rollouts being delivered ahead of schedule;
- A number of demanding Information Technology (IT) projects were successfully completed as Chorus migrates from shared Spark (formerly Telecom) platforms; and
- Fixed line fibre connections have doubled during the year, VDSL connections have increased significantly and total fixed line connections have remained stable.

## In summary

### EBITDA

EBITDA for the year ended 30 June 2014 was \$649 million, representing around 0.3% growth in underlying EBITDA (see *appendix two*). This reflects continued growth in demand for Chorus' basic and enhanced copper products, including steady broadband and fibre uptake over the year. Costs have grown by 3.8%, reflecting increased provisioning costs, information technology costs and growing employee numbers. Growth in connection numbers for both fibre and Very High Speed Digital Subscriber Line (VDSL) installations have driven increases in provisioning and labour costs. A significant focus on costs since the announcement of the UBA benchmarked pricing by the Commerce Commission in November 2013 has seen a reduction in costs in the second half of the year. Initiatives such as restructuring, significantly reducing discretionary activity (such as proactive maintenance) and tight control on general costs (such as travel and telecommunications) have been implemented.

A comparison of the underlying full year results, with commentary on the items being adjusted, with the underlying results for the year ended 30 June 2013 is included in *appendix two*.

### Capital expenditure

Capital expenditure for the year ended 30 June 2014 was \$679 million, consistent with the guidance range of \$660–\$690 million. This included \$42 million of year four UFB build initiated in this financial year and recognised as work in progress and \$6 million for building fibre to schools ahead of the UFB rollout schedule with full cost recovery. Approximately 83% of Chorus' capital expenditure was focused on fibre related investment, principally for the UFB and RBI deployment programmes.

### Dividends

Following the withdrawal of dividend guidance on 18 November 2013, the capital management update provided in February 2014 and the CFH financing and committed bank facility amendments announced in July 2014, Chorus will not pay a final FY14 dividend. In February, Chorus indicated that a future dividend policy would be communicated when financially sustainable and there was sufficient certainty of outcomes from the Chorus initiatives, CFH discussions and regulatory reviews.

As part of the 25 July 2014 bank amendments, Chorus has agreed that no dividends will be paid until the later of the conclusion of the Commission's final pricing principle review processes or 30 June 2015, consistent with February guidance.

In addition to this, Chorus has entered into a conditional agreement with CFH which gives Chorus the option to bring forward part of CFH's existing investment funding. If Chorus uses the facility, Chorus would be unable to pay a dividend before December 2019 without CFH approval, unless Chorus normalises the CFH funding profile.

### Outlook

From a regulatory perspective Chorus has a number of challenges ahead:

- Ongoing uncertainty with today's regulatory framework, its lack of clear alignment with the Government's UFB initiative and the absence of fit-for-purpose regulation that recognises changed market structures and supports product innovation. The post 2020 regulatory framework remains unclear for the industry and regulator and creates difficulty for longer term investment decisions. Addressing both frameworks is important to ensure investors receive a fair rate of return.
- Changes to regulated pricing through the implementation of benchmarked UBA pricing on 1 December 2014 and the Commission's final pricing principle reviews that will shape Chorus' future revenues and industry willingness to migrate to fibre.
- Significant regulatory programmes will continue in FY15 and result in continued high regulatory and consultant costs.

Chorus also faces challenges including:

- Implementation of the extensive range of operating cost, capital expenditure and revenue initiatives identified to help address this ongoing period of pricing uncertainty.
- Delivering the operational capability to meet further growth in UFB connections in a time and cost effective manner. Uptake still varies widely from area to area and is unpredictable in nature. There is also a developing range of connection types (including rights of way and multi dwelling units) as the UFB footprint expands and Retail Service Providers (RSPs) further promote fibre. Access and consents, particularly for connections in rights of way and multi dwelling units, remain a significant impediment to fibre uptake
- Incremental Information Technology (IT) costs as two IT systems are run in parallel and current financial constraints delay planned IT migration.
- The increasing demand for VDSL and fibre connections may cause near term impact on earnings and capital expenditure respectively, with the associated cash flow implications as the cost of the connection is incurred up front, while the revenues are received over time.
- Continued focus on achieving the milestones required by the UFB and RBI contracts and ensuring these programmes continue to meet cost expectations advised to the market.
- Ongoing focus from retail service providers on input costs as they seek opportunities to lower their wholesale costs from Chorus. Copper line connections are also being retained for voice services in some instances where UFB is provisioned and this is expected to cease in the future. Increased competitive pressure from other networks.
- Other UFB network builders had passed about 170,000 end-users at 30 June 2014 and are expected to gain greater market share from Chorus over time. Mobile network operators are also now offering 4G coverage in main centres, providing enhanced mobile broadband capability.

Despite these challenges Chorus is proud of its role in lifting broadband performance in New Zealand and investing in a fibre network to provide long term benefits for end-users and New Zealand. In addition to this, Chorus remains focussed on achieving a fair rate of return for investors who continue to support the ongoing development of New Zealand's fixed line network.



# Revenue commentary

	2014 \$M	2013 \$M
Basic copper	543	631
Enhanced copper	293	215
Fibre	75	60
Value added network services	38	37
Infrastructure	19	17
Field services	75	85
Other	15	12
<b>Total revenue</b>	<b>1,058</b>	<b>1,057</b>

## Revenue overview

Chorus' revenue strategy focuses on:

- Retaining value by sustaining demand for Chorus' share of market connections;
- Supporting demand for UFB services in line with the Government's objective to maximise fibre uptake. This includes delivering products that support bandwidth growth and encourage adoption of higher speed fibre products of 100Mbps or more;
- Securing sustainable regulatory settings for copper that also support the migration to fibre.

Chorus' product portfolio encompasses a broad range of broadband, data and voice wholesale services. It includes a mix of regulated and commercial copper and legacy products, and contractually agreed fibre products. Chorus' focus is on sustaining demand for connections and supporting retail service providers and stakeholders by growing profitable connections and 'leading New Zealand to fibre'.

Revenues and volumes have remained relatively steady throughout the year.

Unadjusted revenues were flat compared to the prior period. After adjusting for changes in regulated Unbundled Copper Low Frequency Service (UCLFS) pricing and insurance receipts, revenues were up by around 1.6% on a like for like basis (see *appendix two*). Total fixed line connections were largely stable, with a slight decrease of 3,000 connections (from 1,784,000 to 1,781,000).

A summary of Chorus' connection numbers for key products is in *appendix one*.

## Basic copper

Basic copper incorporates core regulated products that, while an important part of the portfolio, are founded on earlier technology and product variants that are being superseded by enhanced copper and fibre services. It includes most of Chorus' layer 1 network products and includes the copper voice input UCLFS, Unbundled Copper Local Loop (UCLL), Sub Loop Unbundling (SLU), Sub Loop Extension Service (SLES) and Basic UBA (including broadband only naked Basic UBA connections).

Basic copper revenues are continuing to decline as retail service providers migrate end-users from Basic UBA broadband services to enhanced copper and Internet Protocol (IP) voice services.

The majority of basic copper revenues are derived from Chorus' Baseband Copper services (including UCLFS) which retail service providers can use as an input into traditional voice offers. At 30 June 2014 there were approximately 1,475,000 Baseband Copper lines<sup>2</sup>, a decrease of 46,000 lines from 30 June 2013. This reduction was offset by the migration of connections to Chorus' other fixed line connection products. In particular, 'naked' connections (naked Basic UBA, naked Enhanced UBA and naked VDSL) grew by 26,000 lines.

The number of unbundled exchanges grew from 183 to 189 over the year, with approximately 131,000 access lines being used by retail service providers to deliver unbundled services to end-users. The total comprised 127,000 UCLL lines and 4,000 SLU lines (offered in conjunction with Chorus' commercial Sub Loop Extension Service).

UCLL lines are currently charged at \$19.08 for urban and \$35.20 for non-urban following the Commission's re-benchmarking of UCLL pricing in December 2012. The urban and non-urban prices are expected to move to an averaged price of \$23.52 in December 2014 (noting that the pricing of these services is still subject to various processes – see the *competition and regulation* section).

<sup>2</sup> 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.

## Revenue commentary (cont.)

Basic UBA is a broadband service delivered on a 'best efforts' basis, typically using older generation technology. The number of Basic UBA connections had declined to about 164,000 connections at 30 June 2014 as retail service providers migrate end-users to the Enhanced UBA 0 service (also a UBA 'best efforts' service).

UBA pricing is due to reduce from \$21.46 to \$10.92 from 1 December 2014 as a result of the Commission's benchmarking price decision of 5 November 2013. Chorus has appealed a review of this decision to the Court of Appeal and it is also subject to a final pricing principle review by the Commission (see the *competition and regulation* section).

### Enhanced copper

Enhanced copper includes copper based next generation regulated and commercial products that deliver higher speed capability, a better end-user experience and can assist transition to fibre. It includes Enhanced UBA, VDSL, Baseband IP voice input service and High Speed Network Service (HSNS) Lite (Copper) for business data.

Chorus' enhanced copper category grew steadily over the year, reflecting the continued migration to Enhanced UBA 0 services and continued growth in new connections.

Enhanced UBA connections were approximately 802,000 at 30 June 2014, up from 680,000 at 30 June 2013. There were also approximately 93,000 naked Enhanced UBA connections at 30 June 2014. As noted earlier, the pricing of UBA services is currently under review (see the *competition and regulation* section).

Uptake of VDSL increased significantly through the year after it was re-priced by Chorus in June 2013 and retail service providers began promoting it. The number of VDSL connections had increased to 49,000 by 30 June 2014, up from 2,000 at 30 June 2013. There were also 15,000 naked VDSL lines, up from 2,000 at the start of the year.

VDSL utilises existing copper based capability and can provide download speeds of about 20-50Mbps and upload speeds of up to 20Mbps, subject to an end-user's distance from the broadband equipment and line capability. About 60% of lines nationwide are within reach of VDSL, including a growing number of rural users within the RBI rollout footprint.

'Data service over copper' connections reduced by 9,000 lines as the classification of legacy connections was reviewed and retail service providers scrutinised input costs.

Baseband IP connections, used by retail service providers to deliver a voice over internet protocol service over copper, grew slowly from a small base. Baseband IP is currently available across about 10% of Chorus' lines and is charged at \$23.52 per month. Chorus may consider expanding the Baseband IP footprint further where retail service provider demand and the business case supports it.

### Fibre

Fibre revenues are earned from Chorus' existing business fibre products (such as HSNS Premium) and new UFB residential and business fibre services. This category also captures UFB backhaul, and Direct Fibre, which is the equivalent of dark fibre and can also be used to deliver backhaul connections to mobile sites.

Fibre connections nationwide more than doubled during the year, increasing from 19,000 to 42,000 lines. This growth reflected new demand linked to the ongoing expansion of the UFB footprint and continued demand for new business and carrier connections via Chorus' existing fibre network.

About 31,000 of Chorus' fibre connections were residential Next Generation Access (NGA) end-users (which includes UFB Bitstream 2 and 3 and education connections) or non-UFB fibre subdivision end-users. UFB uptake has increased as the UFB coverage area has grown and more retail service providers have been promoting services. However, uptake does vary widely from area to area, largely reflecting the degree of retail service provider focus on promoting fibre services in each area. The majority of end-users are on entry level 30Mbps fibre products. Chorus has recently introduced new 100Mbps plans at a \$40 wholesale price to help establish this speed as the entry level plan and increase average revenue per user.

Direct Fibre Access connections were about 3,800 of total fibre connections by 30 June 2014. Bandwidth Fibre and HSNS Premium fibre connections (also referred to as Bitstream 4 under the UFB agreement) accounted for the remaining 7,000 fibre connections. Demand for business fibre connections has been predominantly for higher grade HSNS Premium connections rather than Bitstream 3 business services. This may change over time as the UFB network makes Bitstream 3 business services more widely available and Chorus introduces new fibre products with higher speed performance.

About 353,000 end-users were within reach of the UFB network at 30 June 2014. Chorus had approximately 27,000 fibre connections within the areas where it had deployed UFB communal network at 30 June 2014, up from 6,300 connections at 30 June 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.

### Value added network services

The main revenue driver for this category is carrier network services, which provide network connectivity across backhaul links. The nature of these services means volumes and revenues in this category were largely unchanged.

### Infrastructure

Infrastructure revenue relates to services that provide access to Chorus' network assets, including civil works and telecommunications exchange space. It also includes co-location of equipment and access to poles.

Chorus provides commercial access to its exchanges, poles and other infrastructure. Co-location revenue derives from retail service providers and other network operators installing their equipment in Chorus exchanges, as well as leased commercial space in exchange buildings.

Infrastructure revenue has increased due to strong growth in commercial co-location. Commercial co-location enables retail service providers to interconnect with Chorus' UFB footprint. The capacity for this product to grow much further is limited.

### Field services

This category includes work performed by Chorus' service company technicians providing new services, chargeable cable location services, maintaining retail service provider networks and relocating Chorus' network on request. As Chorus utilises service companies to perform the field services' work, there is a direct cost associated with all field services revenues recognised in the network maintenance expense category.

Provisioning revenues are generally based on orders for technicians to install services and are driven by the number and nature of orders, and the type of work required.

Maintenance revenues are generated when faults are proven to be on the retail service provider's rather than Chorus' network, and are driven by the number of reported faults and proactive maintenance programmes performed on behalf of retail service providers.

These revenues also include costs recovered for damage to Chorus' network by third parties.

Revenue in this category is dependent on third party demand or damages to Chorus' network by third parties. It is therefore difficult to establish specific trends in this revenue category.

Included in field services revenue is the connection charges for various products. UCLFS connection charges have been reset so that they are the same (and backdated) as the benchmarked UCLL connection charges that were set in December 2012. Chorus' view is that these connection charges are part of the UCLL final pricing principle review by the Commission (see the *competition and regulation* section). Excluding the impact of backdating, field services revenue has decreased slightly.

### Other

Other income consists largely of revenue generated from the transitional services agreements with Spark put in place at demerger and expiring at 30 June 2014. Revenues from these agreements (approximately \$2 million) represent a recovery of cost and as such have no margin. Also included in other revenue are revenues relating to cable locates (all cable locates are now billed) and revenues that are one-off in nature such as gain on sale of fixed assets and insurance claim proceeds. Approximately \$2 million (30 June 2013: \$1 million) was received for Christchurch earthquake related insurance proceeds.

## Expenditure commentary

### Operating expenses

	2014 \$M	2013 \$M
Labour costs	79	67
Provisioning	56	51
Network maintenance	99	100
Other network costs	38	37
Information technology costs	55	52
Rent and rates	12	12
Property maintenance	12	12
Electricity	13	13
Insurance	4	4
Consultants	5	6
Other	36	40
<b>Total operating expenses</b>	<b>409</b>	<b>394</b>

Operating expenditure has increased by 3.8% relative to 2013, reflecting ongoing growth in the labour force, increased provisioning activity and higher information technology costs. Costs in the second half of the year are lower reflecting the effect of initiatives arising from reshaping the business. Areas of significant change include:

**Labour costs** of \$79 million for the year represent staff costs that are not capitalised. At 30 June 2014 Chorus had 823 permanent and fixed term employees. This was up from 763 employees at 30 June 2013. Additional people were employed to support the continued growth in complex provisioning and fibre provisioning, while a shared services team has also been employed by Chorus (as the provision of these services fell away under the transitional services agreement with Spark). Business restructuring has been undertaken which resulted in a number of fixed term contractors exiting the business, disestablishing certain permanent roles in support teams and the short term incentive for FY15 being reduced by 50% unless there are offsetting additional earnings. While this has a slight impact on the second half of FY14 it will have a greater impact in FY15.

**Provisioning costs** are incurred where Chorus provides new or changed service to retail service providers. The total provisioning cost is driven by the volume of orders, the type of work required to fulfil them, technician labour, material and overhead costs. The volume of provisioning truck rolls has decreased year on year, however the mix of products being purchased has changed and a Consumer Price Index (CPI) price increase has resulted in higher costs. The provisioning cost per truck roll for VDSL installations is higher (due to it being a more labour intensive product to provision) and strong uptake of VDSL has resulted in higher costs which are recovered over time.

**Network maintenance** costs relate to fixing network faults and any operational expenditure arising from the proactive maintenance programme. Where faults are on a retail service provider's network (rather than the Chorus network), Chorus charges the retail service provider for this service. Network maintenance costs are driven by the number of retail service provider reported faults, the type of work required to fix the faults and the extent of Chorus' proactive maintenance programme.

One of the key drivers for reported faults is the weather. During the year ended 30 June 2014, severe weather events in September 2013, March 2014 and April 2014 resulted in 10% more reactive maintenance required compared to the year ended 30 June 2013. Approximately 77% of the reactive maintenance work was on the Chorus network and this was not recoverable (compared to 74% on the Chorus network in the year to 30 June 2013). The level, type and cost of faults is affected by factors such as rainfall, lightning, network degradation, labour costs, material costs and network growth. Chorus network faults are typically more expensive than retail service provider network faults because they can span multiple end-users, require restoration of more complex network elements and involve reinstatement. Total maintenance spend for the year ended 30 June 2014 has decreased year on year due to savings in proactive maintenance spend and reduced customer network spend.

**Other network** costs relate to costs associated with service partner contract costs, engineering services and the cost of network spares.



**Information technology** costs of \$55 million represent the costs paid directly by Chorus to third party vendors, as well as the operating expenditure component of systems currently shared with Spark. Late in the year ended 30 June 2014 Chorus concluded a number of projects to enable migration from some Spark systems, including implementing a stand-alone desktop environment, information management system and enterprise resource planning system. A portion of these costs are reflected in 2014, but it does not include the full ongoing maintenance and support costs for the majority of these projects. The costs arising from the Spark systems arrangements will fall away, however the overall relative spend is increased reflecting the costs to support a smaller scale organisation.

