



STOCK EXCHANGE ANNOUNCEMENT

August 31, 2011

Standard and Poor's indicates ratings for Telecom and Chorus

Standard and Poor's (S&P) Ratings Services has today announced that it has undertaken an assessment of Telecom's proposed asset composition and financial profile following the demerger.

Based on this assessment, it expects to lower the ratings on Telecom by one notch to 'A-/A-2' from 'A/A-1' if the demerger proceeds as planned.

S&P has also assigned a preliminary long-term issuer credit rating of 'BBB' to Chorus with a stable rating outlook.

This is based on S&P's view that Chorus has strong market position, high capital barriers to competition, and strong operating cash flow.

Standard and Poor's statements are attached.

- ends -

For more information, contact:

Ian Bonnar 027 215 7564

Research Update:

**Telecom Corp. of New Zealand Ltd.
Stays On CreditWatch, But Ratings
Will Be Lowered To 'A-/A-2' After
Chorus Demerger**

Primary Credit Analyst:

Paul Draffin, Melbourne (61) 3-9631-2122; paul_draffin@standardandpoors.com

Secondary Contact:

May Zhong, Melbourne (61) 3-9631-2164; may_zhong@standardandpoors.com

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Research Update:

Telecom Corp. of New Zealand Ltd. Stays On CreditWatch, But Ratings Will Be Lowered To 'A-/A-2' After Chorus Demerger

Overview

- TCNZ intends to demerge its fixed-line access business Chorus in late 2011, subject to shareholder and various other approvals.
- We have undertaken an assessment of TCNZ's proposed asset composition and financial profile following the demerger.
- Based on this assessment, we expect to lower the ratings on TCNZ by one notch to 'A-/A-2' from 'A/A-1' if the demerger proceeds as planned.
- The ratings remain on CreditWatch with negative implications pending shareholder and other approvals for the demerger.

Rating Action

On Aug. 31, 2011, Standard & Poor's Ratings Services maintained its 'A' long-term and 'A-1' short-term ratings on Telecom Corp. of New Zealand Ltd. (TCNZ) on CreditWatch with negative implications, where they were initially placed on Aug. 4, 2010.

Rationale

This CreditWatch update follows our latest assessment of TCNZ's proposed asset composition, operating strategy, capital structure, and financial policies following the proposed demerger of its Chorus business in late 2011. Based on this assessment, we expect to lower the long-term ratings on TCNZ by one notch to 'A-' and the short-term rating to 'A-2' if the demerger proceeds as planned. In our opinion, there is a high likelihood that TCNZ will complete the demerger of its Chorus access network business and related infrastructure as part of the New Zealand government's "Ultra Fast Broadband" (UFB) fibre-to-the-home proposal.

The 'A-/A-2' ratings on TCNZ would reflect our opinion of the group's modest financial risk profile and significant market position as the largest provider of telecommunications products and services in New Zealand. These strengths would be tempered by the intensifying competitive environment in both fixed and mobile telecommunications services in New Zealand, and the execution risks associated with delivering new products, technologies, and cost-reduction initiatives.

Under the demerger proposal, TCNZ plans to demerge its fixed-line telecommunications access network, telephone exchanges, and part of its core

backhaul network. In our view, the high-quality access network revenues and integrated business model were key credit strengths of TCNZ, with the access network accounting for about one-third of the group's pre-demerger earnings. Accordingly, we expect to lower our assessment of TCNZ's business risk profile to 'satisfactory', from 'strong', following the demerger.

If the demerger is completed as proposed, TCNZ will remain the second-largest mobile retailer and network services provider in New Zealand. In our view, TCNZ's existing market position and the quality of TCNZ's 3G network should allow the company to maintain and modestly grow its revenue share of the mobile market in New Zealand. We note, however, that new competition in the mobile market, primarily from 2Degrees, is creating significant price competition that is likely to moderate any meaningful revenue and margin growth.

TCNZ will also remain the largest retailer of fixed-line products and services in New Zealand. Although we expect TCNZ to lose some fixed-line market share due to intensifying market competition following the access network demerger, we expect the fixed-line retail business to remain a significant contributor to group earnings. Furthermore, we expect the country's fixed-line telecommunications market to remain relatively concentrated in the medium term, with TCNZ remaining one of the leading players.

