Telecom NZ

Demerger Presentation

September 2011

Agenda

#1 **Introduction**

#2 **Overview of the UFB Initiative**

#3 **Overview of the proposed Demerger**

I. Introduction

Disclaimer

Forward-Looking Statements
This presentation includes forward-looking statements regarding future events and the future performance of Telecom and Chorus, including forward looking statements regarding the Demerger, industry trends, strategies, capital expenditure, the construction of the UFB network, credit ratings and future financial and operational performance. These forward-looking statements are not guarantees or predictions of future performance, and involve known and unknown risks, uncertainties and other factors, many of which are beyond Telecom and / or Chorus's control, and which may cause actual results to differ materially from those expressed in the statements contained in this presentation. Factors that could cause actual results or performance to differ materially from those expressed or implied in the forward-looking statements are discussed in the Scheme Booklet, including, in particular, in the section titled "Risks in relation to New Chorus, New Telecom and the Demerger". Except as required by law or the listing rules of the stock exchanges on which Telecom or Chorus are listed, neither Telecom nor Chorus undertakes any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Non-GAAP Financial Measures
Chorus and Telecom use Earnings Before Interest, Taxation, Depreciation and Amortisation ('EBITDA'), and adjusted EBITDA when discussing financial performance. These are non-GAAP financial measures and are not prepared in accordance with International Financial Reporting Standards ('IFRS'). They are not uniformly defined or utilised by all companies in the telecommunications industry. Accordingly, these measures may not be comparable with similarly titled measures used by other companies. Non-GAAP financial measures should not be viewed in isolation, or considered a substitute for measures reported in accordance with IFRS. Management believes that these measures provide useful information as they are used internally to evaluate performance, analyse trends on cash-based expenses, establish operational goals and allocate resources. See slide 24 for a description of how these measures are calculated.

Basis of preparation of financial information
This presentation includes financial information about Chorus and Telecom that has been prepared on several bases of accounting, including an historical special purpose (carve-out) basis and a pro forma basis. See slide 24 for more information about the basis of accounting. The pro forma financial information in this presentation is not intended to and does not comply with Article 11 of Regulation S-X of the Rules and Regulations of the United States Securities and Exchange Commission in respect of pro forma financial information.

Not an offer of securities
This presentation is not an offer of securities. The securities to be issued in the Demerger have not been registered under the United States Securities Act of 1933 ("US Securities Act") and may not be offered or sold in the United States except in transactions that are exempt from or not subject to the registration requirements of the US Securities Act.

Introduction

- Delivered strong FY11 Group results
- Customer satisfaction improved
- Telecom won ~70% of Government's UFB Initiative
- Significant progress towards the proposed demerger of Chorus ("Demerger") to enable participation in the UFB Initiative
  - All Telecom Directors and the Independent Expert are of the view that the Demerger is in the best interests of Telecom Shareholders
  - We will discuss the benefits of the Demerger today
- Asset Allocation Plan approved by the Minister of Communications and Technology Steven Joyce

II. Overview of the UFB Initiative

The UFB Initiative

The Demerger is effectively a condition of the UFB contracts and will result in regulatory changes. All Telecom Directors believe that the Demerger and the UFB Initiative will maximise long term value for Telecom Shareholders

- New Zealand Government has committed NZ$1.35 billion to roll-out an Ultra-Fast Broadband, fibre to the premise (“FTTP”) network to 75% of New Zealanders by the end of 2019
- Prioritised deployment to schools, hospitals, health service providers and businesses
- On basis of structural separation of Chorus from Telecom, Chorus awarded 24 of the 33 candidate areas covering 830,900 premises
- Chorus has access to approximately NZ$929 million of the Government investment
- Potential for Chorus to expand its role by partnering with other UFB selected providers in other areas
- Aligns interest of Chorus with the Government’s UFB objectives