**Rent and rates, property maintenance, electricity and insurance** costs relate to the operation of Chorus' network estate (for example, exchanges, radio sites and roadside cabinets). The principal cost is electricity, used to operate the network electronics,

and this is dependent on the number of sites, electricity consumption and electricity prices.

Electricity costs were the same as the previous year. Consumption is lower than the previous year as a number of energy saving initiatives have reduced energy usage. In addition to this, Chorus hedges its electricity usage to minimise volatility in electricity spot prices. About 50% of Chorus' requirements have been hedged with a rolling three year horizon.

**Consultant costs** have continued at a high level as the multiple streams of regulatory work have continued through FY14 despite tight cost control during the year.

'Other' includes expenditure incurred by Chorus for shared services provided by Spark, together with general costs such as advertising, travel, training and legal fees. Tight cost control on discretionary spend has resulted in a decrease in other costs.

## Depreciation and amortisation

	2014 \$M	2013 \$M	ESTIMATED USEFUL LIFE (YEARS)	WEIGHTED AVERAGE USEFUL LIFE (YEARS)
<b>Depreciation:</b>				
Copper cables	63	66	10–30	22
Fibre cables	38	29	20	20
Ducts and manholes	22	16	50	50
Cabinets	35	33	5–14	10
Property	16	14	5–50	16
Network electronics	87	95	2–14	8
Other	6	9	2–15	6
Less: Crown funding	(8)	(4)		
<b>Total depreciation</b>	<b>259</b>	<b>258</b>		
<b>Amortisation:</b>				
Software	63	60	2–8	5
Other intangibles	-	1	6–20	20
<b>Total amortisation</b>	<b>63</b>	<b>61</b>		

The weighted average useful life represents the useful life in each category weighted by the net book value of the assets.

During the year ended 30 June 2014 \$679 million of network assets and software were capitalised. The 'UFB communal' and 'UFB connections and fibre layer 2' included in 'fibre' capital expenditure was largely capitalised against the network assets categories of fibre cables (40%) and ducts and manholes (53%). The average depreciation rate for UFB communal infrastructure spend is currently 35 years, reflecting the very high proportion of long life assets being constructed (with ducts and manholes having a depreciation rate of 50 years).

Software and other intangibles largely consist of the software components of billing, provisioning and operational systems (including Chorus spend on Spark owned systems). A total of \$52 million of software was capitalised during the year, which will be amortised over an average of five years.

Chorus' depreciation profile is expected to continue to change, reflecting the greater mix of longer dated assets as the UFB and RBI rollouts progress. The Crown funding release against depreciation is also expected to continue to increase over time as the amount of funding received from the Crown accumulates, with the associated amortisation to depreciation increasing accordingly.

## Expenditure commentary (cont.)

### Net finance expense

	2014 \$M	2013 \$M
<b>Finance income</b>	<b>(8)</b>	<b>(7)</b>
<b>Finance expense</b>		
Interest on syndicated bank facility	64	58
Interest on EMTN	49	46
Other interest expense	20	16
Capitalised interest	(7)	(6)
<b>Total finance expenses excluding Crown funding</b>	<b>126</b>	<b>114</b>
CFH securities (notional interest)	3	1
<b>Total finance expense</b>	<b>129</b>	<b>115</b>

Interest costs increased in FY14 reflecting a combination of increased average debt levels, interest margin on the revolving credit facilities (following Moody's rating downgrade as a consequence of the Commission's initial pricing principle UBA decision) and the impact of Chorus choosing to reset 'in the money' interest rate swaps in December 2013 (as part of cash management initiatives post the Commission's 5 November initial pricing principle UBA decision).

Interest rate swaps with a face value of \$676 million and fair value of \$31 million were reset at the prevailing market interest rates (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 fair value of the swaps and the proceeds realised. The reset swaps hedge the same underlying exposure and risk profile, but at a higher effective borrowing cost.

Other interest expense includes finance lease interest of \$13 million (30 June 2013: \$13 million), \$2 million interest in relation to shared and network systems, interest costs in relation to UCLFS backdating and costs relating to the close out of the interest rate swaps.

Also included in other interest expense is any ineffectiveness arising from the Euro Medium Term Note (EMTN) hedging relationship. Following the close out of the interest rate swaps relating to the EMTN the hedge relationship was reset on 9 December 2013 with a fair value of \$49 million. As long as the hedge remains effective any future gains or losses will be processed through the hedge reserve, however the \$49 million will flow as ineffectiveness to interest expense in the income statement at some time over the life of the derivatives. It will be a non-cash charge. Neither the direction, nor

the rate of the impact on the income statement can be predicted. For the current financial year there has been no ineffectiveness and therefore no impact on the income statement (30 June 2013: no ineffectiveness).

At a minimum, Chorus aims to maintain 50 percent of its debt obligations at a fixed rate of interest. It has fully hedged the foreign exchange exposure on the EMTN with cross currency interest rate swaps. The floating interest on these derivatives has been hedged using interest rate swap instruments. The exposure to floating rate interest on the syndicated bank facility has been reduced using interest rate swaps.

As at 30 June 2014, approximately 68% (30 June 2013: 66%) of the outstanding debt obligation was fixed through derivative or fixed rate debt arrangements.

### Taxation

The 2014 effective tax rate of 28% equates to the statutory rate of 28%. There are no material permanent differences between net earnings before income tax and what is, or will be, taxable for the year to 30 June 2014.

Payments of provisional tax (from the second payment) during the tax year to 30 June 2014 have been paid via a tax financing arrangement with Tax Management New Zealand (TMNZ). This means that Chorus notifies TMNZ that they wish to make 'payment' via tax financing, and TMNZ then arranges for a payment to the Inland Revenue Department on Chorus' behalf. This effectively results in a delayed cash flow for Chorus, with the cash flow associated with the second and third provisional tax payments for 2014 being deferred until 4 June 2015.

## Capital expenditure commentary

	2014 \$M	2013 \$M
Fibre	566	579
Copper	61	69
Common	52	33
<b>Gross capital expenditure</b>	<b>679</b>	<b>681</b>

Chorus reports capital expenditure in three categories reflecting its core network asset and build programmes.

**Fibre** includes spend specifically focused on fibre assets (layer 0 and layer 1 UFB network assets), spend to support the fibre network (IT delivering fibre products) and programmes largely focused on fibre (UFB and RBI).

**Copper** includes spend on copper related network assets and supporting capability (such as layer 2 electronics).

**Common** includes a range of spend unrelated to network asset classes, such as Chorus' enterprise systems, buildings and office equipment.

Gross capital expenditure for the year to 30 June 2014 was \$679 million, which is consistent with the FY14 guidance range of \$660 million to \$690 million. This total included \$42 million of year four UFB build initiated in this financial year and recognised in work in progress and \$6 million for building fibre to schools ahead of the UFB rollout schedule with full cost recovery.

### Fibre capital expenditure

	2014 \$M	2013 \$M
UFB communal	338	362
UFB connections and fibre layer 2	74	31
Fibre products and systems	38	27
Other fibre connections and growth	63	53
RBI	53	106
<b>Total fibre capital expenditure</b>	<b>566</b>	<b>579</b>

Fibre capital expenditure represents about 83% of Chorus' gross capital expenditure spend, mainly for the UFB and RBI programmes.

UFB communal network deployment is at full pace and made good progress during the year. Build work had been completed for about 261,000 premises at 30 June 2014, representing the addition of 108,000 premises passed during the year, or 2,000 premises ahead of target. There were 353,000 end-users able to be connected to the UFB network.

Chorus estimates the total cost to build the UFB communal network by the end of 2019 is \$1.7–\$1.9 billion. The cost of the deployment of UFB communal network for the year was \$338 million. About \$4 million was 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.

The average cost per premises passed was \$2,973 for UFB deployment to brownfields premises for the year ended 30 June 2014, or \$2,948 when including greenfields premises for which Crown Funding was received. This was at the low end of Chorus' target of an average cost of \$2,900 to \$3,200 for the year.

As at 30 June 2014, \$42 million had been spent on work in progress for UFB communal deployment scheduled to be completed in the following year. This was up from \$30 million in the previous year, reflecting the deployment programme's increasing momentum.

UFB connections and layer 2 spend increased from \$31 million at 30 June 2013 to \$74 million for this year as the volume of fibre connections grew in line with Chorus' expanding UFB footprint and retail service provider marketing. Layer 2 equipment, such as Gigabit capable Passive Optical Network (GPON) ports and splitters, was also installed ahead of demand as the UFB footprint grew. The average cost of connection per standard residential premises was approximately \$1,780 for the year inclusive of the long run average cost of Layer 2 equipment.

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 life of the UFB network. Installation processes, arrangements with service companies and close co-ordination with RSPs are all areas of focus as Chorus continues to establish a sustainable framework for UFB connections. At 30 June, Chorus had about 27,000 connections within the areas where it had deployed UFB. This represents about 2% of end-users within the Chorus planned UFB footprint by 2020.

## Capital expenditure commentary (cont.)

A significant proportion of UFB connections spend was also incurred in providing 'backbone' network to enable the connection of end-users located along rights of ways or in multi dwelling units. This spend represents upfront investment as it ultimately enables multiple end-users in a building, or along a right of way, to connect to UFB services.

Chorus is able to recover some connection costs in instances where the connection is 'non-standard' as defined by the UFB contract with CFH. Chorus had previously made \$20 million of funding available to encourage fibre uptake with free installation for some non-standard residential connections. This funding was increased to \$28 million as part of a March 2014 package of improvements to the UFB initiative agreed with CFH. The period over which this funding will be available will depend on the volume and type of non-standard installs received.

Fibre products and systems spend increased to \$38 million as Chorus built new fibre inventory systems to improve the ordering and provisioning process for fibre connections.

Capital expenditure of \$63 million on other fibre connections and growth reflected demand for fibre connections in areas where UFB has not yet been deployed, new 'greenfield' fibre subdivisions, fibre lifecycle investment and regional backhaul connections for retail service provider data traffic.

Spend for RBI reduced to \$53 million this year as the peak of the RBI rollout has passed. A total of 3,100 kilometres of fibre had been laid by 30 June 2014, bringing better broadband within reach of 951 schools and 72,000 rural end-users since the start of the programme in 2012. The rollout is scheduled to be completed in FY16 and Chorus' role is to deploy network duct and fibre (largely grant funded, see *contributions to capital expenditure* section below) to connect schools, hospitals, wireless broadband towers and other priority users in rural areas. Chorus is also deploying cabinets and cabinet electronics to expand its broadband footprint as part of the programme. Chorus expects to receive approximately \$236 million in Government grant funding for the RBI, with the grant covering about 80-85% of Chorus' annual RBI capital expenditure.

### Copper capital expenditure

	2014 \$M	2013 \$M
Network sustain	35	33
Copper connections	15	21
Copper layer 2	10	8
Product fixed	1	7
<b>Total copper capital expenditure</b>	<b>61</b>	<b>69</b>

Copper capital expenditure was \$61 million for the year, reflecting the ongoing shift in focus to fibre related capital expenditure and Chorus' focus on cash management following the UBA final benchmarking price decision.

Network sustain refers to capital expenditure where the network is being upgraded or network elements such as poles, cabinets and cables are replaced. This is typically where there is risk of network failure or degraded service for end-users and network replacement is deemed more cost effective than reactive maintenance.

Requests to shift network for road works purposes increased this year and this cost is largely recovered in 'Crown Funding – other'.

Capital expenditure on copper connections occurs where there is demand for copper connections for residential or business

end-users, such as infill housing or new buildings. Demand for copper connections is expected to decrease over time as the UFB network footprint expands and demand for fibre connections grows. There was a significant decrease in this category in the year as the UFB footprint expanded and investment in baseband IP deployment was reduced.

Copper layer 2 reflects investment in network electronics and equipment as a consequence of demand for broadband capacity and growth. This is expected to decline over time in line with the UFB network rollout and uptake, subject to possible investment in Chorus' proposed commercial UBA products which are under consultation with industry. Capital expenditure on 'Product fixed' was reduced as there was limited development of copper related products.

### Common capital expenditure

	2014 \$M	2013 \$M
Information technology	35	16
Building and engineering services	12	16
Other	5	1
<b>Total common capital expenditure</b>	<b>52</b>	<b>33</b>



Common capital expenditure was \$52 million. This included \$35 million investment in information technology systems to 30 June 2014. Chorus is continuing to undertake a significant programme of IT systems development as part of Minister approved systems separation plans. This included the development of standalone enterprise, business intelligence and desktop systems during the year.

Building and engineering services reflects the capital spent on growth and plant replacement (e.g. power and air conditioning) at Chorus exchanges, buildings and remote sites. This spend was reduced compared to the prior year as Chorus cut or deferred discretionary investment.

'Other' includes items such as office accommodation and equipment and the increased spend reflected Chorus revising its post demerger accommodation requirements.

### Contributions to capital expenditure

Chorus receives significant financing and contributions towards its gross capital expenditure each year. During the year to 30 June 2014, Chorus received contributions from the following sources:

- i) **RBI funding:** The Crown is contributing grant funding of about \$236 million towards Chorus' layer 0 and layer 1 capital spend over the five year Rural Broadband Initiative. The grant is payable on completion of build work and will vary each year subject to the agreed build programme and the grantable network that is built. For the year ended 30 June 2014 \$81 million was recognised.
- ii) **Other:** Chorus is able to recover the cost of other capital spend in certain circumstances. This includes replacing network damaged by third parties, or instances where central or local government authorities ask Chorus to relocate or rebuild existing network. A total of \$7 million was recognised in the current year and is included as part of Crown funding given its modest size.

## Long term capital management

Chorus' principal source of liquidity is operating cash flows and external borrowing from established debt programmes such as the EMTN and bank facilities. Chorus issues debt and equity securities to CFH as it completes relevant UFB milestones. It also receives grants from the Crown in relation to its RBI build programme.

The Chorus Board's broader capital management objectives include maintaining an investment grade credit rating with headroom. In the longer term, the Board continues to consider a 'BBB' rating appropriate for a business like Chorus.

Chorus indicated in February that capital management initiatives would form part of Chorus' approach to addressing the very material reduction in revenues resulting from implementation of the Commission's initial pricing principle decision from 1 December 2014. In the short term this has involved withdrawal of dividend guidance, changes to the CFH funding arrangements and committed bank facilities.

On 18 July 2014 Chorus announced that it had entered into a conditional agreement with CFH, giving Chorus the option of bringing forward the present value of CFH funding of up to \$178 million that is budgeted to be spent on Chorus' UFB programme in 2018 and 2019. Funding from this facility is only available from October 2015, which is expected to be after the conclusion of the Commission's final pricing principle reviews. The facility will automatically terminate if Chorus does not use it by 30 June 2016.

On 25 July 2014 Chorus announced an amendment to its committed banking facilities. Under the agreements the banks have agreed to:

- increase Chorus' covenant levels from 3.75 to 4.25 times net debt to EBITDA at pricing levels consistent with the

Commission's initial pricing principle decisions, with covenant levels stepping down to 3.75 times net debt to EBITDA if the Commission's final pricing principle prices are consistent with current regulated pricing;

- extend the maturity of Chorus' November 2015 facility to 31 July 2016; and
- waive rights potentially available to the banks associated with the material reduction in regulated pricing to take effect on 1 December 2014.

Chorus has also agreed to limit total drawings across all committed bank facilities to \$1.2 billion until outcomes from the Commission's final pricing principle processes are known and also reduce its July 2016 facility by \$100 million (to \$575 million), which is expected to provide Chorus with sufficient operating liquidity.

Chorus withdrew its FY14 dividend guidance on 18 November 2013 following the Commission's initial pricing principle decision for UBA. As part of its capital management update in February 2014, Chorus indicated that a future dividend policy would be communicated when financially sustainable and there was sufficient certainty of outcomes of the Chorus initiatives, CFH discussions and regulatory reviews. As part of the bank amendments, Chorus has agreed that no dividends will be paid until the later of the conclusion of the Commission's final pricing principle review processes or 30 June 2015. If Chorus chooses to use the CFH facility, Chorus would be unable to pay a dividend before December 2019 without CFH approval, unless Chorus normalises the CFH funding profile.

At 30 June 2014, Chorus had a long term credit rating of BBB/ negative outlook by Standard & Poor's (30 June 2013: BBB/stable) and Baa3/negative by Moody's Investors Service (30 June 2013: Baa2/negative).

# Competition and regulation

Significant developments in Chorus' competitive and regulatory environment during the year are set out below. This should be read in conjunction with previous disclosures which are available online at: [www.chorus.co.nz/investor-centre](http://www.chorus.co.nz/investor-centre).

## Chorus Open Access Deeds of Undertaking

Chorus is bound by three open access deeds of undertaking (Deeds). The Copper, Fibre and Rural Broadband Initiative undertakings represent a series of legally binding obligations focused around the provision of services on a non-discriminatory or equivalent basis.

Chorus submitted a transition plan to the Minister in late 2012, and an annual update to the plan in late 2013, relating to the actions required to move to ending the sharing arrangements between Spark and Chorus, as required by the Deeds.

## Telecommunications Services Obligations (TSO) and Levies

The TSO is the regulatory mechanism by which universal service obligations for residential, local access and calling services are imposed and administered. Chorus is required to maintain lines and coverage obligations, and provide a voice input service. On 9 July 2013, the Government issued a discussion document on the TSO, as part of a scheduled review and Chorus made submissions. The timing for a formal update on the review from Government is unknown and there is no guarantee or certainty of the outcome.