We consider that TCNZ's proposed conservative financial risk profile and financial policy framework following the demerger to be key credit strengths. TCNZ intends to manage its fully adjusted debt to EBITDA below 1.5x, and funds from operations (FFO) to debt above 60%, which would be supportive of an 'A-' rating. In our view, TCNZ remains committed to maintaining a rating in the 'A' category, and we expect these financial policy objectives to be sustainable in the medium term. Furthermore, we expect TCNZ's initial financial profile to be positioned comfortably within these financial policy objectives. A modest financial risk profile should provide the group with flexibility to accommodate the intensifying competitive environment, and to internally fund all of its capital-expenditure requirements and shareholder distributions.

The existing 'A/A-1' ratings on TCNZ reflect our opinion of the group's strong market position as the incumbent provider of integrated telecommunications networks and services in New Zealand. Also underpinning the ratings is TCNZ's improving free-cash-flow generation and commitment to maintaining a modest financial risk profile. These strengths are offset by the significant regulatory-driven uncertainties surrounding the group's future earnings and asset composition, as well as the increasingly competitive operating environment and operating and technological risks associated with the evolving telecommunications landscape.

CreditWatch

The ratings on TCNZ remain on CreditWatch with negative implications. If the demerger of Chorus were completed as proposed, we expect to lower the long-

Research Update: Telecom Corp. of New Zealand Ltd. Stays On CreditWatch, But Ratings Will Be Lowered To 'A-/A-2' After Chorus Demerger

and short-term ratings on TCNZ by one notch to 'A-' and 'A-2' respectively. Accordingly, the ratings on TCNZ will remain on CreditWatch until the demerger has received all necessary approvals, which is scheduled to occur in late calendar year 2011.

Related Criteria And Research

- Corporate Ratings Criteria 2008, published April 15, 2008.
- Use Of CreditWatch And Outlooks, published Sept. 14, 2009.

Ratings List

Ratings Remaining On CreditWatch
Telecom Corp. of New Zealand Ltd.

Corporate credit rating	A/Watch Neg/A-1
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Teleco Insurance Ltd.

Counterparty credit rating	A/Watch Neg/ A-1
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TCNZ Finance Ltd.

Senior unsecured	A/Watch Neg
Commercial paper	A-1/Watch Neg

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The McGraw-Hill Companies

Research Update:

**N.Z.'s Chorus Ltd. Assigned
Preliminary 'BBB' Rating On Strong
Market Position, Outlook Stable**

Primary Credit Analyst:

Paul Draffin, Melbourne (61) 3-9631-2122; paul_draffin@standardandpoors.com

Secondary Contact:

May Zhong, Melbourne (61) 3-9631-2164; may_zhong@standardandpoors.com

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N.Z.'s Chorus Ltd. Assigned Preliminary 'BBB' Rating On Strong Market Position, Outlook Stable

Overview

- Telecom Corp. of New Zealand is proposing to demerge its fixed-line access network business, Chorus Ltd., in late 2011.
- We have assigned a preliminary long-term issuer credit rating of 'BBB' to Chorus Ltd., with a stable rating outlook.
- In our view, Chorus has strong market position, high capital barriers to competition, and strong operating cash flow.
- We expect to finalize the Chorus rating on completion of the demerger.

Rating Action

On Aug. 31, 2011, Standard & Poor's Ratings Services assigned its 'BBB' preliminary long-term issuer credit rating to New Zealand-based telecommunications company Chorus Ltd. (Chorus). The outlook on the rating is stable. Chorus is the access network business of Telecom Corp. of New Zealand Ltd. (TCNZ; A/Watch Neg/A-1), which is planning to demerge the Chorus business and related infrastructure in late 2011, subject to shareholder and various other approvals.

Rationale

The preliminary 'BBB' rating on Chorus reflects our view of the company's strong market position as the dominant fixed-line telecommunications access network in New Zealand, high capital barriers to competition, and strong operating cash flow. These strengths are tempered by the network volume risks associated with fixed to mobile network substitution, and the execution and cost risks associated with the rollout of the proposed Ultra Fast Broadband (UFB) fibre-to-the-home (FTTH) network.

We consider Chorus to have a 'strong' business risk profile, underpinned by high barriers to entry created by the substantial capital costs of its fixed-line access network and the relatively small and low-density nature of the New Zealand population. That said, we expect the key competitive challenge to Chorus' network position in the next few years to come from fixed to mobile network substitution. The rating incorporates an expectation that mobile-only households will continue to grow and could reach up to 15% of the New Zealand population in the next five years, from about 5% currently. However, we consider that Chorus' access network remains well positioned to retain a large share of total New Zealand telecommunications users in the long term. In our

view, increasing demand for data-intensive products and services (such as video/television services), mobile network capacity constraints, and the ongoing convergence of fixed and mobile networks should underpin satisfactory demand for Chorus' fibre fixed-line networks in the long term. Furthermore, free local calling and relatively high mobile costs in New Zealand should also support near-term network demand.