UFB Coverage network providers

III. Overview of the proposed Demerger

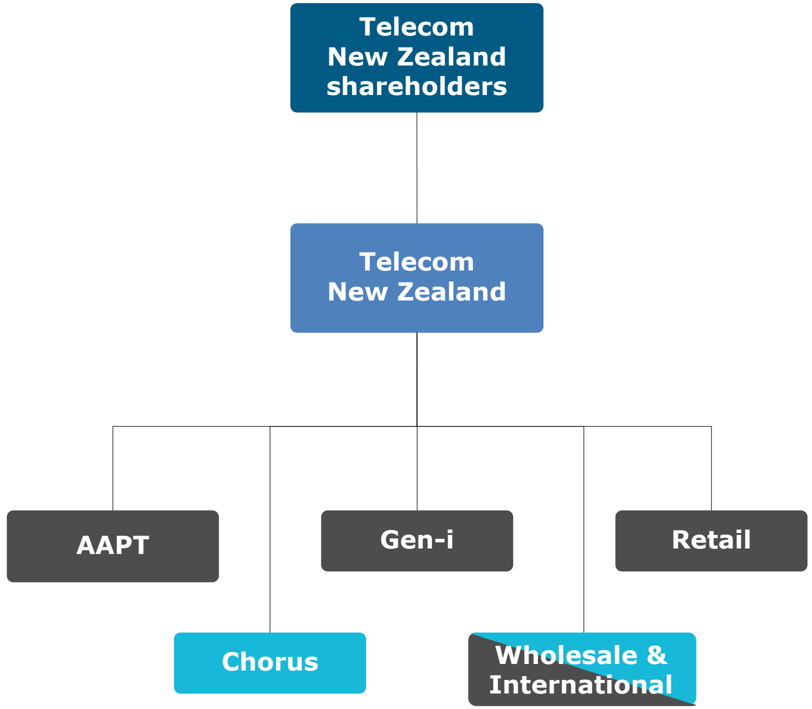
Demerger overview

- Chorus' cornerstone role in the UFB Initiative and the associated regulatory changes are effectively conditional on Telecom demerging Chorus (the Demerger)
- The Demerger will create two independent listed entities:
  - **Chorus** – The largest telecommunications infrastructure business in New Zealand with approximately 93% market share of fixed line access market; and
  - **Telecom (post Demerger)** – New Zealand's leading telecommunications and IT services provider with #1 or #2 market positions across all key markets
- Eligible shareholders[1] to retain their existing Telecom shares and receive **1 Chorus share for every 5 Telecom shares** (subject to rounding)
- The Demerger will be implemented by way of a court approved Scheme Of Arrangement
- Telecom is expected to remain in the NZX50, S&P/ASX200 and the MSCI World (Standard) Index. It is anticipated that Chorus will qualify for inclusion in the NZX50
- Shareholders expected to vote on the Demerger at the annual meeting on 26 October 2011[2]
  - Aim to complete the Demerger by 30 November 2011, subject to shareholder and court approvals
  - Demerger distribution expected to qualify for demerger tax relief in New Zealand, Australia and the US [3]

[1] Eligible shareholders are Telecom Shareholders with registered address at the record date in New Zealand, Australia, United States of America, the United Kingdom, Canada, Germany, Hong Kong, Japan, Luxembourg, Norway, the Netherlands, Singapore or Switzerland; or a jurisdiction in which Telecom reasonably believes that it is not prohibited and not unduly onerous or impractical to implement the Demerger and to distribute Chorus Shares to a Telecom Shareholder pursuant to the Demerger.
[2] Dates may be subject to change.
[3] . A binding product ruling has been obtained from the New Zealand Inland Revenue for Telecom shareholders, Telecom has applied to the Commissioner of Taxation for a class ruling confirming that Telecom Shareholders who are residents of Australia and hold their shares on capital account will be able to choose demerger tax relief, a private ruling from the IRS is expected to conclude that for US federal income tax purposes the Demerger will qualify as a tax-free distribution to US holders of Telecom Shares or ADSs