The Telecommunications Development Levy (TDL) is an industry levy of \$50 million per year between FY10 and FY16 and \$10 million each year thereafter. On 27 May 2013, the Commission determined that Chorus was liable for \$11.1 million of the TDL for FY13.

Chorus is also required to contribute towards the Commission's costs through a Telecommunications Regulatory Levy (TRL). Chorus was determined to be liable for \$0.9 million of the TRL for FY13.

## UCLL and SLU pricing

The terms, including price, for UCLL and SLU are currently regulated by the Commission. On 3 December 2012, the Commission issued a final decision on its benchmarking review of the price Chorus can charge for UCLL. The final averaged UCLL price of \$23.52 represented a 3.8% drop. The UCLL price is linked to a number of other Chorus services, meaning that the UCLFS and SLU prices, and some UBA prices, were impacted by the decision.

After the final decision, Chorus applied to the Commission to review the UCLL price, using a final pricing principle of Total Service Long Run Incremental Cost (TSLRIC). The application was made on the basis that Chorus considered that the initial price set by the Commission by reference to benchmarking underestimates the TSLRIC of providing the UCLL in New Zealand. Spark, Vodafone, CallPlus and Kordia also made final pricing principle applications to the Commission. The Commission expects to complete the final pricing principle process in April 2015 with a draft decision due by 1 December 2014.

## Unbundled Copper Low Frequency Service (UCLFS)

To meet its TSO requirements, Chorus has made a technology neutral voice input service, Baseband, available on a commercial basis. The pricing of a subset of this service, UCLFS (a voice input service offered over the copper access network), is set at the averaged UCLL price as determined by the Commission. Because the UCLFS price is linked to the UCLL price, a new UCLFS price of \$23.52 per month applied from 3 December 2012 (previously \$24.46 per month). Any change to the UCLL price as a result of the final pricing principle process should flow through to the UCLFS price. As noted above, the Commission expects to complete its reviews by April 2015.

On 24 April 2014 the Commission also announced that UCLFS connection charges should be re-set so that they are the same as benchmarked UCLL prices set on 3 December 2012. The Commission also required that the new UCLFS connection charges be backdated to 3 December 2012 and refunded to retail service providers, including interest.

## UBA pricing

The terms, including price, for UBA are currently regulated by the Commission. On 5 November 2013, the Commission issued a final decision on UBA pricing for a reduction in price from \$21.46 to \$10.92 per month based on benchmarking of pricing in two countries.

After the final decision, Chorus applied to the Commission to review the UBA price, using a final pricing principle of TSLRIC. The application was made on the basis that Chorus considered that the initial price set by the Commission by reference to benchmarking underestimates the TSLRIC of providing UBA in New Zealand. Spark, Vodafone, CallPlus and Orcon also made final pricing principle applications to the Commission. The Commission expects to complete the final pricing principle process in April 2015 with a draft decision due by 1 December 2014.

The Commission's benchmarked price of \$10.92 will apply from 1 December 2014.

In parallel with the Commission's review process, Chorus has asked the High Court to determine whether the Commission was correct in law to rely on pricing from two countries when setting the initial UBA price and whether s18(2A) of the Telecommunications Act was considered as intended. The High Court dismissed Chorus' appeal. Chorus has appealed that decision to the Court of Appeal. The Court of Appeal hearing was held in late July and a decision is pending.

### Commercial UBA variants

On 14 May 2014, Chorus announced that it proposed to launch two new commercial UBA variants – Boost HD and Boost VDSL (the Boost services). In accordance with the requirements of the UBA Standard Terms Determination (STD), Chorus gave notice to the Commission of the proposed Boost services. The Commission initiated a process to assess whether the Boost services are, or should be, covered by the existing STD. The Commission's timetables are unclear.

On 22 July 2014, the Commission announced that it had received a complaint that changes Chorus proposed to make to the regulated UBA service in parallel to the Boost services were in breach of the STD. The Commission has initiated an investigation, and Chorus is awaiting next steps.

### Regulatory framework review

Under amendments made to the Telecommunications Act to facilitate Chorus' demerger, the Government is required to commence a review of the regulatory framework by 2016, with a particular focus on the framework to apply once the UFB build is complete in 2020.

On 8 February 2013 the New Zealand Government announced that it was bringing forward the regulatory review and on 7 August 2013

it released a discussion paper proposing a phased approach – with an immediate focus on copper pricing. Chorus made submissions, but the review has not closed or continued. Next steps on the review are pending.

### Other legislation

Chorus is subject to other legislative requirements such as the requirements of the Commerce Act 1986, Fair Trading Act 1986, as well as telecommunications codes.

Chorus is also subject to the Telecommunications (Interception Capability and Security) Act 2013 (TICSA), which replaces the Telecommunications (Interception Capability) Act 2004. The TICSA has reduced Chorus' obligations to provide lawful interception capability as Chorus is no longer required to pre-invest in lawful interception solutions for wholesale network services and infrastructure level services.

However, the TICSA introduced new obligations on network operators to prevent, sufficiently mitigate or remove network security risks arising from public telecommunications networks. Chorus, like other network operators, is obliged to engage with the Government Communications Security Bureau where it might affect New Zealand's national security and this has the potential to drive significant compliance costs.

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## Litigation

Chorus has ongoing claims, investigations and inquiries, none of which are currently expected to have significant effect on the financial position or profitability of Chorus.

Chorus cannot reasonably estimate the adverse effect, if any, on Chorus if any of the outstanding claims or inquiries are ultimately resolved against Chorus' interest. There can be no assurance that such cases will not have a significant effect on Chorus' business, financial position, and results of operations or profitability.

# Appendix one

## Chorus summary connection facts

	CONNECTIONS 30 JUNE 2014	CONNECTIONS 31 DEC 2013	CONNECTIONS 30 JUNE 2013
<b>Total fixed line connections</b>	<b>1,781,000</b>	<b>1,776,000</b>	<b>1,784,000</b>
Baseband Copper	1,475,000	1,497,000	1,521,000
UCLL	127,000	125,000	122,000
SLU/SLES	4,000	5,000	6,000
Naked Basic / Enhanced UBA / naked VDSL	117,000	103,000	91,000
Data services over copper	16,000	19,000	25,000
Fibre	42,000	27,000	19,000
<b>Total Broadband</b>	<b>1,163,000</b>	<b>1,132,000</b>	<b>1,112,000</b>
Basic UBA	164,000	246,000	331,000
Naked Basic UBA	9,000	11,000	11,000
Enhanced UBA	802,000	747,000	680,000
Naked Enhanced UBA	93,000	87,000	78,000
VDSL	49,000	20,000	2,000
Naked VDSL	15,000	5,000	2,000
Fibre (Bitstream 2, 3 and fibre subdivisions)	31,000	16,000	8,000

## Appendix two

### Non statutory measure: underlying EBITDA

This appendix provides a high level trend analysis of the underlying EBITDA (excluding those items which are non-recurring and not part of business as usual operations). The commentary included here is for information purposes only. Appendix two has not been audited.

#### Summary

	UNDERLYING 2014 \$M	UNDERLYING 2013 \$M	%
Operating revenue	1,065	1,048	1.6
Operating expenses	(409)	(394)	3.8
<b>Underlying EBITDA</b>	<b>656</b>	<b>654</b>	<b>0.3</b>

The table above shows comparable underlying results for FY14 when compared to the underlying results for FY13. The details of the items which have been adjusted will be discussed in further detail later in this section.

Underlying FY14 has shown good revenue growth, while expenses have continued to grow, culminating in a steady EBITDA result.

#### Operating revenue

	UNDERLYING 2014 \$M	UNDERLYING 2013 \$M	%
Basic copper	543	623	(12.8)
Enhanced copper	293	215	36.3
Fibre	75	60	25.0
Value added network services	38	37	2.7
Infrastructure	19	17	11.8
Field services	84	85	(1.2)
Other	13	11	18.2
<b>Total operating revenue</b>	<b>1,065</b>	<b>1,048</b>	<b>1.6</b>

The decline in basic copper revenues is slightly lower when the impact of the UCLFS monthly charge price change (effective December 2012) is excluded. There has been continued migration from basic copper to enhanced copper and IP voice services. This reflects the ongoing increase in broadband connections. In addition to this there has been a steady migration of end-users from copper to fibre services throughout the year.

Field services revenue includes the impact of the reset of the UCLFS connections charges (and backdating). Excluding the impact of this results in a slight decrease in field services revenue as third party demand for network maintenance services has decreased.

All other revenue categories are unchanged, so no additional commentary is required to that included in the main body of the management commentary.

#### Adjustments to the results

Both the FY14 and FY13 results contain a number of balances that do not make them directly comparable in isolation. These balances have been removed from the balances described above so that a more direct comparison can be made. The adjustments made to the balances are discussed below.



### Underlying FY14 results

	2014 \$M	LESS: INSURANCE PROCEEDS \$M	ADD: UCLFS \$M	UNDERLYING FY14 \$M
Operating revenue	1,058	(2)	9	1,065
Operating expenses	(409)	-	-	(409)
<b>EBITDA</b>	<b>649</b>	<b>(2)</b>	<b>9</b>	<b>656</b>

Included in FY14 is \$2 million of insurance proceeds received in the second half of the year and the impact of the change in price of UCLFS connection charges (including removing the impact of backdating this price change to 1 December 2012).

### Underlying FY13 results

	2013 \$M	LESS: INSURANCE PROCEEDS \$M	LESS: UCLFS \$M	UNDERLYING FY13 \$M
Operating revenue	1,057	(1)	(8)	1,048
Operating expenses	(394)	-	-	(394)
<b>EBITDA</b>	<b>663</b>	<b>(1)</b>	<b>(8)</b>	<b>654</b>

Included in the FY13 results is \$1 million of insurance proceeds received in the second half of the year. Also adjusted is the impact of the change in price on 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).



# Financial Statements

## CONTENTS

Independent auditor's report	42
Income statement	43
Statement of comprehensive income	43
Statement of financial position	44
Statement of changes in equity	45
Statement of cash flows	47
Notes to the financial statements	49

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# Independent auditor's report



TO THE SHAREHOLDERS OF CHORUS LIMITED

## Report on the company and group financial statements

We have audited the accompanying financial statements of Chorus Limited ("the company") and the group, comprising the company and its subsidiary, on pages 43 to 80. The financial statements comprise the statement of financial position as at 30 June 2014, the income statement and statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, for both the company and the group.

## Directors' responsibility for the company and group financial statements

The directors are responsible for the preparation of company and group financial statements in accordance with generally accepted accounting practice in New Zealand and International Financial Reporting Standards that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of company and group financial statements that are free from material misstatement whether due to fraud or error.

## Auditor's responsibility

Our responsibility is to express an opinion on these company and group financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the company and group financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the company and group financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the company and group financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company and group's preparation of the financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company and group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Our firm has also provided regulatory audit services, other assurance services, technical accounting advice and tax compliance services to the company and group. These matters have not impaired our independence as auditor of the company and group. The firm has no other relationship with, or interest in, the company and group.

## Opinion

In our opinion the company and group financial statements on pages 43 to 80:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards;
- give a true and fair view of the financial position of the company and group as at 30 June 2014 and of the financial performance and cash flows of the company and group for the year then ended.

## Carrying value of assets

We draw your attention to pages 50 and 53 of the company and group financial statements which explain 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.

## Report on other legal and regulatory requirements

In accordance with the requirements of sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993, we report that:

- we have obtained all the information and explanations that we have required; and
- in our opinion, proper accounting records have been kept by Chorus Limited as far as appears from our examination of those records.

24 August 2014  
Wellington

# Income statement

FOR THE YEAR ENDED 30 JUNE 2014

(DOLLARS IN MILLIONS)	NOTES	GROUP		PARENT	
		2014 \$M	2013 \$M	2014 \$M	2013 \$M
Operating revenue	7	1,058	1,057	83	86
Operating expenses	8	(409)	(394)	-	(1)
<b>Earnings before interest, income tax, depreciation and amortisation</b>		<b>649</b>	<b>663</b>	<b>83</b>	<b>85</b>
Depreciation	1	(259)	(258)	3	1
Amortisation	2	(63)	(61)	-	-
<b>Earnings before interest and income tax</b>		<b>327</b>	<b>344</b>	<b>86</b>	<b>86</b>
Finance income		8	7	121	106
Finance expense	9	(129)	(115)	(122)	(105)
<b>Net earnings before income tax</b>		<b>206</b>	<b>236</b>	<b>85</b>	<b>87</b>
Income tax expense	13	(58)	(65)	(1)	-
<b>Net earnings for the year</b>		<b>148</b>	<b>171</b>	<b>84</b>	<b>87</b>
<b>Earnings per share</b>					
Basic earnings per share (dollars)	18	0.38	0.44		
Diluted earnings per share (dollars)	18	0.31	0.42		

# Statement of comprehensive income

FOR THE YEAR ENDED 30 JUNE 2014

(DOLLARS IN MILLIONS)	NOTES	GROUP		PARENT	
		2014 \$M	2013 \$M	2014 \$M	2013 \$M
<b>Net earnings for the year</b>		<b>148</b>	<b>171</b>	<b>84</b>	<b>87</b>
<b>Other comprehensive income</b>					
<b>Items that will be reclassified subsequently to income statement when specific conditions are met</b>					
Effective portion of changes in fair value of cash flow hedges (pre-tax)		3	13	3	13
Amortisation of de-designated cash flow hedges transferred to income statement	17	(1)	-	(1)	-
Tax expense on cash flow hedge	13	(1)	(4)	(1)	(4)
<b>Other comprehensive income net of tax</b>		<b>1</b>	<b>9</b>	<b>1</b>	<b>9</b>
<b>Total comprehensive income for the year net of tax</b>		<b>149</b>	<b>180</b>	<b>85</b>	<b>96</b>

The accompanying notes are an integral part of these financial statements

# Statement of financial position

AS AT 30 JUNE 2014

(DOLLARS IN MILLIONS)	NOTES	GROUP		PARENT	
		2014 \$M	2013 \$M	2014 \$M	2013 \$M
<b>Current assets</b>					
Cash and call deposits	14	176	80	92	69
Income tax receivable		-	-	-	8
Trade and other receivables	10	196	294	406	243
Finance lease receivable	15	3	3	-	-
<b>Total current assets</b>		<b>375</b>	<b>377</b>	<b>498</b>	<b>320</b>
<b>Non-current assets</b>					
Derivative financial instruments	20	3	7	3	7
Investments and advances	16	-	-	2,238	2,238
Software and other intangibles	2	166	153	-	-
Network assets	1	3,136	2,796	-	-
<b>Total non-current assets</b>		<b>3,305</b>	<b>2,956</b>	<b>2,241</b>	<b>2,245</b>
<b>Total assets</b>		<b>3,680</b>	<b>3,333</b>	<b>2,739</b>	<b>2,565</b>
<b>Current liabilities</b>					
Trade and other payables	11	323	328	35	33
Income tax payable		32	5	2	-
<b>Total current liabilities excluding Crown funding</b>		<b>355</b>	<b>333</b>	<b>37</b>	<b>33</b>
Current portion of Crown funding	5	11	6	5	2
<b>Total current liabilities</b>		<b>366</b>	<b>339</b>	<b>42</b>	<b>35</b>
<b>Non-current liabilities</b>					
Trade and other payables	11	-	2	-	-
Derivative financial instruments	20	136	106	136	106
Finance lease payable	15	126	123	-	-
Debt	3	1,639	1,697	1,639	1,697
Deferred tax payable	13	192	190	11	16
<b>Total non-current liabilities excluding CFH securities and Crown funding</b>		<b>2,093</b>	<b>2,118</b>	<b>1,786</b>	<b>1,819</b>
CFH securities	4	73	30	73	30
Crown funding	5	417	222	215	101
<b>Total non-current liabilities</b>		<b>2,583</b>	<b>2,370</b>	<b>2,074</b>	<b>1,950</b>
<b>Total liabilities</b>		<b>2,949</b>	<b>2,709</b>	<b>2,116</b>	<b>1,985</b>
<b>Equity</b>					
Share capital	17	465	447	611	593
Reserves	17	-	(1)	-	(1)
Retained earnings		266	178	12	(12)
<b>Total equity</b>		<b>731</b>	<b>624</b>	<b>623</b>	<b>580</b>
<b>Total liabilities and equity</b>		<b>3,680</b>	<b>3,333</b>	<b>2,739</b>	<b>2,565</b>

The accompanying notes are an integral part of these financial statements

On behalf of the Board



Sue Sheldon, Chairman  
Authorised for issue on 24 August 2014



Mark Ratcliffe, Managing Director



# Statement of changes in equity

FOR THE YEAR ENDED 30 JUNE 2014

(DOLLARS IN MILLIONS)	NOTE	GROUP			TOTAL \$M
		SHARE CAPITAL \$M	RETAINED EARNINGS \$M	CASH FLOW HEDGE RESERVE \$M	
<b>Balance at 1 July 2012</b>		<b>435</b>	<b>102</b>	<b>(10)</b>	<b>527</b>
<b>Comprehensive income</b>					
Net earnings for the year		-	171	-	171
<b>Other comprehensive income</b>					
Net effective portion of changes in fair value of cash flow hedges	17	-	-	9	9
<b>Total comprehensive income</b>		<b>-</b>	<b>171</b>	<b>9</b>	<b>180</b>
<b>Contributions by and (distributions to) owners:</b>					
Dividends	17	-	(95)	-	(95)
Supplementary dividends		-	(8)	-	(8)
Tax credit on supplementary dividends		-	8	-	8
Dividend reinvestment plan	17	12	-	-	12
<b>Total transactions with owners</b>		<b>12</b>	<b>(95)</b>	<b>-</b>	<b>(83)</b>
<b>Balance at 30 June 2013</b>		<b>447</b>	<b>178</b>	<b>(1)</b>	<b>624</b>
<b>Comprehensive income</b>					
Net earnings for the year		-	148	-	148
<b>Other comprehensive income</b>					
Amortisation of de-designated cash flow hedges transferred to income statement	17	-	-	(1)	(1)
Net effective portion of changes in fair value of cash flow hedges	17	-	-	2	2
<b>Total comprehensive income</b>		<b>-</b>	<b>148</b>	<b>1</b>	<b>149</b>
<b>Contributions by and (distributions to) owners:</b>					
Dividends	17	-	(60)	-	(60)
Supplementary dividends		-	(5)	-	(5)
Tax credit on supplementary dividends		-	5	-	5
Dividend reinvestment plan	17	18	-	-	18
<b>Total transactions with owners</b>		<b>18</b>	<b>(60)</b>	<b>-</b>	<b>(42)</b>
<b>Balance at 30 June 2014</b>		<b>465</b>	<b>266</b>	<b>-</b>	<b>731</b>