Following the demerger, Chorus's asset base will comprise a fibre-to-the-node (FTTN) access network (with a market share of about 93% of the New Zealand population), more than 600 telephone exchanges, and a large core backhaul network. In addition, as part of the New Zealand government's UFB and Rural Broadband Initiative (RBI) FTTH network proposals, Chorus will deliver a FTTH network to 70% of the regions covered by the UFB initiative, and can compete with the UFB in the remaining regions of New Zealand with its FTTN network. Although material execution risks exist for Chorus in delivering the fibre rollouts, these are mitigated to some extent by Chorus's experience in delivering the FTTN network and by the New Zealand government's funding contribution toward the fibre roll-outs. In this respect, Chorus is expected to receive NZ\$930 million in government funding over the 8.5-year roll-out period, comprising equal proportions of debt and equity-like securities. Under our criteria, we treat the equity securities as 100% equity in our calculations, and the net present value of the debt securities as 100% debt.

Chorus revenues will be subject to regulatory determinations by the New Zealand Commerce Commission (NZCC) for its copper and fibre network access pricing, and is expected to be based on a 'cost plus' pricing model from 2014. Importantly, we note that Chorus will benefit from some government compensation if the regulated pricing or changes to the rollout program leads to different returns than those assumed as part of the UFB agreement. This should help to mitigate any near-term regulatory uncertainties associated with Chorus' returns from the fibre network.

Importantly also, we do not expect Chorus' earnings to be materially sensitive to the rate of customer take-up of the UFB network. Given the incremental costs associated with connecting a customer to the fibre network compared with the incremental revenues earned, we do not expect earnings to be materially affected if fibre take-up is slower than anticipated. However, if take-up of the fibre network has not reached 20% of the coverage area by 2020, it will trigger earlier payments under the government's debt and equity-like instruments.

In our view, Chorus' proposed financial policies following the demerger are consistent with the 'BBB' rating, and include maintaining unadjusted net debt to EBITDA below 3.5x and funds from operations (FFO) interest cover above 2.75x. Furthermore, we consider that the group's financial profile immediately following the demerger should provide adequate headroom within these financial policies and significant flexibility at the 'BBB' rating level. This should allow the group to accommodate any unexpected increase in costs associated with the UFB rollout and some moderate acceleration in fixed to mobile network substitution. Our base case forecasts assume that FFO to debt will track at

about the 20% level or more in the next two years, although we note that the UFB rollout may weaken the group's financial profile during the second half of the 8.5-year roll-out period.

Liquidity

As a newly demerged entity, Chorus is expected to have approximately NZ\$1,700 million of net interested bearing debt, some of which will be assumed from TCNZ's existing long-term debt obligations. The preliminary rating assumes that following demerger, Chorus will maintain an adequate level of liquidity to cover all of its near-term funding requirements.

Outlook

The stable outlook reflects our expectation that Chorus' strong network position, prudent capital structure, and balanced approach to capital management should offset risks at the 'BBB' rating associated with the group's large and complex FTTH capital-expenditure program and revenue risks associated with fixed to mobile substitution.

Upward ratings pressure could emerge in the short-to-medium term if:

- Chorus successfully manages the initial stages of the FTTH rollout on time and within cost expectations;
- Fixed to mobile substitution does not increase at a higher-than-expected rate, which would include a trajectory of reaching about 20% or more of total users by fiscal 2016; and
- Chorus maintains an intermediate financial risk profile consistent with a 'BBB+' rating. This would include FFO to debt being sustained at about the 20% level or more over the medium-to-long term.

We consider downward rating pressure at the 'BBB' rating level as less likely in the next few years. However, pressure may emerge if there were higher-than-expected fixed to mobile substitution or poor execution of the group's capital-expenditure program, together with a material erosion in the group's financial risk profile, including FFO to debt declining below 15%.

Related Criteria And Research

- Corporate Ratings Criteria 2008, published April 15, 2008.

Ratings List

Ratings Assigned

Chorus Ltd.

Preliminary corporate credit rating BBB/Stable/--

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