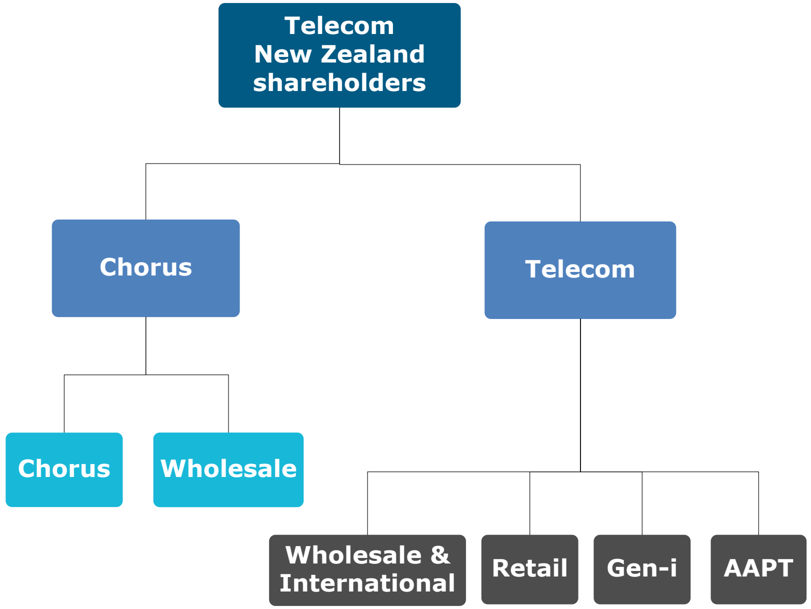
Overview of the proposed Demerger

Current structure



- Indicates transfer to Telecom
- Indicates transfer to Chorus
- Indicates split between Telecom and Chorus

Structure post demerger



Key benefits of the Demerger

All Telecom Directors and the Independent Expert are of the view that the Demerger, on balance, is in the best interests of Telecom Shareholders

#1	Facilitates Chorus undertaking a leading role in the Government led fibre initiative
#2	Aligns the interests of Chorus with the Government's UFB objectives
#3	Avoids Telecom competing with Government backed fibre competition
#4	Leads to the introduction of a simplified regulatory regime with greater certainty, reduced burden and less associated cost
#5	Allows Telecom and Chorus to further focus on their independent strategies and core competencies
#6	Enables tailored capital structure and financial policies for Telecom and Chorus
#7	Allows for improved alignment of management incentives with performance at Telecom and Chorus
#8	Providers greater transparency and flexibility for investors

Simplified regulatory regime

The proposed regulatory changes were enacted on 30 June 2011 and are conditional on the successful Demerger of Chorus

	Pre Demerger	Post Demerger	
	Telecom	Telecom	Chorus
Operational Separation Undertakings 'three box' model[1]	Yes	N/A	N/A
Accounting separation	Yes	No	No
Independent Oversight Group	Yes	No	No
Ownership restrictions	Yes	No	Yes
Open access undertakings[2]	N/A	No	Yes
Obligations under the TSO[3]	Yes	Yes	Yes
Line of business restrictions[4]	No	No	Yes
Oversight of transitional and long term sharing arrangements between New Chorus and New Telecom	N/A	Yes	Yes
Aligned regulatory regime enabling long term fixed network investment	No	N/A	Yes

[1] The three box model is defined as the separation of the Chorus, Telecom Wholesale and Retail business units as per the Operational Separation Undertakings.
[2] The new open access deeds of undertakings are primarily aimed at holding the principles of non-discrimination and equivalence. The draft open access deeds of undertakings currently provide that New Chorus is not required to have separate business units or internal trading.
[3] The Telecommunications Amendment Act requires a review of the TSO in 2013.
[4] Chorus will be restricted to selling products and services only to non-end-users as per the register that will be kept by the Commerce Commission. Telecom will be prohibited from purchasing UCLL for three years.

Experienced board and management teams

- Chorus has operated independently since 2008 but has not had its own Board
- Chorus Board members have been drawn from the current Telecom board and external candidates with significant telecoms and local market experience

Telecom[1]

Directors

Mark Verbiest	Chairman, Non-Executive Director
Paul Berriman	Non-Executive Director
Murray Horn	Non-Executive Director
Maury Leyland	Non-Executive Director
Paul Reynolds	CEO & Executive Director
Kevin Roberts	Non-Executive Director
Charles Sitch	Non-Executive Director
Justine Smyth	Non-Executive Director

Executives

Paul Reynolds	CEO & Executive Director
Tristan Gilbertson	Group General Counsel & Company Secretary
Alan Gourdie	Chief Executive Officer, Retail
David Havercroft	Group Chief Technology Officer
Nick Olson	Chief Financial Officer
Chris Quin	Chief Executive Officer, Gen-i
Rod Snodgrass	Chief Product Officer
Tina Symmans	Corporate Relations Director
David Yuile	Chief Executive Officer, AAPT