The accompanying notes are an integral part of these financial statements

## Statement of changes in equity (cont.)

FOR THE YEAR ENDED 30 JUNE 2014

(DOLLARS IN MILLIONS)	NOTE	PARENT			TOTAL \$M
		SHARE CAPITAL \$M	RETAINED EARNINGS \$M	CASH FLOW HEDGE RESERVE \$M	
<b>Balance at 1 July 2012</b>		<b>581</b>	<b>(4)</b>	<b>(10)</b>	<b>567</b>
<b>Comprehensive income</b>					
Net earnings for the year		-	87	-	87
<b>Other comprehensive income</b>					
Net effective portion of changes in fair value of cash flow hedges	17	-	-	9	9
<b>Total comprehensive income</b>		<b>-</b>	<b>87</b>	<b>9</b>	<b>96</b>
<b>Contributions by and (distributions to) owners:</b>					
Dividends	17	-	(95)	-	(95)
Supplementary dividends		-	(8)	-	(8)
Tax credit on supplementary dividends		-	8	-	8
Dividend reinvestment plan	17	12	-	-	12
<b>Total transactions with owners</b>		<b>12</b>	<b>(95)</b>	<b>-</b>	<b>(83)</b>
<b>Balance at 30 June 2013</b>		<b>593</b>	<b>(12)</b>	<b>(1)</b>	<b>580</b>
<b>Comprehensive income</b>					
Net earnings for the year		-	84	-	84
<b>Other comprehensive income</b>					
Amortisation of de-designated cash flow hedges transferred to income statement	17	-	-	(1)	(1)
Net effective portion of changes in fair value of cash flow hedges	17	-	-	2	2
<b>Total comprehensive income</b>		<b>-</b>	<b>84</b>	<b>1</b>	<b>85</b>
<b>Contributions by and (distributions to) owners:</b>					
Dividends	17	-	(60)	-	(60)
Supplementary dividends		-	(5)	-	(5)
Tax credit on supplementary dividends		-	5	-	5
Dividend reinvestment plan	17	18	-	-	18
<b>Total transactions with owners</b>		<b>18</b>	<b>(60)</b>	<b>-</b>	<b>(42)</b>
<b>Balance at 30 June 2014</b>		<b>611</b>	<b>12</b>	<b>-</b>	<b>623</b>

The accompanying notes are an integral part of these financial statements

# Statement of cash flows

FOR THE YEAR ENDED 30 JUNE 2014

(DOLLARS IN MILLIONS)	NOTES	GROUP		PARENT	
		2014 \$M	2013 \$M	2014 \$M	2013 \$M
<b>Cash flows from operating activities</b>					
Cash was provided from/(applied to):					
Cash received from customers		1,173	967	-	-
Finance income		5	7	118	106
Intercompany dividend received		-	-	83	86
Payment to suppliers and employees		(406)	(378)	(1)	(1)
Taxation paid		(30)	(65)	(5)	(7)
Interest paid on debt and derivatives		(120)	(108)	(112)	(99)
<b>Net cash flows from operating activities</b>		<b>622</b>	<b>423</b>	<b>83</b>	<b>85</b>
<b>Cash flows applied to investing activities</b>					
Cash was applied to:					
Subsidiary funding		-	-	(138)	(189)
Purchase of network assets and software and intangible assets		(690)	(681)	-	-
Capitalised interest paid		(7)	(6)	-	-
<b>Net cash flows applied to investing activities</b>		<b>(697)</b>	<b>(687)</b>	<b>(138)</b>	<b>(189)</b>
<b>Cash flows from financing activities</b>					
Cash was provided from/(applied to):					
Net (repayment of)/proceeds from finance leases		(3)	(1)	-	-
Crown funding (including CFH securities)		241	198	145	105
Proceeds from debt		450	190	450	190
Repayment of debt		(505)	(100)	(505)	(100)
Settlement of derivatives	20	30	-	30	-
Dividends paid		(42)	(83)	(42)	(83)
<b>Net cash flows from financing activities</b>		<b>171</b>	<b>204</b>	<b>78</b>	<b>112</b>
<b>Net cash flow</b>		<b>96</b>	<b>(60)</b>	<b>23</b>	<b>8</b>
Cash at the beginning of the year		80	140	69	61
<b>Cash at the end of the year</b>	14	<b>176</b>	<b>80</b>	<b>92</b>	<b>69</b>

The accompanying notes are an integral part of these financial statements

## Statement of cash flows (cont.)

### RECONCILIATION OF NET EARNINGS TO NET CASH FLOWS FROM OPERATING ACTIVITIES

(DOLLARS IN MILLIONS)	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Net earnings for the year	148	171	84	87
<i>Adjustment for:</i>				
Depreciation charged on network assets	267	262	-	-
Amortisation of Crown funding	(8)	(4)	(3)	(1)
Amortisation of software and other intangible assets	63	61	-	-
Deferred income tax	1	9	(7)	-
Other	8	6	5	4
	<b>479</b>	<b>505</b>	<b>79</b>	<b>90</b>
<i>Change in current assets and liabilities:</i>				
Change in trade and other receivables	92	(70)	(1)	-
Change in trade and other payables	24	(3)	3	2
Change in income tax payable/ (receivable)	27	(9)	2	(7)
	<b>143</b>	<b>(82)</b>	<b>4</b>	<b>(5)</b>
<b>Net cash flows from operating activities</b>	<b>622</b>	<b>423</b>	<b>83</b>	<b>85</b>

The accompanying notes are an integral part of these financial statements

# Notes to the financial statements

## Reporting entity and statutory base

Chorus Limited is registered in New Zealand under the Companies Act 1993 and is an issuer for the purposes of the Financial Reporting Act 1993. Chorus Limited was established as a standalone, publicly listed entity on 1 December 2011, upon its demerger from Telecom Corporation of New Zealand Limited (Telecom), now known as Spark. The demerger was a condition of an agreement with Crown Fibre Holdings Limited (CFH) to enable Chorus Limited to be the Crown's Ultra-Fast Broadband (UFB) provider in 24 regions, representing approximately 70% of the UFB coverage area. Chorus Limited is listed and its ordinary shares quoted on the NZX main board equity security market (NZX Main Board) and on the Australian Stock Exchange (ASX). American Depositary Shares (ADSs), each representing five ordinary shares (and evidenced by American Depositary Receipts (ADRs)), are not listed but are traded on the over-the-counter (OTC) market in the United States.

The 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).

## Nature of operations

Chorus is New Zealand's largest fixed line communications infrastructure services provider. Chorus maintains and builds a network predominantly made up of local telephone exchanges, cabinets, copper and fibre cables. Chorus has approximately 1.8 million fixed line connections. There are around 130,000 kilometres of copper cable and about 36,000 kilometres of fibre cable connecting homes and businesses to local exchanges, and roadside cabinets throughout the country.

## Basis of preparation

These financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand (NZ GAAP) and the Financial Reporting Act 1993. They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) as appropriate for profit-oriented entities. They also comply with International Financial Reporting Standards.

These financial statements are expressed in New Zealand dollars, which is Chorus' functional currency. References in these financial statements to '\$', 'NZ\$' and 'NZD' are to New Zealand dollars, references to 'USD' are to US dollars, references to 'AUD' are to Australian dollars, references to 'EUR' are to Euros and references to 'GBP' are to pounds sterling. All financial information has been rounded to the nearest million, unless otherwise stated.

## 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 below and the accompanying notes.

## Specific accounting policies

Chorus was established as a standalone publicly listed entity on 1 December 2011. The accounting policies adopted have been applied consistently throughout the periods presented in these financial statements. Certain comparative information has been reclassified to conform with the current year's presentation.

## Basis of consolidation

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiary are prepared for the same reporting period as the Parent Company, using consistent accounting policies. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated in full. Subsidiaries are recorded at cost less any impairment losses in the Parent Company financial statements.

## Critical accounting estimates and assumptions

In preparing the 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 financial statements, new significant judgements made by management in applying Chorus' accounting policies are as follows:

- Additional judgements have been required 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; and
- Credit valuations have been adjusted to reflect credit risk as required by NZ IFRS 13: Fair Value Measurement. The effect of credit risk is quantified using an expected future exposure methodology where credit default swap prices are used to represent the probability of default.



Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The principal areas of judgement in preparing these financial statements are set out below.

**Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following notes:**

**Crown funding (note 5)**

Chorus must exercise judgement when recognising Crown funding to determine if conditions of the funding contract have been satisfied. This judgement will be based on the facts and circumstances that are evident for each contract at the time of preparing the financial statements.

**Leases (note 15)**

Determining whether a lease agreement is a finance lease or operating lease requires judgement as to whether the agreement transfers substantially all the risks and rewards of ownership to Chorus.

**Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:**

**Network assets (note 1)**

Assessing the appropriateness of useful life and residual value estimates of network assets requires a number of factors to be considered such as the physical condition of the asset, expected period of use of the asset by Chorus, technological advances, regulation and expected disposal proceeds from the future sale of the asset.

The regulatory environment is currently having a significant impact on the operating environment of Chorus, including future cash flows. The Commerce Commission (the Commission) announced on 5 November 2013 its final benchmarked price for the copper broadband service (UBA) at a level substantially below existing pricing levels. This determination applies from 1 December 2014.

In addition to this the Government announced that it was bringing forward a review of the regulatory framework (regulatory review) with a discussion paper released in August 2013. The regulatory review is designed to provide clarity and certainty for the new generation telecommunications infrastructure.

The determination and the regulatory review causes challenges and uncertainty on the estimates of Chorus' future cash flows 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 of Chorus' UBA services rather than benchmarking prices against other countries. The outcome of this review is unknown, however the draft decision is expected by December 2014 and final decision by April 2015;
- Chorus has appealed the Commission's November 2013 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 upheld the Commission's decision, Chorus has appealed the High Court judgement;
- Chorus continues to develop options available to it, and within its own control, to mitigate the impact of the Commission's November 2013 decision; and
- The regulatory pricing and policy post 2020 is not known specifically until after the conclusion of the regulatory review. The outcome and timing of this review is unknown.

While the Director's 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.

**CFH securities (note 4)**

Determining the fair value of the CFH securities requires assumptions on expected future cash flow and discount rate based on future long dated swap curves.

## Note 1 – Network assets

In the statement of financial position, network assets are stated at cost less accumulated depreciation and any accumulated impairment losses. The cost of additions to network assets and work in progress constructed by Chorus includes the cost of all materials used in construction, direct labour costs specifically associated with construction, interest costs that are attributable to the asset, resource management consent costs and attributable overheads.

Repairs and maintenance costs are recognised in the income statement as incurred.

### Estimating useful lives and residual values of network assets

The determination of the appropriate useful life for a particular asset requires management to make judgements about, amongst other factors, the expected period of service potential of the asset, the likelihood of the asset becoming obsolete as a result of technological advances, the likelihood of Chorus ceasing to use the asset in its business operations and the effect of government regulation.

Where an item of network assets comprises major components having different useful lives, the components are accounted for as separate items of network assets.

Where the remaining useful lives or recoverable values have diminished due to technological, regulatory or market condition changes, depreciation is accelerated. The asset's residual values, useful lives, and methods of depreciation are reviewed annually and adjusted prospectively, if appropriate.

Depreciation is charged on a straight-line basis to write down the cost of network assets to its estimated residual value over its estimated useful life. Estimated useful lives are as follows:

Copper cables	10-30 years
Fibre cables	20 years
Ducts and manholes	50 years
Cabinets	5-14 years
Property	5-50 years
Network electronics	2-14 years
Other	2-15 years

Other network assets include motor vehicles, network management and administration systems and radio infrastructure.

Any future adverse impacts arising in assessing the carrying value or lives of Chorus' network assets could lead to future impairment losses or increases in depreciation charges that could affect future earnings.

An item of network assets and any significant part is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Where network assets are disposed of, the profit or loss recognised in the income statement is calculated as the difference between the sale price and the carrying value of the asset.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Land and work in progress are not depreciated.

**Note 1 – Network assets (cont.)**

	GROUP								
AS AT 30 JUNE 2014	COPPER CABLES \$M	FIBRE CABLES \$M	DUCTS AND MANHOLES \$M	CABINETS \$M	PROPERTY \$M	NETWORK ELECTRONICS \$M	OTHER \$M	WORK IN PROGRESS \$M	TOTAL \$M
<b>Cost</b>									
Balance as at 1 July 2013	2,349	752	1,092	409	501	1,377	200	94	6,774
Additions	-	-	-	-	-	-	-	607	607
Other	-	-	-	-	-	-	-	1	1
Disposals	-	(1)	-	-	(43)	(29)	(20)	-	(93)
Transfers	-	1	-	-	1	(2)	-	-	-
Transfers from work in progress	49	198	253	24	19	48	9	(600)	-
<b>Balance as at 30 June 2014</b>	<b>2,398</b>	<b>950</b>	<b>1,345</b>	<b>433</b>	<b>478</b>	<b>1,394</b>	<b>189</b>	<b>102</b>	<b>7,289</b>
<b>Accumulated depreciation</b>									
Balance as at 1 July 2013	(1,708)	(236)	(340)	(189)	(214)	(1,108)	(183)	-	(3,978)
Depreciation	(63)	(38)	(22)	(35)	(16)	(87)	(6)	-	(267)
Disposals	-	-	-	-	43	29	20	-	92
<b>Balance as at 30 June 2014</b>	<b>(1,771)</b>	<b>(274)</b>	<b>(362)</b>	<b>(224)</b>	<b>(187)</b>	<b>(1,166)</b>	<b>(169)</b>	<b>-</b>	<b>(4,153)</b>
<b>Net carrying amount</b>	<b>627</b>	<b>676</b>	<b>983</b>	<b>209</b>	<b>291</b>	<b>228</b>	<b>20</b>	<b>102</b>	<b>3,136</b>

	GROUP								
AS AT 30 JUNE 2013	COPPER CABLES \$M	FIBRE CABLES \$M	DUCTS AND MANHOLES \$M	CABINETS \$M	PROPERTY \$M	NETWORK ELECTRONICS \$M	OTHER \$M	WORK IN PROGRESS \$M	TOTAL \$M
<b>Cost</b>									
Balance as at 1 July 2012	2,393	567	791	380	475	1,306	188	119	6,219
Additions	-	-	-	-	-	-	-	646	646
Other	-	-	-	-	-	-	1	1	2
Disposals	(93)	-	-	-	-	-	-	-	(93)
Transfers	1	(1)	-	-	1	-	(1)	-	-
Transfers from work in progress	48	186	301	29	25	71	12	(672)	-
<b>Balance as at 30 June 2013</b>	<b>2,349</b>	<b>752</b>	<b>1,092</b>	<b>409</b>	<b>501</b>	<b>1,377</b>	<b>200</b>	<b>94</b>	<b>6,774</b>
<b>Accumulated depreciation</b>									
Balance as at 1 July 2012	(1,734)	(207)	(324)	(156)	(200)	(1,013)	(174)	-	(3,808)
Depreciation	(66)	(29)	(16)	(33)	(14)	(95)	(9)	-	(262)
Disposals	92	-	-	-	-	-	-	-	92
<b>Balance as at 30 June 2013</b>	<b>(1,708)</b>	<b>(236)</b>	<b>(340)</b>	<b>(189)</b>	<b>(214)</b>	<b>(1,108)</b>	<b>(183)</b>	<b>-</b>	<b>(3,978)</b>
<b>Net carrying amount</b>	<b>641</b>	<b>516</b>	<b>752</b>	<b>220</b>	<b>287</b>	<b>269</b>	<b>17</b>	<b>94</b>	<b>2,796</b>

## Note 1 – Network assets (cont.)

The Parent does not hold any network assets.

There are no restrictions on Chorus network assets or any network assets pledged as securities for liabilities. At 30 June 2014 the contractual commitment for acquisition and construction of network assets was \$17 million (30 June 2013: \$28 million).

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Depreciation charged on network assets	267	262	-	-
Less: Crown funding – Ultra-Fast Broadband	(3)	(1)	(3)	(1)
Crown funding – Rural Broadband Initiative	(3)	(1)	-	-
Crown funding – other	(2)	(2)	-	-
<b>Total depreciation</b>	<b>259</b>	<b>258</b>	<b>(3)</b>	<b>(1)</b>

Refer to note 5 for information on Crown funding.

### Property Exchanges

Chorus has leased property exchange space owned by Spark subject to finance lease arrangements. These have been included in Chorus' network assets under the property category. As at 30 June 2014 the property exchange assets capitalised under a finance lease had a cost of \$157 million (30 June 2013: \$157 million) together with accumulated depreciation of \$12 million (30 June 2013: \$7 million).

### Network electronics

Chorus has joint arrangements for use of certain network electronics assets with Spark. The equipment used by Chorus is included in the network electronics category. As at 30 June 2014 the equipment capitalised had a cost of \$16 million (30 June 2013: \$16 million) together with accumulated depreciation of \$12 million (30 June 2013: \$7 million).

### Impairment

The carrying amounts of non-financial assets including network assets, software and other intangibles are reviewed at the end of each reporting period for any indicators of impairment. If any such indication exists, the recoverable amount of the asset is estimated. An impairment loss is recognised in earnings whenever the carrying amount of an asset exceeds its estimated recoverable amount. Should the conditions that gave rise to the impairment loss no longer exist, and the assets are no longer considered to be impaired, a reversal of an impairment loss would be recognised immediately in earnings.

The recoverable amount is the greater of an asset's value in use and fair value less costs to sell. Chorus' assets do not generate independent cash flows and are therefore assessed from a single cash-generating unit perspective. In assessing the recoverable amount, the estimates of future cash flows are discounted to their net present value using a discount rate that reflects current market

### Depreciation

Chorus receives funding from the Crown to finance the capital expenditure associated with the development of the Ultra-Fast Broadband network, rural broadband services and other services. The contract for Ultra-Fast Broadband is agreed between the Parent and Crown Fibre Holdings. The Parent receives the Crown funding directly, however the construction of the network assets is carried out by the subsidiary. Funding is offset against depreciation over the life of the assets the funding is used to construct. Crown funding released against depreciation for the current year is as follows:

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Depreciation charged on network assets	267	262	-	-
Less: Crown funding – Ultra-Fast Broadband	(3)	(1)	(3)	(1)
Crown funding – Rural Broadband Initiative	(3)	(1)	-	-
Crown funding – other	(2)	(2)	-	-
<b>Total depreciation</b>	<b>259</b>	<b>258</b>	<b>(3)</b>	<b>(1)</b>

assessments of the time value of money and the risks specific to the business.

During the year ended 30 June 2014 there was an indicator of impairment and additional work was performed to assess the carrying value of assets. The following key assumptions were used in this assessment.

Although Chorus believes that the estimate of future cash flows is appropriate, the use of different methodologies or assumptions could lead to different measurements of these component parts.

Key inputs and assumptions used in the impairment model include:

- Cash flows have been modelled out to 2037 in line with the repayment schedule of the CFH securities;
- Fibre uptake has been based on an estimate that the proportion of premises with a fibre connection within Chorus' coverage area will exceed 20% at 30 June 2020 consistent with the estimate used to value CFH securities (refer to note 4 – *CFH securities* for further information);
- Post 2020 regulatory price increases have been based on observable data points from other industries in New Zealand regulated under a building block methodology, while expenses are increasing at an estimated rate of inflation; and
- A terminal growth rate of 2% has been used.

No impairment losses were recognised on network assets, software and other intangibles in the current year (30 June 2013: nil).

### Capitalised interest

Finance costs are capitalised on qualifying items of network assets and software assets at an annualised rate of 6.00% (30 June 2013: 6.00%). Interest is capitalised for the period required to complete the assets and prepare for their intended use. In the current year finance costs totalling \$7 million (30 June 2013: \$6 million) have been capitalised against network assets and software assets.

## Note 2 – Software and other intangibles

Software and other intangible assets are initially measured at cost. The direct costs associated with the development of network and business software for internal use are capitalised where project success is probable and the capitalisation criteria is met. Following initial recognition, software and other intangible assets are stated at cost less accumulated amortisation and impairment losses. Software and other intangible assets with a finite life are amortised from the date the asset is ready for use on a straight-line basis over its estimated useful life which is as follows:

Software	2–8 years
Other intangibles	6–20 years

Other intangibles mainly consist of land easements.

At each reporting date, Chorus reviews the carrying amounts of its software and other intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. For impairment policy and process refer to note 1.

Where estimated useful lives or recoverable values have diminished due to technological change or market conditions, amortisation is accelerated.

AS AT 30 JUNE 2014	GROUP			TOTAL \$M
	SOFTWARE \$M	OTHER INTANGIBLES \$M	WORK IN PROGRESS \$M	
<b>Cost</b>				
Balance as at 1 July 2013	408	6	27	441
Additions	-	-	72	72
Other	5	-	-	5
Disposals	(21)	-	-	(21)
Transfers from work in progress	52	-	(52)	-
<b>Balance as at 30 June 2014</b>	<b>444</b>	<b>6</b>	<b>47</b>	<b>497</b>
<b>Accumulated amortisation</b>				
Balance as at 1 July 2013	(287)	(1)	-	(288)
Amortisation	(63)	-	-	(63)
Disposals	20	-	-	20
<b>Balance as at 30 June 2014</b>	<b>(330)</b>	<b>(1)</b>	<b>-</b>	<b>(331)</b>
<b>Net carrying amount</b>	<b>114</b>	<b>5</b>	<b>47</b>	<b>166</b>

AS AT 30 JUNE 2013	GROUP			TOTAL \$M
	SOFTWARE \$M	OTHER INTANGIBLES \$M	WORK IN PROGRESS \$M	
<b>Cost</b>				
Balance as at 1 July 2012	367	6	34	407
Additions	-	-	35	35
Disposals	(1)	-	-	(1)
Transfers from work in progress	42	-	(42)	-
<b>Balance as at 30 June 2013</b>	<b>408</b>	<b>6</b>	<b>27</b>	<b>441</b>
<b>Accumulated amortisation</b>				
Balance as at 1 July 2012	(227)	-	-	(227)
Amortisation	(60)	(1)	-	(61)
<b>Balance as at 30 June 2013</b>	<b>(287)</b>	<b>(1)</b>	<b>-</b>	<b>(288)</b>
<b>Net carrying amount</b>	<b>121</b>	<b>5</b>	<b>27</b>	<b>153</b>



## Note 2 – Software and other intangibles (cont.)

The Parent does not hold any software and other intangible assets.

There are no restrictions on Chorus software and other intangible assets or any software and other intangible assets pledged as securities for liabilities. At 30 June 2014 the contractual commitment for acquisition of software and other intangible assets was \$11 million (30 June 2013: \$10 million).

### Shared systems and other cost movement

Chorus shares a number of Information Technology (IT) systems with Spark with some systems owned by Chorus and some owned by Spark. Due to the terms of the governance framework in place, these systems are deemed to be jointly controlled assets, as

defined in NZ IAS 31: Interests in Joint Ventures. For assets that it does not own, Chorus recognises its share of the jointly controlled assets, as well as a liability for the future payments due, similar to a finance lease. For assets that it does own, Chorus derecognises the share of the asset used by Spark, as well as recognising a receivable for the future receipts due. The other cost movement relates to a reassessment of the extent of Spark's use of Chorus owned assets during the year, resulting in the recognition of \$5 million previously derecognised assets. As at 30 June 2014 Chorus recognised jointly controlled system assets owned by Spark with a net book value in Chorus financial statements of \$2 million (30 June 2013: \$3 million).

## Note 3 – Debt

Debt is included as non-current liabilities except for those with maturities less than 12 months from the reporting date, which are classified as current liabilities.

Debt is initially measured at fair value, less any transaction costs that are directly attributable to the issue of the instruments.

Debt is subsequently measured at amortised cost using the effective interest method. The weighted effective interest rate on debt including the effect of derivative financial instruments was 6.27% (30 June 2013: 5.88%).

	DUE DATE	GROUP AND PARENT	
		2014 \$M	2013 \$M
Syndicated bank facility A	Nov 2015	500	675
Syndicated bank facility B	Nov 2017	390	520
Syndicated bank facility	May 2019	250	-
Euro medium term notes	Apr 2020	504	509
Less: syndicated loans facility fee		(5)	(7)
		<b>1,639</b>	<b>1,697</b>
<b>Current</b>		-	-
<b>Non-current</b>		<b>1,639</b>	<b>1,697</b>

### Syndicated bank facilities

As at 30 June 2014 Chorus had in place \$1,600 million committed syndicated bank facilities on market standard terms and conditions (30 June 2013: \$1,350 million). The amount of undrawn syndicated bank facilities that is available for future operating activities is \$460 million (30 June 2013: \$155 million). The syndicated bank facilities are held with bank and institutional counterparties rated -A to AAA, based on rating agency Standard & Poor's ratings.

Chorus utilises hedging instruments to manage the interest rate risk associated with the syndicated bank facilities. The Group manages interest rate exposure within Board approved parameters set out in the treasury policy.

The carrying value of syndicated bank facilities approximates their fair value. Refer to note 23 (*post balance date events*) for further information on these facilities.

### Note 3 – Debt (cont.)

#### Euro Medium Term Notes (EMTN)

FACE VALUE	INTEREST RATE	GROUP AND PARENT	
		2014 \$M	2013 \$M
GBP 260 million	6.75%	504	509

Chorus has in place cross currency interest rate swaps to hedge the foreign currency exposure to the EMTN. The cross currency interest rate swaps entitle Chorus to receive GBP principal and GBP fixed coupon payments for NZD principal and NZD floating interest payments. The floating interest rate exposure on the NZD interest payments have been hedged using interest rate swaps.

The following table reconciles EMTN at hedged rates to EMTN at spot rates as reported under IFRS. EMTN at hedged rates is a non-GAAP measure and is not defined by NZ IFRS.

	GROUP AND PARENT	
	2014 \$M	2013 \$M
EMTN	504	509
Impact of hedged rates used	173	168
<b>EMTN at hedged rates</b>	<b>677</b>	<b>677</b>

The fair value of EMTN, calculated based on the present value of future principal and interest cash flows, discounted at market interest rates at balance date, was \$552 million (30 June 2013:

\$581 million) compared to a carrying value of \$504 million (30 June 2013: \$509 million). This fair value has been determined using Level 2 of the fair value hierarchy as described in note 21.

#### Schedule of maturities

	GROUP AND PARENT	
	2014 \$M	2013 \$M
Current	-	-
Due 1 to 2 years	500	-
Due 2 to 3 years	-	675
Due 3 to 4 years	390	-
Due 4 to 5 years	250	520
Due over 5 years	504	509
<b>Total due after one year</b>	<b>1,644</b>	<b>1,704</b>
Less: syndicated loans facility fee	(5)	(7)
	<b>1,639</b>	<b>1,697</b>

None of Chorus' debt has been secured against assets. However, there are financial covenants and event of default triggers, as defined in the various debt agreements. During the current year Chorus fully complied with the requirements set out in its financing arrangements (30 June 2013: full compliance).

Chorus New Zealand Limited (subsidiary) has provided a guarantee to the lenders in respect of the Chorus Limited syndicated bank facilities and EMTN.

Refer to note 21 for information on financial risk management.

## Note 4 – CFH securities

Chorus receives funding from the Crown to finance construction costs associated with the development of the UFB network.

Chorus receives funding at a rate of \$1,118 for every premises passed (as certified by CFH), in return Chorus issues CFH equity securities, CFH debt securities and CFH warrants. The equity and debt securities issued by Chorus have an issue price of \$1 and are issued on a 50:50 basis. For each premises passed, \$559 of equity securities and \$559 of debt securities are issued by Chorus for which Chorus receives \$1,118 funding in return. CFH warrants are issued for nil value. The total committed funding available for Chorus over the period of UFB network construction is expected to be \$929 million.

The CFH equity and debt securities are recognised initially at fair value plus any directly attributable transaction costs. Subsequently they are measured at amortised cost using the effective interest method. The fair value is derived by discounting the \$559 of equity securities and \$559 of debt securities per premises passed by the effective interest rate based on market rates. The difference between funding received (\$1,118 per premises passed) and the fair value of the securities is recognised as Crown funding. Over time, the CFH debt and equity securities increase to face value and the Crown funding is released against depreciation and reduces to nil.

### CFH equity securities

CFH equity securities are a class of non-interest bearing security that carry no right to vote at meetings of holders of Chorus ordinary shares, but entitle the holder to a preferential right to repayment on liquidation and additional rights that relate to Chorus' performance under its construction contract with CFH.

Dividends will become payable on a portion of the CFH equity securities from 2025 onwards, with the portion of CFH equity securities that attract dividends increasing over time. A greater portion of CFH equity securities attract dividends if the proportion of premises with a fibre connection within Chorus' coverage area at 30 June 2020 does not exceed 20%. The dividend rate will be equal to the New Zealand 180-day bank bill rate plus a margin of 6%. CFH equity instruments can be settled by issuing Chorus shares valued at a 5% discount to the 20-day volume weighted average price for Chorus shares traded in ordinary trading on the NZX Main Board.

The CFH equity securities are treated as a compound financial instrument with a Crown funding component due to the instrument including an interest free loan from a government entity. On initial recognition, the fair value of the liability component of the compound instrument is calculated using market inputs with no residual amounts allocated to equity. Until the liability component of the compound instrument expires the CFH equity securities are required to be disclosed as a liability. The difference between the face value of the CFH equity securities and the fair value of the liability component is then recorded as Crown funding.

After this, the liability component is measured at amortised cost using the effective interest method and the Crown funding is amortised to depreciation on a systematic basis over the useful lives of the relevant UFB assets.

### CFH debt securities

CFH debt securities are unsecured, non-interest bearing and carry no voting rights at meetings of holders of Chorus ordinary shares. Chorus is required to redeem the CFH debt securities in tranches from 2025 to 2036 (at the latest) by repaying the face value to CFH. An accelerated repayment schedule applies if the proportion of premises with a fibre connection within Chorus' coverage area at 30 June 2020 does not exceed 20%.

The CFH debt securities are treated as a financial liability with a Crown funding component due to the instrument including an interest free loan from a government entity. On initial recognition the difference between the face value of the CFH debt securities and their fair value (calculated using market inputs) is recorded as Crown funding. After this the liability component is measured at amortised cost using the effective interest method and the Crown funding is amortised to depreciation on a systematic basis over the useful lives of the relevant UFB assets.

The principal amount of CFH debt securities consists of a senior portion and a subordinated portion. The senior portion ranks equally with all other unsecured, unsubordinated creditors of Chorus, and has the benefit of any negative pledge covenant that may be contained in any of Chorus' debt arrangements. The subordinated portion ranks above ordinary shares of Chorus. The initial value of the senior portion is the present value (using a discount rate of 8.5%) of the sum repayable on the CFH debt securities, and the initial subordinated portion will be the difference between the issue price of the CFH debt security and the value of the senior portion.

### CFH warrants

Chorus issues CFH warrants to CFH for nil consideration along with each tranche of CFH equity securities. Each CFH warrant gives CFH the right, on a specified exercise date, to purchase at a set strike price a Chorus share to be issued by Chorus. A CFH warrant will therefore be 'in the money' to the extent that the price that CFH can realise for the Chorus share exceeds the price paid to exercise the CFH warrant. The strike price for a CFH warrant is based on a total shareholder return of 16% per annum on Chorus shares over the period December 2011 to June 2036. Therefore, a holder of a CFH warrant is only likely to exercise the CFH warrant if total shareholder return on Chorus shares has exceeded 16% per annum over the issue date period from June 2025 to June 2036.

At balance date Chorus had issued in total 7,261,722 warrants which had a fair value and carrying value that approximated zero (30 June 2013: 2,838,382 warrants issued). The number of fibre connections made by 30 June 2020 impacts the number of warrants that could be exercised. Should fibre connections at 30 June 2020 exceed 20% then the number of warrants that would be able to be exercised is 3,124,672 (30 June 2013: 1,204,971).

## Note 4 – CFH securities (cont.)

At balance date the component parts of debt and equity instruments including notional interest were:

	GROUP AND PARENT			GROUP AND PARENT		
	2014			2013		
	CFH DEBT SECURITIES \$M	CFH EQUITY SECURITIES \$M	TOTAL CFH SECURITIES \$M	CFH DEBT SECURITIES \$M	CFH EQUITY SECURITIES \$M	TOTAL CFH SECURITIES \$M
Fair value on initial recognition:						
Balance as at 1 July	19	10	29	2	1	3
Additional securities recognised at fair value	24	16	40	17	9	26
<b>Balance as at 30 June</b>	<b>43</b>	<b>26</b>	<b>69</b>	<b>19</b>	<b>10</b>	<b>29</b>
Accumulated notional interest:						
Balance as at 1 July	1	-	1	-	-	-
Current year notional interest	2	1	3	1	-	1
<b>Balance as at 30 June</b>	<b>3</b>	<b>1</b>	<b>4</b>	<b>1</b>	<b>-</b>	<b>1</b>
<b>Total CFH securities</b>	<b>46</b>	<b>27</b>	<b>73</b>	<b>20</b>	<b>10</b>	<b>30</b>

Refer to note 23 (post balance date events) for further information on these securities.

The fair value of CFH debt securities at balance date was \$48 million (30 June 2013: \$20 million) compared to a carrying value of \$46 million (30 June 2013: \$20 million). The fair value of CFH equity securities at balance date was \$33 million (30 June 2013: \$11 million) compared to a carrying value of \$27 million (30 June 2013: \$10 million). The fair value has been calculated using discount rates from market rates at balance date and using Level 2 of the fair value hierarchy as described in note 21.

### Key assumptions

Although Chorus believes that the estimate of the liability components of the CFH securities on initial recognition is appropriate, the use of different methodologies or assumptions could lead to different measurements of these component parts. The liability components of the CFH securities have been calculated using expected cash flows discounted at risk-adjusted discount rates. As the number of CFH securities expected to be issued increases over time the potential impact of alternative methodologies and assumptions will become increasingly material. Key inputs and assumptions used in these calculations on initial recognition include:

### Discount rate

On initial recognition, the discount rate between 8.88% to 10.98% (30 June 2013: 10.36% to 10.77%) for the CFH equity securities and 6.18% to 7.65% (30 June 2013: 6.37% to 6.95%) for the CFH debt securities applied to the expected cash flows is based on long dated NZ swap curves. The swap rates were adjusted for Chorus specific credit spreads (based on market observed credit spreads for debt issued with similar credit ratings and tenure). The discount rate on the CFH equity securities is capped at Chorus' estimated cost of (ordinary) equity.