Chorus[1]

Directors

Sue Sheldon CNZM	Chairman, Non-Executive Director
Prue Flacks	Non-Executive Director
Jon Hartley	Non-Executive Director
Keith Turner	Non-Executive Director
Anne Urlwin	Non-Executive Director
Clayton Wakefield	Non-Executive Director

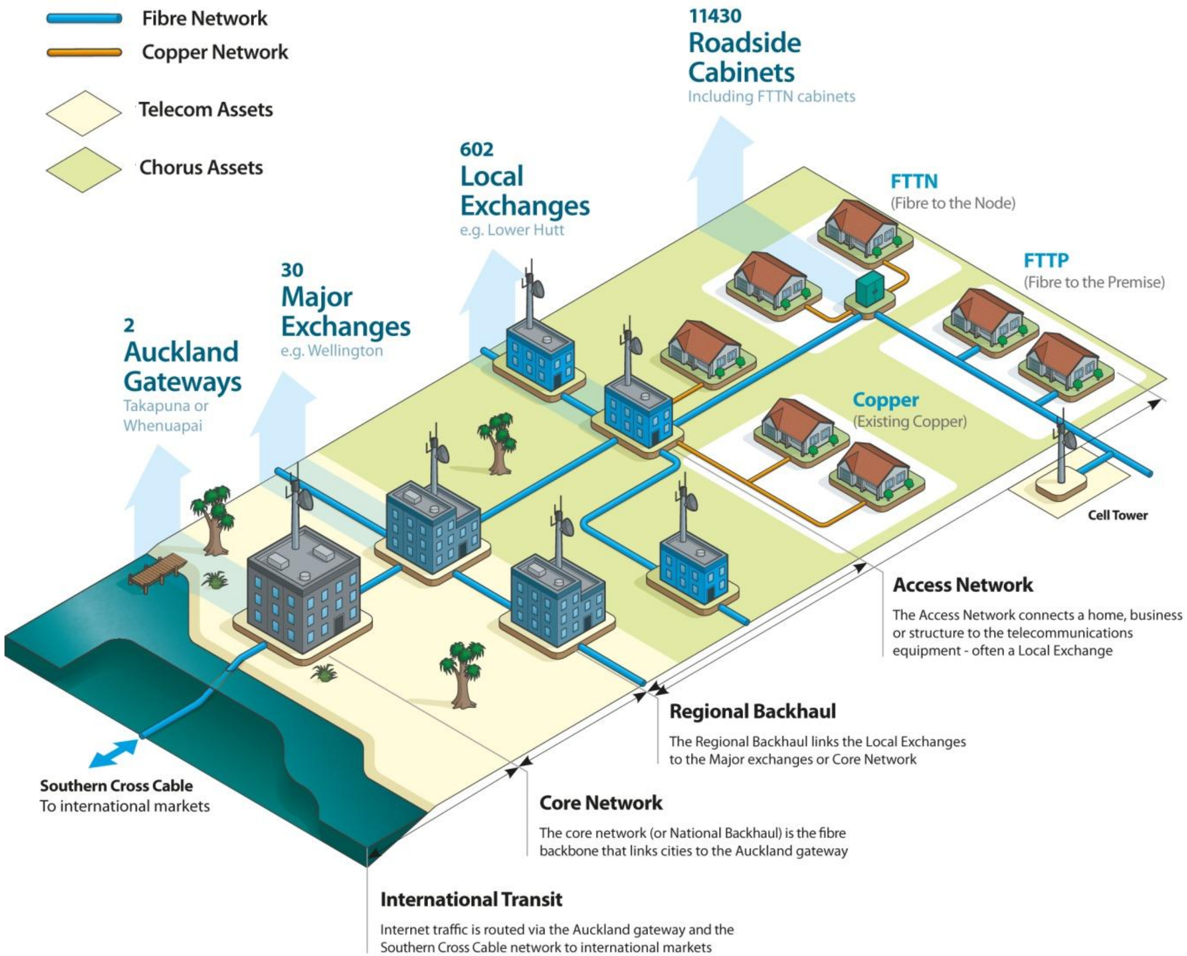
Executives

Mark Ratcliffe	Chief Executive Officer
Ed Beattie	GM Property & Network Operations
Sara Broadhurst	GM Human Resources
Victoria Crone	GM Sales & Marketing
Chris Dyhrberg	GM Network Build
Brian Hall	Acting Chief Financial Officer
Vanessa Oakley	General Counsel & Company Secretary
Ewen Powell	Chief Information Officer
Nick Woodward	GM Customer Services