### Expected cash flows

Timing of principal repayments and dividend cash flows has been based on forecasts that reflect economically rational outcomes given the terms of the CFH debt and equity securities.

Repayment dates have been based on an estimate that the proportion of premises with a fibre connection within Chorus' coverage area will exceed 20% at 30 June 2020.

### Sensitivity analysis

Chorus considers that it is reasonably possible that future outcomes may be different from the assumptions applied and could require a material adjustment to the carrying amount of the component parts of the CFH securities. The number of fibre connections assumed to have been made by 30 June 2020 is one of the key sensitivities implicit in the measurement of the CFH securities. A change in this proportion would result in the following impact on the financial statements:

	ACTUAL	ALTERNATIVE OUTCOME	IMPACT ON FINANCIAL STATEMENTS
<b>CFH debt securities</b>			
Fibre connection proportion	≥ 20%	< 20%	Increase CFH debt securities liability by \$8.0 million (30 June 2013: \$2.9 million) Decrease Crown funding by \$8.0 million (30 June 2013: \$2.9 million)
<b>CFH equity securities</b>			
Fibre connection proportion	≥ 20%	< 20%	Increase CFH equity securities liability by \$8.5 million (30 June 2013: \$2.3 million) Decrease Crown funding by \$8.5 million (30 June 2013: \$2.3 million)

## Note 5 – Crown funding

Funding from the Crown is recognised at fair value where there is reasonable assurance that the funding is receivable and Chorus complies with all attached conditions. Crown funding is then

recognised in earnings as a reduction to depreciation expense on a systematic basis over the useful life of the asset the funding was used to construct. The accumulated funding has been recognised as follows:

	GROUP				GROUP			
	2014				2013			
	UFB \$M	RBI \$M	OTHER \$M	TOTAL \$M	UFB \$M	RBI \$M	OTHER \$M	TOTAL \$M
Fair value on initial recognition:								
Balance as at 1 July	104	108	21	233	10	18	9	37
Additional funding recognised at fair value	120	81	7	208	94	90	12	196
Balance as at 30 June	224	189	28	441	104	108	21	233
Accumulated amortisation of funding:								
Balance as at 1 July	(1)	(1)	(3)	(5)	-	-	(1)	(1)
Current year amortisation	(3)	(3)	(2)	(8)	(1)	(1)	(2)	(4)
Balance as at 30 June	(4)	(4)	(5)	(13)	(1)	(1)	(3)	(5)
<b>Total Crown funding</b>	<b>220</b>	<b>185</b>	<b>23</b>	<b>428</b>	<b>103</b>	<b>107</b>	<b>18</b>	<b>228</b>
<b>Current</b>				<b>11</b>				<b>6</b>
<b>Non-current</b>				<b>417</b>				<b>222</b>

The Parent balances are equivalent to the Ultra-Fast Broadband Crown funding balances for the Group.

### Ultra-Fast Broadband

Chorus receives funding from the Crown to finance construction costs associated with the development of the UFB network. During the year, Chorus has recognised funding for 142,554 premises passed (30 June 2013: 107,806) where user acceptance testing was complete. This brings the total premises passed at 30 June 2014 to approximately 261,000 (30 June 2013: 119,000).

Continued recognition of the full amount of the Crown funding is contingent on certain material performance targets being met by Chorus. The most significant of these material performance targets relate to the number of premises passed by fibre optic cables by key dates and compliance with certain specifications under user acceptance testing by CFH.

### Rural Broadband Initiative (RBI)

Chorus receives Crown funding from the Ministry of Business, Innovation and Employment (MBIE) for capital expenditure incurred under the Rural Broadband Initiative.

Chorus is entitled to claim payment for the grantable costs attributable to the relevant milestones for deploying the rural link or rural cabinets. The MBIE will pay Chorus one dollar of funding for each dollar of grantable costs incurred by Chorus up to a maximum funding limit of around \$236 million. In addition the MBIE reimburses Chorus for all capital expenditure attributable to school lead-ins.

### Other

Chorus receives funding towards the cost of relocation of telecommunications equipment, school lead-ins and extending the network coverage to rural areas.

### Note 6 – Segmental reporting

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses and for which operating results are regularly reviewed by the entity's chief operating decision maker and for which discrete financial information is available.

Chorus' Chief Executive Officer has been identified as the chief operating decision maker for the purpose of 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 in assessing performance, allocating resources and making strategic decisions.

All of Chorus' operations are provided in New Zealand, therefore no geographic information is provided.

Two Chorus customers met the reporting threshold of 10 percent of Chorus' operating revenue in the year to 30 June 2014. The total revenue for the year ending 30 June 2014 from one customer was \$775 million (30 June 2013: \$815 million) and from the other customer was \$125 million (30 June 2013: \$101 million).

### Note 7 – Operating revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to Chorus and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable.

Chorus recognises revenue as it provides services to its customers. Billings are generally made on a monthly basis.

Unbilled revenues from the billing cycle date to the end of each month are recognised as revenue during the month the service is provided. Revenue is deferred in respect of the portion of fixed monthly charges that have been billed in advance. Revenue from installations and connections is recognised upon completion of the installation or connection.

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Basic copper	543	631	-	-
Enhanced copper	293	215	-	-
Fibre	75	60	-	-
Value added network services	38	37	-	-
Infrastructure	19	17	-	-
Field services	75	85	-	-
Other	15	12	-	-
Intercompany dividend income	-	-	83	86
<b>Total operating revenue</b>	<b>1,058</b>	<b>1,057</b>	<b>83</b>	<b>86</b>



## Note 8 – Operating expenses

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Labour costs	(79)	(67)	-	-
Provisioning	(56)	(51)	-	-
Network maintenance	(99)	(100)	-	-
Other network costs	(38)	(37)	-	-
Information technology costs	(55)	(52)	-	-
Rent and rates	(12)	(12)	-	-
Property maintenance	(12)	(12)	-	-
Electricity	(13)	(13)	-	-
Insurance	(4)	(4)	-	-
Consultants	(5)	(6)	-	-
Other	(36)	(40)	-	(1)
<b>Total operating expenses</b>	<b>(409)</b>	<b>(394)</b>	<b>-</b>	<b>(1)</b>

### Labour costs

Labour costs of \$79 million (30 June 2013: \$67 million) represents employee costs related to non-capital expenditure.

### Share based payments

In September 2013 Chorus 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 granted at an average price of \$2.897 per share. The shares are held by a trustee and vest as equity to participating employees after a three year period.

### Pension contributions

Included in labour costs are payments to the New Zealand Government Superannuation Fund of \$369,000 (30 June 2013: \$333,000) and contributions to KiwiSaver of \$1,878,000 (30 June 2013: \$1,112,000). At 30 June 2014 there were 27 employees in

New Zealand Government Superannuation Fund (30 June 2013: 27 employees) and 676 employees in KiwiSaver (30 June 2013: 545 employees). Chorus has no other obligations to provide pension benefits in respect of employees.

### Charitable and political donations

Other costs include charitable donations of \$25,000 (30 June 2013: \$50,000). Chorus has not made any political donations (30 June 2013: nil).

### Operating leases

Rent and rates costs include leasing and rental expenditure of \$5 million for property, network infrastructure and items of equipment (30 June 2013: \$5 million).

### Auditor remuneration

Included in other expenses are fees paid to auditors:

	GROUP		PARENT	
	2014 \$000's	2013 \$000's	2014 \$000's	2013 \$000's
Audit of statutory financial statements	535	430	-	-
Regulatory audit work <sup>1</sup>	388	348	-	-
Tax compliance services	36	37	-	-
Other assurance services <sup>2</sup>	3	3	-	-
Other services <sup>3</sup>	29	30	-	-
<b>Total other services</b>	<b>456</b>	<b>418</b>	<b>-</b>	<b>-</b>
<b>Total fees paid to the auditor</b>	<b>991</b>	<b>848</b>	<b>-</b>	<b>-</b>

1 Includes audit of Information Disclosure Determination, Telecommunications Services Obligations and Telecommunications Development Levy.

2 Relates to attendance at the Annual General Meeting.

3 Other services primarily relate to accounting advice relating to financial instrument disclosure.

## Note 9 – Finance expense

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Interest on syndicated bank facility	(64)	(58)	(64)	(58)
Interest on EMTN	(49)	(46)	(49)	(46)
Other interest expense	(20)	(16)	(6)	-
Capitalised interest	7	6	-	-
<b>Total finance expense excluding CFH securities</b>	<b>(126)</b>	<b>(114)</b>	<b>(119)</b>	<b>(104)</b>
CFH securities (notional interest)	(3)	(1)	(3)	(1)
<b>Total finance expense</b>	<b>(129)</b>	<b>(115)</b>	<b>(122)</b>	<b>(105)</b>

Other interest expense includes \$13 million finance lease interest expense (30 June 2013: \$13 million) and \$1 million of costs relating to the December 2013 reset of interest rate swaps and \$2 million amortisation arising from the difference between fair value and proceeds realised from the swaps reset (refer to note 20).

## Note 10 – Trade and other receivables

Trade and other receivables are initially recognised at the fair value of the amounts to be received, plus transaction costs (if any). They are subsequently measured at amortised cost (using the effective interest method) less impairment losses.

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Trade receivables	130	229	-	-
Other receivables	56	51	49	32
Intercompany receivables	-	-	357	211
	<b>186</b>	<b>280</b>	<b>406</b>	<b>243</b>
Prepayments	10	14	-	-
<b>Trade and other receivables</b>	<b>196</b>	<b>294</b>	<b>406</b>	<b>243</b>

Trade receivables are non-interest bearing and are generally on terms 20 working days or less.

Chorus maintains a provision for impairment losses when there is objective evidence of its customers being unable to make required

payments and make provision for doubtful debt where debt is more than 90 days overdue. There have been no significant individual impairment amounts recognised as an expense. Trade receivables are net of allowances for disputed balances with customers.

### Note 10 – Trade and other receivables (cont.)

The ageing profile of trade receivables as at 30 June 2014 is as follows:

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Not past due	112	208	-	-
Past due 1-30 days	11	13	-	-
Past due 31-60 days	3	3	-	-
Past due 61-90 days	4	1	-	-
Past due over 90 days	-	4	-	-
	<b>130</b>	<b>229</b>	<b>-</b>	<b>-</b>

Chorus has a concentrated customer base consisting predominantly of a small number of retail service providers. The concentration of Chorus' customer base heightens the risk that a dispute with a customer, or a customer's failure to pay for services, will have a material adverse effect on Chorus' collectability of receivables.

Any disputes arising that may affect the relationship between the parties will be raised by relationship managers and follow the Chorus dispute resolution process. Chorus has \$18 million of accounts receivable that are past due but not impaired (30 June 2013: \$21 million). The carrying value of trade and other receivables approximate the fair value. The maximum credit exposure is limited to the carrying value of trade and other receivables.

### Note 11 – Trade and other payables

Trade and other payables are initially recognised at fair value less transaction costs (if any). They are subsequently measured at amortised cost using the effective interest method.

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Trade payables	119	121	-	-
Joint arrangements	4	11	-	-
Accruals	148	154	35	33
Personnel accrual	20	17	-	-
Revenue billed in advance	32	27	-	-
<b>Trade and other payables</b>	<b>323</b>	<b>330</b>	<b>35</b>	<b>33</b>
<b>Current</b>	<b>323</b>	<b>328</b>	<b>35</b>	<b>33</b>
<b>Non-current</b>	<b>-</b>	<b>2</b>	<b>-</b>	<b>-</b>

Trade and other payables are non-interest bearing and normally settled within 30 day terms. The carrying value of trade and other payables approximate their fair values.

#### Joint arrangements

Certain network electronic assets and shared systems owned by Spark are required for continued use by Chorus post demerger. The right to use these assets has been granted by Spark under joint arrangements over the life of the assets.

## Note 12 – Commitments

### Network infrastructure project agreement

Chorus is committed to deploying infrastructure for premises in the UFB candidate areas awarded to Chorus, to be built according to annual build milestones and to be complete by no later than 31 December 2019. In total it is expected that the communal infrastructure will pass an estimated 830,900 premises. Chorus has estimated that it will cost \$1.7–\$1.9 billion to build the communal UFB network by the end of 2019.

### Rural Broadband Initiative

As part of the Rural Broadband Initiative Phase 1, Chorus is committed to deploying approximately 3,100 kilometres of fibre to connect approximately 830 schools and enable approximately 57% of rural users to access broadband speeds of at least 5Mbps. In addition, under Phase 2 of the Rural Broadband Initiative,

Chorus will be deploying a further 250 kilometres of fibre to connect 189 provincial schools, up to 181 rural public libraries and 45 rural hospitals and family health centres.

The estimated cost of the build is in the range of \$280–\$295 million.

### Capital expenditure

Refer to note 1 and note 2 for details of capital expenditure commitments.

### Lease commitments

Chorus has buildings, car parks and site licenses under operating lease arrangements. The future non-cancellable minimum operating lease commitment as at 30 June 2014 for the Group was \$27 million (30 June 2013: \$26 million). Refer to note 15 (leases) for further information on leases.

## Note 13 – Taxation

Current and deferred tax is calculated on the basis of the laws enacted or substantively enacted at balance date.

Deferred taxation is recognised in respect of temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Future tax benefits are recognised where realisation of the asset is probable.

Current and deferred tax are recognised in the income statement, except when the tax relates to items charged or credited to other comprehensive income, in which case the tax is also recognised in other comprehensive income.

### Income tax

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
<b>Income statement</b>				
Current income tax				
Current year income tax expense	(57)	(62)	(7)	-
Adjustments in respect of prior periods	-	6	-	-
Deferred income tax				
Network assets, software and other intangibles	(4)	2	-	-
Fair value portion of derivatives	6	-	6	-
Other	(4)	(6)	-	-
Adjustments in respect of prior periods	1	(5)	-	-
<b>Income tax expense recognised in income statement</b>	<b>(58)</b>	<b>(65)</b>	<b>(1)</b>	<b>-</b>
<b>Other comprehensive income</b>				
Current income tax				
Current year income tax expense	-	-	-	-
Deferred income tax				
Changes in fair value of cash flow hedges	(1)	(4)	(1)	(4)
<b>Income tax expense recognised in other comprehensive income</b>	<b>(1)</b>	<b>(4)</b>	<b>(1)</b>	<b>(4)</b>

The taxation expense charged to earnings includes both current and deferred tax and is calculated after allowing for adjustments.

**Note 13 – Taxation (cont.)**

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
<b>Reconciliation of effective tax rate</b>				
<b>Net earnings for the year</b>	<b>148</b>	<b>171</b>	<b>84</b>	<b>87</b>
Add: Income tax expense	(58)	(65)	(1)	-
<b>Net earnings before income tax</b>	<b>206</b>	<b>236</b>	<b>85</b>	<b>87</b>
Income tax at 28%	(58)	(66)	(24)	(24)
<b>Adjustment to taxation</b>				
Non taxable intercompany dividends	-	-	23	24
Other non taxable items	(1)	-	-	-
Adjustments in respect of prior periods	1	1	-	-
	<b>(58)</b>	<b>(65)</b>	<b>(1)</b>	<b>-</b>

For the year ended 30 June 2014 the effective tax rate of 28% equates to the statutory rate (30 June 2013: 28%).

Payments of provisional tax (from the second payment) during the tax year to 30 June 2014 have been paid via a tax financing arrangement with Tax Management New Zealand (TMNZ). This means that Chorus notifies TMNZ that they wish to make 'payment' via financing, and TMNZ then arranges for a payment to the Inland Revenue Department on Chorus' behalf. This effectively results in a delayed cash flow for Chorus, with the cash flow associated with the second and third provisional tax payments for 2014 being deferred until 4 June 2015.

**Movement in deferred tax balance**

(Assets)/liabilities	GROUP						TOTAL
	FAIR VALUE PORTION OF DERIVATIVES	NETWORK ASSETS, SOFTWARE AND OTHER INTANGIBLES	EMPLOYEE ENTITLEMENTS	FINANCE LEASES	OTHER	CHANGES IN FAIR VALUE OF CASH FLOW HEDGES	
Balance 1 July 2012	16	214	(4)	(35)	(10)	(4)	177
Recognised in Income Statement	-	3	3	-	3	-	9
Recognised in other comprehensive income	-	-	-	-	-	4	4
<b>Balance 30 June 2013</b>	<b>16</b>	<b>217</b>	<b>(1)</b>	<b>(35)</b>	<b>(7)</b>	<b>-</b>	<b>190</b>
Recognised in Income Statement	(6)	4	-	-	3	-	1
Recognised in other comprehensive income	-	-	-	-	-	1	1
<b>Balance 30 June 2014</b>	<b>10</b>	<b>221</b>	<b>(1)</b>	<b>(35)</b>	<b>(4)</b>	<b>1</b>	<b>192</b>

(Assets)/liabilities	PARENT		
	FAIR VALUE PORTION OF DERIVATIVES	CHANGES IN FAIR VALUE OF CASH FLOW HEDGES	TOTAL
Balance 1 July 2012	16	(4)	12
Recognised in Income Statement	-	-	-
Recognised in other comprehensive income	-	4	4
<b>Balance 30 June 2013</b>	<b>16</b>	<b>-</b>	<b>16</b>
Recognised in Income Statement	(6)	-	(6)
Recognised in other comprehensive income	-	1	1
<b>Balance 30 June 2014</b>	<b>10</b>	<b>1</b>	<b>11</b>

## Note 13 – Taxation (cont.)

### Imputation credits

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Imputation credits available for subsequent reporting periods	<b>88</b>	<b>63</b>	<b>21</b>	<b>5</b>

The imputation credit amount represents the balance of the imputation credit account as at the end of the reporting period, adjusted for imputation credits that will arise from the payment of the provision for income tax. Imputation credits are available for

use subject to the requirements of the Income Tax Act 2007 being satisfied. For the purposes of the Income Tax Act 2007 demerger transactions do not give rise to, and are ignored for the purposes of calculating, available subscribed capital of Chorus.