[1] *These appointments are subject to change; in particular if any of the current Directors or members of senior management cease to hold office at Telecom prior to implementation of the Demerger.*

The proposed asset split

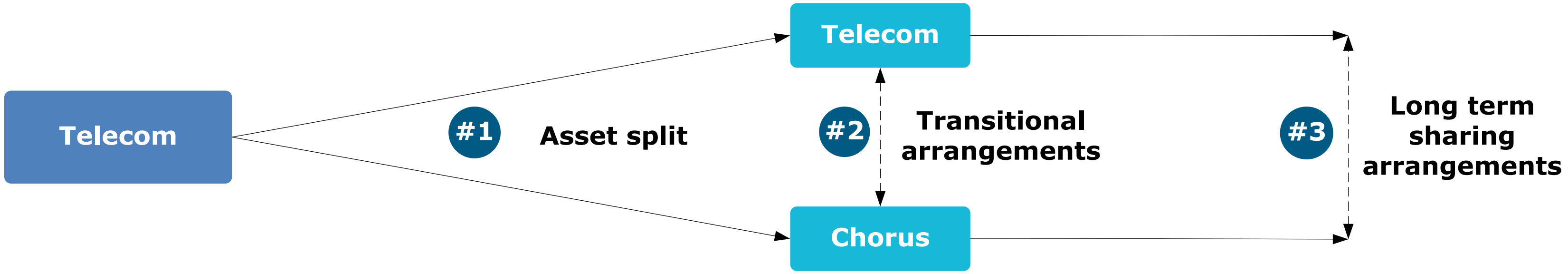
The Asset Allocation Plan was approved by the Minister for Communications and Information Technology on 29 August 2011



- Chorus assets will include:
  - 130,000 km of copper and 27,600 km of fibre
  - Majority of the exchanges
  - Regional backhaul network
  - Access electronics including DSLAMs
- Telecom assets will include:
  - The mobile networks
  - PSTN equipment
  - The core national transport network
  - International assets, including AAPT and 50% ownership interest in the Southern Cross international cable

Separation agreements

As a result of the Demerger transitional and long term service agreements will be put in place to reduce costs and to minimise the impact on customers



#1 **Asset split**	• The draft Asset Allocation Plan has been approved by the Minister of Communications and Information Technology
#2 **Transitional arrangements**	• Facilitate the transition of Chorus to a standalone entity with arrangements in place for up to 3 years • Covers some shared network equipment, shared office facilities, accounting and IT systems and support functions (eg Fulfil, Assure and Bill)
#3 **Long term arrangements**	• Reduces duplication of network assets required to deliver cost effective services and ensures ongoing regulatory compliance – Expected to lower the cost of the demerger and reduce the potential impact to customers • Arms length commercial agreements likely to remain in place for the duration of the asset life (eg transport radio antennae and feeders, network routers)

Capital structure and dividend policy

Each company will have a capital structure and dividend policy reflecting its specific profile