## Note 14 – Cash and call deposits

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Cash and call deposits	<b>176</b>	<b>80</b>	<b>92</b>	<b>69</b>

Cash and call deposits are held with bank and financial institutions counterparties rated at a minimum of A+, based on rating agency Standard & Poor's ratings. Interest earned on call deposits is based on the daily deposit rate.

There are no cash or call deposit balances held by Chorus that are not available for use.

The carrying values of cash and call deposits approximate their fair values. The maximum credit exposure is limited to the carrying value of cash and call deposits.

Cash and call deposits denominated in foreign currencies are retranslated into New Zealand dollars at the spot rate of exchange

at the reporting date. All differences arising on settlement or translation of monetary items are taken to the income statement.

### Cash flow

Cash flows from derivatives in cash flow and fair value hedge relationships are recognised in the cash flow statement in the same category as the hedged item.

For the purposes of the statement of cash flows, cash is considered to be cash on hand, in banks and cash equivalents, including bank overdrafts and highly liquid investments that are readily convertible to known amounts of cash which are subject to an insignificant risk of changes in values.

## Note 15 – Leases

Chorus is a lessee of certain network assets under both operating and finance lease arrangements. Lease costs relating to operating leases are recognised on a straight-line basis over the life of the lease. Finance leases, which effectively transfer to Chorus substantially all the risks and benefits of ownership of the leased assets, are capitalised at the lower of the leased asset's fair value or the present value of the minimum lease payments at inception of the lease. The leased assets and corresponding liabilities are recognised, and the leased assets are depreciated over their estimated useful lives.

Determining whether a lease agreement is a finance lease or an operating lease requires judgement as to whether the agreement

transfers substantially all the risks and rewards of ownership to Chorus. Judgement is required on various aspects that include, but are not limited to, the fair value of the leased asset, the economic life of the leased asset, whether or not to include renewal options in the lease term, and determining an appropriate discount rate to calculate the present value of the minimum lease payments.

Classification as a finance lease means the asset is recognised in the statement of financial position as network assets whereas for an operating lease no such asset is recognised.

Chorus has exercised its judgement on the appropriate classification of network asset leases, and has determined a number of lease arrangements are finance leases.



## Note 15 – Leases (cont.)

### Finance leases

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
<b>Assets/(liabilities)</b>				
<b>Expected future lease payments:</b>				
Less than one year	(8)	(7)	-	-
Between one and five years	(32)	(32)	-	-
More than five years	(379)	(387)	-	-
<b>Total expected future lease payments</b>	<b>(419)</b>	<b>(426)</b>	<b>-</b>	<b>-</b>
Less: future finance charges	296	306	-	-
<b>Present value of expected future lease payments</b>	<b>(123)</b>	<b>(120)</b>	<b>-</b>	<b>-</b>
<b>Present value of expected future lease payments payable:</b>				
Less than one year	3	3	-	-
Between one and five years	15	14	-	-
More than five years	(141)	(137)	-	-
<b>Total present value of expected future lease payments</b>	<b>(123)</b>	<b>(120)</b>	<b>-</b>	<b>-</b>
<b>Classified as:</b>				
Current asset – finance lease receivable	3	3	-	-
Non-current liability – finance lease payable	(126)	(123)	-	-
<b>Total</b>	<b>(123)</b>	<b>(120)</b>	<b>-</b>	<b>-</b>

The carrying value of the finance leases approximates their fair value.

### Property exchanges

Chorus has leased exchange space and commercial co-location space owned by Spark which is subject to finance lease arrangements. Chorus in turn leases exchange space and commercial co-location space owned by Chorus to Spark under a finance lease arrangement. The term of the lease where Chorus is lessee is for ten years with multiple rights of renewal for a further twenty five years. The term of the lease where Chorus is lessor is

for three years with two rights of renewal for a further three years each. The full term has been used in the calculation of finance lease payables and receivables as it is likely due to the specialised nature of the buildings that the leases will be renewed to the maximum term. The payable and receivable under these finance lease arrangements are net settled in cash. The finance lease arrangement above reflects the net finance lease receivable and payable position.

## Note 15 – Leases (cont.)

### Operating leases

	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
<b>Non-cancellable operating lease rentals are payable as follows:</b>				
Less than one year	6	6	-	-
Between one and five years	15	14	-	-
More than five years	6	6	-	-
<b>Total</b>	<b>27</b>	<b>26</b>	<b>-</b>	<b>-</b>

Chorus has entered into leasing arrangements for properties, network infrastructure and other items of equipment which are classified as operating leases. Certain leases are subject to Chorus being able to renew or extend the lease period based on terms that would then be agreed with the lessor. There are no other significant lease terms that relate to contingent rents, purchase options or other restrictions on Chorus.

## Note 16 – Investments and advances

Chorus New Zealand Limited incorporated in New Zealand is a wholly owned operating subsidiary of Chorus Limited.

The investment in the subsidiary is carried at cost less any impairments losses and comprises:

	PARENT	
	2014 \$M	2013 \$M
Shares at cost	538	538
Term advance	1,700	1,700
<b>Total investments and advances</b>	<b>2,238</b>	<b>2,238</b>

There were no impairment losses on investments and advances at 30 June 2014 (30 June 2013: nil).

## Note 17 – Equity

### Share capital

Movements in Chorus Limited's issued ordinary shares were as follows:

NUMBER OF SHARES (MILLIONS)	GROUP AND PARENT	
	2014 M	2013 M
Balance 1 July	389	385
Dividend Reinvestment Plan	7	4
<b>Balance at 30 June</b>	<b>396</b>	<b>389</b>

Chorus Limited has 396,369,767 fully paid ordinary shares (30 June 2013: 389,299,049 fully paid ordinary shares). The issued shares have no par value. The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of Chorus Limited. Under Chorus Limited's constitution, Crown approval is required if a shareholder wishes to have a holding of 10% or more of Chorus Limited ordinary shares, or if a shareholder who is not a New Zealand national wishes to have a holding of 49.9% or more of ordinary shares.

Chorus Limited has implemented a Dividend Reinvestment Plan where eligible shareholders (those who have an address in New Zealand or Australia) can choose to have Chorus Limited reinvest all or part of their future dividends in additional Chorus

Limited shares. In respect of the year ended 30 June 2014, 7,070,718 shares with a total value of \$18 million were issued in lieu of dividends (30 June 2013: 4,216,926 shares with a total value of \$12 million were issued in lieu of dividends). The plan was suspended on 11 April 2014.

Chorus Limited issues securities to CFH based on the number of premises passed. CFH securities are a class of security that carry no right to vote at meetings of holders of Chorus Limited ordinary shares but carry preference on liquidation. Refer to note 4 for additional information on CFH securities.

Should Chorus Limited return capital to shareholders, any return of capital that arose on demerger is expected to be taxable as Chorus Limited had zero available subscribed capital on demerger.

The following dividends were declared and paid by Chorus Limited for the year ended 30 June 2014:

	GROUP AND PARENT		GROUP AND PARENT	
	2014 \$M	2014 CENTS PER SHARE	2013 \$M	2013 CENTS PER SHARE
2012 dividend paid	-	-	56	14.6
2013 interim dividend paid	-	-	39	10.0
2013 final dividend paid	60	15.5	-	-
<b>Dividends paid during the year</b>	<b>60</b>	<b>15.5</b>	<b>95</b>	<b>-</b>
Final dividend declared subsequent to balance date not provided	-	-	60	15.5

## Note 17 – Equity (cont.)

### Reserves

#### Cash flow hedge reserve

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet affected earnings.

For cash flow hedges, the effective portion of gains or losses from remeasuring the fair value of the hedging instrument is recognised in other comprehensive income and accumulated in the cash flow hedge reserve. Accumulated gains or losses are subsequently

transferred to the income statement when the hedged item affects the income statement, or when the hedged item is a forecast transaction that is no longer expected to occur. Alternatively, when the hedged item results in a non-financial asset or liability, the accumulated gains and losses are included in the initial measurement of the cost of the asset or liability.

The remeasurement gain or loss on the ineffective portion of a cash flow hedge is recognised immediately in the income statement.

A reconciliation of movements in the cash flow hedge reserve follows:

	GROUP AND PARENT	
	2014 \$M	2013 \$M
Opening balance	1	10
(Gain)/loss recognised in other comprehensive income	(2)	(9)
Amortisation of de-designated cash flow hedges transferred to income statement	1	-
<b>Closing balance</b>	<b>-</b>	<b>1</b>

The periods in which the cash flows associated with cash flow hedges are expected to impact earnings are as follows:

	GROUP AND PARENT					
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M
AS AT 30 JUNE 2014						
Cross currency interest rate swaps	2	2	2	2	2	4
Interest rate swaps	(3)	(3)	(5)	(3)	(3)	3
Forward exchange contracts	-	-	-	-	-	-
Electricity contracts	-	-	-	-	-	-
	<b>(1)</b>	<b>(1)</b>	<b>(3)</b>	<b>(1)</b>	<b>(1)</b>	<b>7</b>

	GROUP AND PARENT					
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M
AS AT 30 JUNE 2013						
Cross currency interest rate swaps	-	-	-	-	-	1
Interest rate swaps	-	1	-	1	-	(2)
Forward exchange contracts	-	-	-	-	-	-
Electricity contracts	-	-	-	-	-	-
	<b>-</b>	<b>1</b>	<b>-</b>	<b>1</b>	<b>-</b>	<b>(1)</b>

#### Fair value hedges

Gains or losses from remeasuring the fair value of the hedging instrument are recognised in the income statement together with any changes in the fair value of the hedged asset or liability.

Chorus did not have any hedging arrangements designated as a fair value hedge in the current year (30 June 2013: nil).

### Note 18 – Earnings per share

The calculation of basic earnings per share at 30 June 2014 is based on the net earnings for the year of \$148 million (30 June

2013: \$171 million), and a weighted average number of ordinary shares outstanding during the period of 394 million (30 June 2013: 386 million), calculated as follows:

	GROUP	
	2014	2013
<b>Basic earnings per share</b>		
Net earnings attributable to ordinary shareholders (\$ millions)	148	171
Denominator – weighted average number of ordinary shares (millions)	394	386
<b>Basic earnings per share (dollars)</b>	<b>0.38</b>	<b>0.44</b>
<b>Diluted earnings per share</b>		
Net earnings attributable to ordinary shareholders (\$ millions)	148	171
Weighted average number of ordinary shares (millions)	394	386
Ordinary shares required to settle CFH equity securities (millions)	80	25
Ordinary shares required to settle CFH warrants (millions)	4	1
Denominator – diluted weighted average number of shares (millions)	<b>478</b>	<b>412</b>
<b>Diluted earnings per share (dollars)</b>	<b>0.31</b>	<b>0.42</b>

The number of ordinary shares that would have been required to settle all CFH equity securities and CFH warrants on issue at 30 June has been used for the purposes of the diluted earnings per share calculation.

## Note 19 – Related party transactions

### Transactions with related parties

Certain Chorus directors have relevant interests in a number of companies with which Chorus has transactions in the normal

### Key management personnel compensation

course of business. A number of Chorus' directors are also non-executive directors of other companies. Any transactions undertaken with these entities have been entered in the ordinary course of business.

	GROUP		PARENT	
	2014 \$000's	2013 \$000's	2014 \$000's	2013 \$000's
Short term employee benefits	5,491	5,494	-	-
Post employment benefits	-	-	-	-
Termination benefits	-	242	-	-
Other long term benefits	316	650	-	-
Share based payments	-	-	-	-
	<b>5,807</b>	<b>6,386</b>	-	-

This table above includes remuneration of \$889,500 (30 June 2013: \$863,500) paid to directors for the year.

### Parent/subsidiary relationship

Chorus Limited is the listed holding company with the debt obligation for the EMTN and syndicated bank facilities and is the issuer of the CFH securities. Chorus New Zealand Limited is an operational subsidiary providing fixed access and aggregation services in New Zealand. Chorus Limited provides funding to Chorus New Zealand Limited for the operation and construction of the network. Chorus New Zealand Limited has provided a guarantee to the lenders in respect of the Chorus Limited syndicated bank facilities and EMTN debt.

	PARENT	
	2014 \$M	2013 \$M
Intercompany dividend	83	86
Intercompany interest income	116	104
Intercompany short term receivable	357	211
Intercompany term advance	1,700	1,700



## Note 20 – 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. The use of hedging instruments is governed by the treasury policy approved by the Board. Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to fair value with an adjustment made for credit risk in accordance with NZ IFRS 13: Fair Value Measurement. The fair values are estimated on the basis of the quoted market prices for similar instruments in an active market or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The method of recognising the resulting remeasurement gain or loss depends on whether the derivative is designated as a hedging instrument. If the derivative is not designated as a hedging instrument, the remeasurement gain or loss is recognised immediately in the income statement.

During the year ended 30 June 2014 interest rate swaps with a face value of \$676 million and fair value of \$31 million were reset at the prevailing market interest rates. These transactions realised \$30 million of cash, and resulted in an \$11 million gain being recorded in the cash flow hedge reserve to be amortised over the period to 2020. During the year ended 30 June 2014 amortisation totalled \$3 million finance income and \$2 million finance expense. New swaps that hedge the same underlying exposure and risk profile were entered into on the same date but at a higher effective borrowing cost (4.89% compared to 3.99% prior to the transaction).

	GROUP AND PARENT	
	2014 \$M	2013 \$M
<b>Non-current derivative assets</b>		
Interest rate swaps	3	7
Forward exchange rate contracts	-	-
Cross currency interest rate swaps	-	-
Electricity contracts	-	-
	<b>3</b>	<b>7</b>
<b>Non-current derivative liabilities</b>		
Interest rate swaps	8	2
Forward exchange rate contracts	-	-
Cross currency interest rate swaps	128	103
Electricity contracts	-	1
	<b>136</b>	<b>106</b>

The notional values of contract amounts outstanding are as follows:

	CURRENCY	MATURITY	GROUP AND PARENT	
			2014 \$M	2013 \$M
Interest rate swaps	NZD	2014-2020	1,242	1,242
Forward exchange rate contracts	NZD:AUD	2014	2	3
	NZD:EUR	2014-2016	5	11
Cross currency interest rate swaps	NZD:GBP	2020	677	677
Electricity contracts	NZD	2014-2016	12	7
			<b>1,938</b>	<b>1,940</b>

Credit risk associated with derivative financial instruments is managed by ensuring that transactions are executed with counterparties with high quality credit ratings along with credit exposure limits for different credit classes. The counterparty credit risk is monitored and reviewed by the Board on a regular basis.

## Note 21 – Financial risk management

### Financial risk management

Chorus' financial instruments consist of cash, short-term deposits, trade and other receivables (excluding prepayments), investments and advances, trade payables and certain other payables, syndicated bank facilities, EMTN, derivative financial instruments and CFH securities. Financial risk management for currency and interest rate risk is carried out by the treasury function under policies approved by the Board. Chorus' risk management policy, approved by the Board, provides the basis for overall risk management.

Chorus does not hold or issue derivative financial instruments for trading purposes. All contracts have been entered into with major creditworthy financial institutions. The risk associated with these transactions is the cost of replacing these agreements at the current market rates in the event of default by a counterparty.

### Currency risk

Chorus' exposure to foreign currency fluctuations predominantly arise from the foreign currency debt and future commitment to purchase foreign currency denominated assets. The primary objective in managing foreign currency risk is to protect against the risk that Chorus assets, liabilities and financial performance will fluctuate due to changes in foreign currency exchange rates. Chorus enters into foreign exchange contracts, foreign currency options and cross currency interest rate swaps to manage the foreign exchange exposure.

Chorus has issued GBP 260 million foreign currency debt in the form of EMTN. Chorus has in place cross currency interest rate swaps under which Chorus receives GBP 260 million principal and GBP fixed coupon payments for \$677 million principal and floating NZD interest payments. The exchange gain or loss resulting

from the translation of EMTN denominated in foreign currency to New Zealand dollars is recognised in the income statement. The movement is offset by the translation of the principal value of the related cross currency interest rate swap.

As at 30 June 2014, Chorus did not have any significant unhedged exposure to currency risk (30 June 2013: no significant unhedged exposure to currency risk). A 10% increase or decrease in the exchange rate, with all other variables held constant, has minimal impact on profit and equity reserves of Chorus.

### Price risk

In the normal course of business, Chorus is exposed to a variety of financial risks which include the volatility in electricity prices. Chorus has entered into electricity swap contracts to reduce the exposure to electricity spot price movements. Chorus has designated the electricity contracts in cash flow hedge relationships.

A 10% increase or decrease in the spot price of electricity, with all other variables held constant, has minimal impact on profit and equity reserves of Chorus.

### Interest rate risk

Chorus has interest rate risk arising from the cross currency interest rate swap converting the foreign debt into a floating rate New Zealand dollar obligation and the floating rate on the drawn down portion of the syndicated bank facilities. Chorus aims to reduce the uncertainty of changes in interest rates by entering into interest rate swaps to fix the effective interest rate to minimise the cost of net debt and manage the impact of interest rate volatility on earnings. The interest risk on the cross currency interest rate swaps has been hedged using interest rate swaps. The interest rate exposure on the syndicated banking facilities has been hedged up to \$565 million with the remaining paying floating interest.

### Interest rate repricing analysis

AS AT 30 JUNE 2014	GROUP						TOTAL \$M
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M	
<b>Floating rate</b>							
Cash and deposits	176	-	-	-	-	-	176
Debt	575	-	-	-	-	-	575
<b>Fixed rate</b>							
Joint arrangements	4	-	-	-	-	-	4
Debt (after hedging)	350	-	215	-	-	677	1,242
CFH securities	-	-	-	-	-	73	73
Finance lease (net settled)	(3)	(3)	(4)	(4)	(4)	141	123
	<b>1,102</b>	<b>(3)</b>	<b>211</b>	<b>(4)</b>	<b>(4)</b>	<b>891</b>	<b>2,193</b>

**Note 21 – Financial risk management (cont.)**

AS AT 30 JUNE 2013	GROUP						TOTAL \$M
	WITHIN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	GREATER THAN 5 YEARS \$M	
<b>Floating rate</b>							
Cash and deposits	80	-	-	-	-	-	80
Debt	630	-	-	-	-	-	630
<b>Fixed rate</b>							
Joint arrangements	8	3	-	-	-	-	11
Debt (after hedging)	-	350	-	215	-	677	1,242
CFH securities	-	-	-	-	-	30	30
Finance lease (net settled)	(3)	(3)	(3)	(4)	(4)	137	120
	<b>715</b>	<b>350</b>	<b>(3)</b>	<b>211</b>	<b>(4)</b>	<b>844</b>	<b>2,113</b>

The Parent has floating rate exposures of cash (30 June 2014: \$92 million, 30 June 2013: \$69 million) and debt (30 June 2014: \$575 million, 30 June 2013: \$630 million) both of which are due to reset within one year. The exposures of debt (after hedging) and CFH securities are the same as for the Group for the current and prior year.

**Sensitivity analysis**

A change of 100 basis points in interest rates with all other variables held constant, would increase/(decrease) equity (after hedging) and earnings after tax by the amounts shown below:

	GROUP AND PARENT			
	2014 PROFIT OR (LOSS) \$M	2014 EQUITY \$M	2013 PROFIT OR (LOSS) \$M	2013 EQUITY \$M
100 basis point increase	(3)	(7)	(3)	(5)
100 basis point decrease	3	7	3	13

**Credit risk**

In the normal course of its business, Chorus incurs counterparty credit risk from financial instruments, including cash, trade and other receivables, finance lease receivables and derivative financial instruments.

Chorus has certain derivative transactions that are subject to bilateral credit support agreements that require Chorus or the counterparty to post collateral to support the value of certain derivatives. As at 30 June 2014 no collateral was posted.

The maximum exposure to credit risk at the reporting date was as follows:

NOTES	GROUP		PARENT	
	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Cash and call deposits	14	176	80	92
Trade and other receivables	10	186	280	406
Derivative financial instruments	20	3	7	3
Finance lease receivable	15	3	3	-
<b>Maximum exposure to credit risk</b>		<b>368</b>	<b>370</b>	<b>501</b>
				<b>319</b>

Refer to individual notes for additional information on credit risk.

## Note 21 – Financial risk management (cont.)

### Liquidity risk

Liquidity risk is the risk that Chorus will encounter difficulty raising liquid funds to meet commitments as they fall due or foregoing

investment opportunities, resulting in defaults or excessive debt costs. Prudent liquidity risk management implies maintaining sufficient cash and the ability to meet its financial obligations. Chorus exposure to liquidity risk based on contractual cash flows relating to financial liabilities is summarised below:

AS AT 30 JUNE 2014	GROUP							
	CARRYING AMOUNT \$M	CONTRACTUAL CASH FLOW \$M	LESS THAN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	5+ YEARS \$M
<b>Non derivative financial liabilities</b>								
Trade and other payables	271	271	271	-	-	-	-	-
Finance lease (net settled)	123	419	8	8	8	8	8	379
Debt	1,639	2,042	101	585	73	448	297	538
CFH securities	73	73	-	-	-	-	-	73
<b>Derivative financial liabilities</b>								
Interest rate swaps	8	1	10	2	(1)	(2)	(3)	(5)
Cross currency interest rate swaps								
Inflows	-	(708)	(34)	(34)	(34)	(34)	(34)	(538)
Outflows	128	981	44	49	51	52	54	731
Electricity contracts	-	5	3	2	-	-	-	-
Forward exchange contracts								
Inflows	-	(6)	(4)	(2)	-	-	-	-
Outflows	-	6	4	2	-	-	-	-

AS AT 30 JUNE 2013	GROUP							
	CARRYING AMOUNT \$M	CONTRACTUAL CASH FLOW \$M	LESS THAN 1 YEAR \$M	1-2 YEARS \$M	2-3 YEARS \$M	3-4 YEARS \$M	4-5 YEARS \$M	5+ YEARS \$M
<b>Non derivative financial liabilities</b>								
Trade and other payables	286	286	283	3	-	-	-	-
Finance lease (net settled)	120	426	7	8	8	8	8	387
Debt	1,697	2,091	77	77	741	54	564	578
CFH securities	30	67	-	-	-	-	-	67
<b>Derivative financial liabilities</b>								
Interest rate swaps	2	75	13	12	12	10	9	19
Cross currency interest rate swaps								
Inflows	-	(750)	(34)	(34)	(34)	(35)	(35)	(578)
Outflows	103	938	37	37	37	37	38	752
Electricity contracts	1	7	3	3	1	-	-	-
Forward exchange contracts								
Inflows	-	(14)	(10)	(2)	(2)	-	-	-
Outflows	-	14	10	2	2	-	-	-

## Note 21 – Financial risk management (cont.)

The liquidity risk for the Parent is the same as for all disclosures for the Group except trade and other payables and finance leases. The carrying amount of trade and other payables in the Parent is \$35 million (30 June 2013: \$33 million), which is equal to the contractual cash flow and is all payable in less than one year. The Parent does not have finance leases for the current or prior year.

The gross (inflows)/outflows of derivative financial liabilities disclosed in the previous table represent the contractual undiscounted cash flows relating to derivative financial liabilities held for risk management purposes and which are usually not closed out prior to contractual maturity. The disclosure shows net cash flow amounts for derivatives that are net cash settled and gross cash inflow and outflow amounts for derivatives that have simultaneous gross cash settlement (for example forward exchange contracts).

Chorus manages liquidity risk by ensuring sufficient access to committed facilities, continuous cash flow monitoring and maintaining prudent levels of short term debt maturities. At balance date, Chorus has available approximately \$460 million under the syndicated bank facilities for its immediate use (30 June 2013: \$155 million), refer to note 23 (*post balance date events*) for more information on the facilities. In addition, a \$10 million overdraft facility is in place to manage short term cash funding requirements.

### Capital risk management

Chorus manages its capital considering shareholders' interests, the value of Chorus assets and Chorus' credit ratings. The capital Chorus manages consists of cash and debt balances.

The Chorus Board's broader capital management objectives include maintaining an investment grade credit rating with headroom. In the longer term, the Board continues to consider a 'BBB' rating appropriate for a business like Chorus.

### Hedge accounting

Chorus designates and documents the relationship between hedging instruments and hedged items, as well as the risk management objective and strategy for undertaking various hedge transactions. At hedge inception (and on an ongoing basis), hedges

are assessed to establish if they are effective in offsetting changes in fair values or cash flows of hedged items. Chorus discontinues hedge accounting if (a) the hedging instrument expires or is sold, terminated, or exercised; (b) the hedge no longer meets the criteria for hedge accounting; or (c) the hedge designation is revoked.

Hedges are classified into two primary types: cash flow hedges and fair value hedges. Refer to note 17 for additional information on cash flow and fair value hedge reserves.

### Fair value

Under NZ IFRS, financial instruments are either carried at amortised cost, less any provision for impairment losses, or fair value. The only significant variances between instruments held at amortised cost and their fair value relates to the EMTN.

For those instruments, recognised at fair value in the statement of financial position, fair values are determined as follows:

**Level 1:** Quoted market prices – financial instruments with quoted prices for identical instruments in active markets.

**Level 2:** Valuation techniques using observable inputs – financial instruments with 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.

**Level 3:** Valuation techniques with significant non-observable inputs – financial instruments valued using models where one or more significant inputs are not observable.

The relevant financial assets and financial liabilities and their respective fair values are outlined in note 20 and are all Level 2 (30 June 2013: Level 2).

### 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.

**Note 21 – Financial risk management (cont.)**

The carrying amounts of financial assets and liabilities are as follows:

	GROUP			
	CARRIED AT COST OR AMORTISED COST 2014 \$M	CARRIED AT FAIR VALUE 2014 \$M	CARRIED AT COST OR AMORTISED COST 2013 \$M	CARRIED AT FAIR VALUE 2013 \$M
<b>Loans and receivables</b>				
Cash and call deposits	176	-	80	-
Trade receivables	130	-	229	-
Other receivables	56	-	51	-
<b>Designated in a hedging relationship</b>				
Derivative financial assets	-	3	-	7
Derivative financial liabilities	-	(136)	-	(106)
<b>Other financial liabilities</b>				
Trade accounts payable	(119)	-	(121)	-
Joint arrangements	(4)	-	(11)	-
Accruals	(148)	-	(154)	-
Finance lease (net settled)	(123)	-	(120)	-
Debt	(1,639)	-	(1,697)	-
CFH securities	(73)	-	(30)	-
	PARENT			
	CARRIED AT COST OR AMORTISED COST 2014 \$M	CARRIED AT FAIR VALUE 2014 \$M	CARRIED AT COST OR AMORTISED COST 2013 \$M	CARRIED AT FAIR VALUE 2013 \$M
<b>Loans and receivables</b>				
Cash and call deposits	92	-	69	-
Other receivables	49	-	32	-
Intercompany receivables	357	-	211	-
Investments and advances	1,700	-	1,700	-
<b>Designated in a hedging relationship</b>				
Derivative financial assets	-	3	-	7
Derivative financial liabilities	-	(136)	-	(106)
<b>Other financial liabilities</b>				
Accruals	(35)	-	(33)	-
Debt	(1,639)	-	(1,697)	-
CFH securities	(73)	-	(30)	-



## Note 22 – Contingencies

### Earthquake-prone buildings

Chorus is undertaking a programme to assess buildings in its property portfolio and take appropriate action where buildings are determined to be earthquake-prone. Chorus considers it has a contingent liability for remedial or other activity for buildings not

yet assessed but that may ultimately be found to be earthquake-prone. Chorus is unable to determine the associated remedial or other costs associated with buildings yet to be assessed.

## Note 23 – Post balance date events

### CFH securities and Crown funding

Chorus issued a call notice on 14 July 2014 to CFH with an aggregate issue price of \$31 million which is allocated as follows: CFH debt securities \$5 million, CFH equity securities \$3 million and Crown funding \$23 million. All of this funding has been accrued in the financial statements at 30 June 2014 representing the portion of the call notice where user acceptance testing was complete. In addition, 920,783 CFH warrants were issued.

Chorus issued a call notice on 14 August 2014 to CFH with an aggregate issue price of \$1 million and 61,799 CFH warrants. This funding is not recognised in the financial statements at 30 June 2014.

### CFH funding option

On 18 July 2014 Chorus announced that it had entered into a conditional agreement with CFH, which gives Chorus the option to bring forward part of CFH's existing investment funding earlier in the build of the Ultra-Fast Broadband network. Funding from this facility is only available from October 2015, which is expected to be after the conclusion of the Commission's final pricing principle reviews. Chorus has the option of bringing forward the present value of CFH funding of up to \$178 million that is budgeted to be spent on Chorus' UFB programme in 2018 and 2019. If Chorus chooses to use the facility, Chorus would be unable to pay a dividend before December 2019 without CFH approval, unless Chorus normalises the CFH funding profile. The facility will automatically terminate if Chorus does not use it by 30 June 2016.

### Bank facility

On 25 July 2014 Chorus announced an amendment to its committed banking facilities. Under the agreements the banks have agreed to:

- increase Chorus' covenant levels from 3.75 times to 4.25 times net debt to EBITDA at pricing levels consistent with the Commission's initial pricing principle decisions, with covenant levels stepping down to 3.75 times net debt to EBITDA if the Commission's final pricing principle prices are consistent with the current regulated pricing;
- extend the maturity of Chorus' November 2015 facility to 31 July 2016; and
- waive rights potentially available to the banks associated with the material reduction in regulated pricing to take effect on 1 December 2014.

Chorus has also agreed to limit total drawings across all committed bank facilities to \$1.2 billion until outcomes from the Commission's final pricing principle processes are known and also reduce its July 2016 facility by \$100 million (to \$575 million), which is expected to provide Chorus with sufficient operating liquidity.

As part of these amendments, Chorus has agreed that no dividends will be paid until the later of either the conclusion of the Commission's final pricing principle review processes or 30 June 2015.

## Note 24 – New standards, frameworks, amendments and interpretations to existing standards and frameworks that have been published but not yet adopted

Certain new standards, frameworks, amendments and interpretations have been published that have not been early adopted, and which are relevant to Chorus are listed below. The financial statement impact of adoption of these standards has not yet been analysed but is not expected to be material.

### Financial Markets Conduct Act (FMC) 2013

Effective for periods ending after 1 December 2014.

This reporting framework removes the requirement to prepare Parent entity financial statements if there are subsidiaries. Chorus will only need to prepare Group financial statements.

### NZ IFRS 9 (2010) Financial instruments

Effective for periods beginning on or after 1 January 2015.

The standard adds requirements related to the classification, measurement and derecognition of financial assets and liabilities.

### NZ IFRS 10 Consolidated financial statements

Effective for periods beginning on or after 1 January 2014.

The standard introduces new principles in identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the Parent company and provides additional guidance to assist in the determination of control where this is difficult to assess.

### NZ IFRS 11 Joint arrangements

Effective for periods beginning on or after 1 January 2016.

The standard outlines the accounting by entities that jointly control an arrangement. Joint control involves the contractual agreed sharing of control and arrangements subject to joint control are classified as either a joint venture (representing a share of net assets and equity accounted) or a joint operation (representing rights to assets and obligations for liabilities, accounted for under proportional consolidation).

### NZ IFRS 12 Disclosure of interest in other entities

Effective for periods beginning on or after 1 January 2014.

The standard applies to entities that have an interest in subsidiaries, joint arrangements, associates or unconsolidated structured entities. It establishes disclosure objectives and specifies minimum disclosures that an entity must provide to meet those objectives.

### NZ IFRS 15 Revenue from contracts with customers

Effective for periods beginning on or after 1 January 2017.

This standard introduces principles for reporting cohesive and useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

### NZ IAS 27 Separate financial statements

Effective for periods beginning on or after 1 January 2014.

These amendments remove the accounting and disclosure requirements for consolidated financial statements as a result of the issue of NZ IFRS 10 Consolidated financial statements and NZ IFRS 12 Disclosure of interests in other entities.

### XRB A1 Accounting Standards Framework

Effective for periods beginning on or after 1 April 2015.

The External Reporting Board of New Zealand ("XRB") has released a new accounting standard framework which establishes the financial standards to be applied to entities with statutory financial reporting obligations. Under the new XRB framework Chorus expects to continue to apply NZ IFRS as applicable for Tier 1 for-profit entities and expects that this will have no material impact on the preparation and disclosures included in the financial statements.

## Glossary of terms

<b>CFH</b>	Crown Fibre Holdings Limited
<b>Chorus</b>	Chorus Limited and subsidiary
<b>Commission</b>	Commerce Commission
<b>CPI</b>	Consumer Price Index
<b>CPPC</b>	Cost per premises connected
<b>CPPP</b>	Cost per premises passed
<b>EBITDA</b>	Earnings before interest, income tax, depreciation and amortisation
<b>EMTN</b>	European Medium Term Note
<b>FY</b>	Financial year – twelve months ended 30 June
<b>HSNS Lite (Fibre)</b>	High Speed Network Service Lite over fibre
<b>HSNS Lite (Copper)</b>	High Speed Network Service Lite over copper
<b>HSNS Premium</b>	High Speed Network Service Premium (Bitstream 4)
<b>IP</b>	Internet Protocol
<b>IT</b>	Information Technology
<b>MBIE</b>	Ministry of Business, Innovation and Employment
<b>Mbps</b>	Megabits per second
<b>Naked UBA</b>	Broadband only UBA connections
<b>NGA</b>	Next Generation Access
<b>POTS</b>	Plain Old Telephone Service
<b>RBI</b>	Rural Broadband Initiative
<b>RSP</b>	Retail Service Provider
<b>SLES</b>	Sub Loop Extension Service
<b>SLU</b>	Sub Loop Unbundling
<b>Spark</b>	Formerly Telecom New Zealand Limited
<b>STD</b>	Standard Terms Determination
<b>TDL</b>	Telecommunications Development Levy
<b>TICSA</b>	Telecommunications (Interception Capability and Security) Act 2013
<b>TMNZ</b>	Tax Management New Zealand Limited
<b>TRL</b>	Telecommunications Regulatory Levy
<b>TSLRIC</b>	Total Service Long Run Incremental Cost
<b>TSO</b>	Telecommunications Service Obligation
<b>UBA</b>	Unbundled Bitstream Access
<b>UCLFS</b>	Unbundled Copper Low Frequency Service
<b>UCLL</b>	Unbundled Copper Local Loop
<b>UFB</b>	Ultra-Fast Broadband
<b>VDSL</b>	Very High Speed Digital Subscriber Line – a DSL technology

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