Telecom

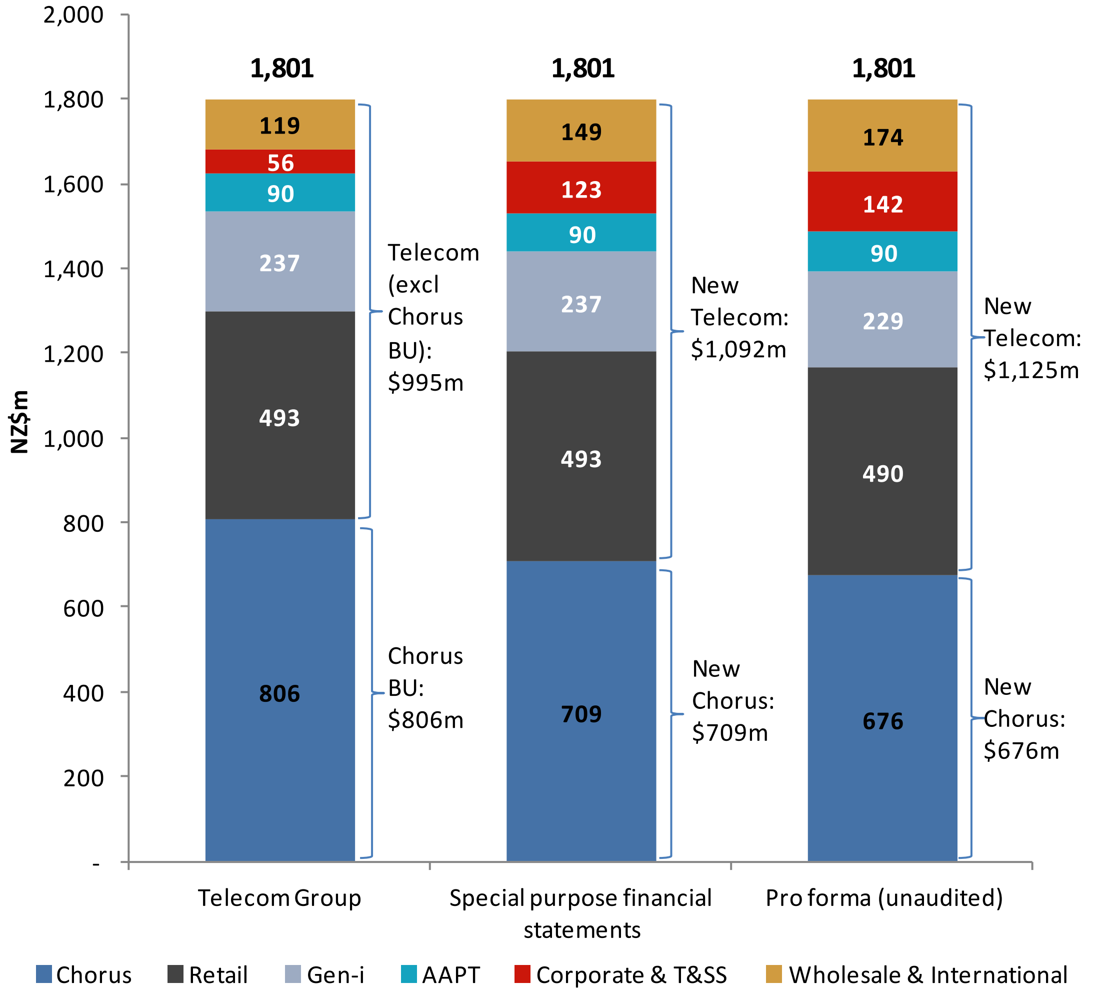
- S&P expects that Telecom could attain an A-/Stable rating upon demerger
- Moody's is likely to assign a preliminary rating of A3/Stable by Moody's
- Targeting net interest bearing debt (inclusive of associated derivatives) to EBITDA ratio not materially exceeding 1.1 times on a long run basis [1]
- Debt restructure process currently underway
- Dividend policy for FY12:
  - 90% of adjusted net earnings
  - Subject to there being no material adverse changes in circumstances or operating outlook
  - DRP will remain in place. Intend to impute dividends to the extent practicable
- Proposed net interest bearing debt at Demerger: NZ$750 million to NZ$950 million[2] (including associated derivatives)
- Demerger transaction costs expected to be within the range of NZ$85 - 120 million

Chorus

- Chorus intends to target an investment grade credit rating
  - S&P has assigned a preliminary credit rating of BBB / Stable
  - Moody's has assigned a preliminary credit rating of Baa2/Stable
- Targeting Net Debt to EBITDA less than 3.5 times[3] on a long run basis
- Dividend policy: FY12 dividend of 25 cps[4]
  - Intend to impute dividends to the extent practicable
  - Subject to there being no material adverse changes in circumstances or operating outlook
- Proposed net interest bearing debt at Demerger: c. NZ$1,700 million (including associated derivatives)
  - Bridge facility of NZ$2,000 million available
  - Bond process for exchange of Telecom GBP EMTNs provides long dated debt maturity profile
  - Seeking to arrange syndicated bank facility of ~NZ$1,000 million for up to 5 years

[1] For credit rating agency purposes, this ratio equates approximately to net interest bearing debt (inclusive of associated derivatives) / EBITDA of 1.5 times. The difference between the two ratios is primarily due to the capitalisation of operating leases.
[2] The actual net debt figure will vary depending on the amount of Telecom's operating, investing and financing cash flows in the period prior to the Demerger and market rates at that time. The net debt figure reflects net interest bearing debt and includes associated derivatives.
[3] This Net Debt metric includes the senior portion of CFH Debt Securities but excludes the subordinated portion of the CFH Debt Securities and the CFH Equity Securities.
[4] It is expected that the Demerger will occur part way through the 2012 financial year, and as a result the 2012 financial year dividend payout will be prorated to reflect only the post-Demerger period. It is expected that Chorus' first dividend will be declared post 30 June 2012.

High level split of FY11 adjusted EBITDA



- **Special purpose financial statements** - Reflect the FY11 adjusted EBITDA split of the businesses that are expected to be held by New Chorus and New Telecom as they were operated as part of Telecom
- **Pro forma (unaudited)** - Illustrate the estimated effect on the special purpose financial statements for the year ended 30 June 2011 of certain aspects of the Demerger as if it had occurred on 1 July 2010
- Special purpose financial statements and pro forma (unaudited) statements do not represent what the FY11 adjusted EBITDA of New Chorus or New Telecom may have been had they operated as separate legal entities[1]

[1] See Appendix A for more information regarding the basis of preparation of the New Telecom and New Chorus special purpose and pro forma financial statements.

Indicative timetable

Indicative timetable[1]	
May 2011	Demerger announcement
13 September 2011	Release of scheme booklet to Telecom shareholders
26 October 2011	Annual meeting and shareholder vote
November 2011	Expected final court approvals
Late November 2011	Trading of Chorus shares on NZX and ASX commences
30 November 2011	Demerger effective date

Further engagement activities

- Comprehensive investor engagement to be undertaken prior to the shareholder vote
- Institutional investor roadshow for both Telecom and Chorus
  - Will include meetings in New Zealand, Australia, USA, Asia and UK
- Retail investor roadshows to be held in seven locations across New Zealand
- Specific Telebond holder meetings also to be held across New Zealand

[1] *Dates are indicative only and may be subject to change.*

Key benefits of the Demerger

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Appendix A: Review of FY11 Telecom Group results

Key Telecom Group FY11 results

- Significant YoY financial improvement:
  - EBITDA[1] of NZ$1,801m, up 2%, stronger H2
  - NPAT[1] of NZ$388m, up 2%
  - Free cash flow[1] of NZ$887m, up 53%
  - Revenues[1] of NZ$5,104m, down 3%
  - Capex of NZ$914m, 23% lower
- Q4 Dividend of 7.5 cps, plus a 2.0 cps special dividend
- Customer satisfaction improved
- Telecom won ~70% of Government's UFB Initiative
- Demerger of Chorus by end of calendar year, subject to approvals

[1] *Reflects adjusted results.*

Vision2013 Strategy in review

May 2010 Strategy		Performance to June 2011
Deliver turnaround in EBITDA	✓	Adjusted EBITDA up 2.1%
Reduce cost	✓	Adjusted expenses down 6%, NZ$195 million of cost out from management action
Simplify the business	✓	Process improvement and restructuring reduced headcount by 7%[1]
Retain value	✓	~80% of retail broadband customers in bundles 82% of mobile revenues on XT
Targeted growth		
- Mobile	●	Growth in revenue and ARPU
- Broadband	✓	Strong connection growth
- ICT	✓	Managed and Cloud services growing
Position the business for UFB world	✓	Chorus announced as cornerstone partner for UFB

[1] *Adjusted to account for in-sourcing of IT Support function.*

Telecom group FY11 operating results

- Access & calling trends are steady
  - Fixed line access steady and New Zealand calling revenue declines slowing as usage patterns improve
- Broadband connections are increasing and retail margins are steady at ~NZ$40 per connection
  - Total market connections grew ~90k in FY11. Share of retail and wholesale connections 53% and 31% respectively
  - ~80% of retail broadband customers in a bundle
- Total market mobile connections continue to grow but there is strong competition
  - ARPU increased 7% H2 FY11 vs H2 FY10 driven by increasing data usage but Telecom mobile connections down 95k in H2 FY11 (majority prepaid)
  - 1.2m connections on XT, 56% of the base, 82% of cellular revenue
- IT Services market returning to growth, revenues up 7% in H2 FY11 vs. H2 FY10
  - Suite of Gen-i “ReadyCloud” products launched

Telecom Group FY11 business unit performance

- Good progress growing EBITDA across the business
  - Chorus, Retail and Gen-i increasing
  - Wholesale & International external EBITDA increasing
  - AAPT impacted by Consumer sale and Telstra wholesale terms
  - Chorus EBITDA increased 9% for the half year

Adjusted EBITDA	FY11 NZ$M	FY11 vs FY10 Change %	H2 FY11 NZ$M	H2 FY11 vs H2 FY10 Change %
Chorus	806	5.1%	415	8.6%
Wholesale & International	119	-42.2%	73	-24.7%
Retail	493	21.4%	253	10.0%
Gen-i	237	6.3%	132	6.5%
AAPT	90	-33.8%	42	-39.1%
T&SS	4	NM	4	NM
Corporate	52	85.7%	14	NM
Total	**1,801**	**2.1%**	**933**	**4.6%**

Additional information regarding financial data

Special purpose historical financial information

The special purpose historical financial statements of Chorus and Telecom represent the financial records for the businesses that will be held by Chorus and Telecom, respectively, at Demerger date. In preparing the special purpose financial statements, management has made a number of assumptions and estimates in order to apportion historical revenues and expenses of Telecom to Chorus and Telecom. The special purpose financial statements reflect the assets, liabilities and results of the businesses that are expected to be held by Chorus and Telecom as they were operated as part of Telecom. The special purpose financial statements are based on assumptions and estimates and do not represent what the results of operations, cash flows or financial position of Chorus and Telecom would have been had they operated as separate legal entities for the years presented.

Pro forma financial information

The Chorus and Telecom pro forma financial statements have been derived from the Chorus and Telecom special purpose financial statements and illustrate the estimated effect on the special purpose financial statements as at and for the year ended 30 June 2011 of certain aspects of the Demerger as if it had occurred on 1 July 2010 for the income statement and statement of cash flows, or on 30 June 2011 for the statement of financial position. You should refer to sections 6.2 and 8.2 of the Scheme Booklet for information regarding the pro forma adjustments that are reflected in the Chorus and Telecom pro forma financial statements.

The pro forma financial statements do not represent what the results of operations, cash flows, or financial position of Chorus or Telecom may have been had it operated as a separate legal entity for the periods indicated, and does not project the results of operations, cash flows, or financial position of Chorus or Telecom in the future.

The pro forma financial statements are not intended to and do not comply with Article 11 of Regulation S-X of the Rules and Regulations of the United Stated Securities and Exchange Commission in respect of pro forma financial information.

Non GAAP financial measures

This presentation includes the following non-GAAP financial measures:

- EBITDA – EBITDA is earnings before interest, tax, depreciation and amortisation. Telecom and Chorus calculate EBITDA by adding back/(deducting) depreciation, amortisation, finance expense/(income), share of associates' (profits)/loss and taxation expense to net earnings/(loss) from continuing operations;
- Adjusted EBITDA – adjusted EBITDA is pro forma EBITDA adjusted to reflect the removal of certain one-off costs. For Chorus, the following one-off costs have been removed to determine adjusted EBITDA:
  - Costs of NZ$6 million incurred in relation to Telecom's UFB proposal;
  - One-off costs of NZ$22 million recognised in relation to the Canterbury earthquakes; and
  - Costs of NZ$42 million of asset impairment charges on copper-based regulatory assets due to the combined effect of the move to a fibre-oriented world and regulatory developments.

For Telecom, the following one-off gains and costs have been removed to determine adjusted EBITDA:

- The consumer division of AAPT's operations was sold to iiNet for A$60 million. This sale resulted in a one-off gain on sale of NZ$18 million;
- Costs of NZ$23 million incurred in relation to Telecom's UFB proposal;
- One-off costs of NZ$20 million recognised in relation to the Canterbury earthquakes; and
- Impairment charges of NZ$215 million were recognised on copper-based regulatory assets due to the combined effect of the move to a fibre-oriented world and regulatory developments.