

STOCK EXCHANGE ANNOUNCEMENT

8 November 2023

Overview of Chorus' expenditure proposal

Attached are the following:

- An overview of Chorus' price quality proposal submitted to the Commerce Commission for the January 2025 to December 2028 regulatory period (called '**PQP2**'); and
- The Chorus Chair's letter that accompanied the PQP2 proposal.

ENDS

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PQP2 Proposal

Overview of Chorus' expenditure proposal

- > We've submitted our price-quality proposal to the Commerce Commission for the January 2025 to December 2028 regulatory period (PQP2). The Commission will consult and seek submissions on our proposal with a final determination on our proposed allowances not expected until Q2 2024.
- > We have proposed capital expenditure of \$1.5bn (nominal) and operating expenditure of ~\$840m for the four-year period.
- > The majority of investment is either for discretionary projects (e.g. rural fibre network expansion and resilience) or demand-driven spend (e.g. fibre installations and data growth). This is consistent with the indicative 10-year view on discretionary growth capex presented in HY23 and our focus on growing shareholder value, while delivering a sustainable growing dividend through time.
- > Fibre network extension and network resilience bring significant benefits to NZ Inc but have challenging commercial cases. Telecommunications is much more dynamic than other utility sectors - evolving technology, policy and macroeconomic developments have a significant influence on our investment decisions. To invest in the network, we need to have confidence in our ability to earn an appropriate return over time.
- > This is why key areas of discretionary capex remain subject to pricing, market and regulatory developments that we'll continue to assess in the lead-up to and during PQP2. And we'll continue to engage with government to find ways to bring fibre to more Kiwi homes and businesses.

Proposal scope

- > This pack summarises key aspects of the proposal, which includes proposed capital and operating expenditure, with the Commission expected to release further information in the coming weeks as part of the consultation process (see slide 4).
- > Our proposal has been subject to external audit, and review by an Independent Verifier. External audit raised no issues and the Independent Verifier found that almost all capex and opex has been verified as 'prudent and efficient' and 'consistent with good telecommunications industry practice'.
- > The proposal represents our best view of the operation and plans for our business in a dynamic market. It includes judgments as to the allocation of costs, with final allocation principles to be decided by the Commission.
- > The proposed expenditure is for fibre fixed line access services (FFLAS) outside of other local fibre company areas and excludes other non-FFLAS fibre or copper related costs. The regulatory cost categories are based on functional groupings and do not reflect our current financial reporting categories.

The Commission's implementation process

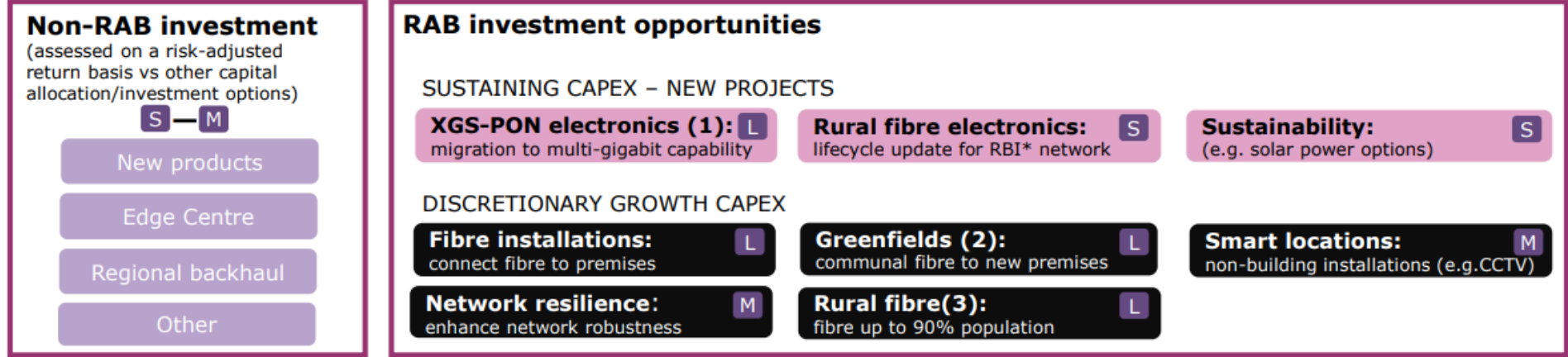
Expected timing (calendar year)	Detail
Q4 2023	<ul style="list-style-type: none">▪ Consultation on Chorus' expenditure proposal▪ Submissions on Chorus' expenditure proposal
Q1 2024	<ul style="list-style-type: none">▪ Draft determination of Chorus' expenditure allowance▪ Draft fibre Input Methodologies (IM) amendments, if required
Q2 2024	<ul style="list-style-type: none">▪ Final fibre IM amendments, if required▪ Final determination of Chorus' capex and opex allowances▪ Draft determination of Chorus' revenue path and quality standards for PQP2▪ WACC determination
Q4 2024	<ul style="list-style-type: none">▪ Final determination of Chorus' revenue path and quality standards for PQP2

Proposal is consistent with HY23 investment view

- > discretionary growth capex:
 - can be phased to fit the parameters of our dividend policy and debt limits
 - will be subject to business casing, market conditions and regulatory settings/approvals
- > it is Chorus' expectation that the range of investment opportunities mean the core RAB value (i.e. excluding the Financial Loss Asset) will be at least maintained in the longer term
- > growing shareholder value and delivering a sustainable growing dividend through time is a key principle of our capital management framework

KEY: **S** Small: <\$100m **M** Medium: \$100m to \$400m **L** Large: \$400m+

HY23 overview of indicative long-term investment opportunities (10-year \$m totals in 2023 dollars)

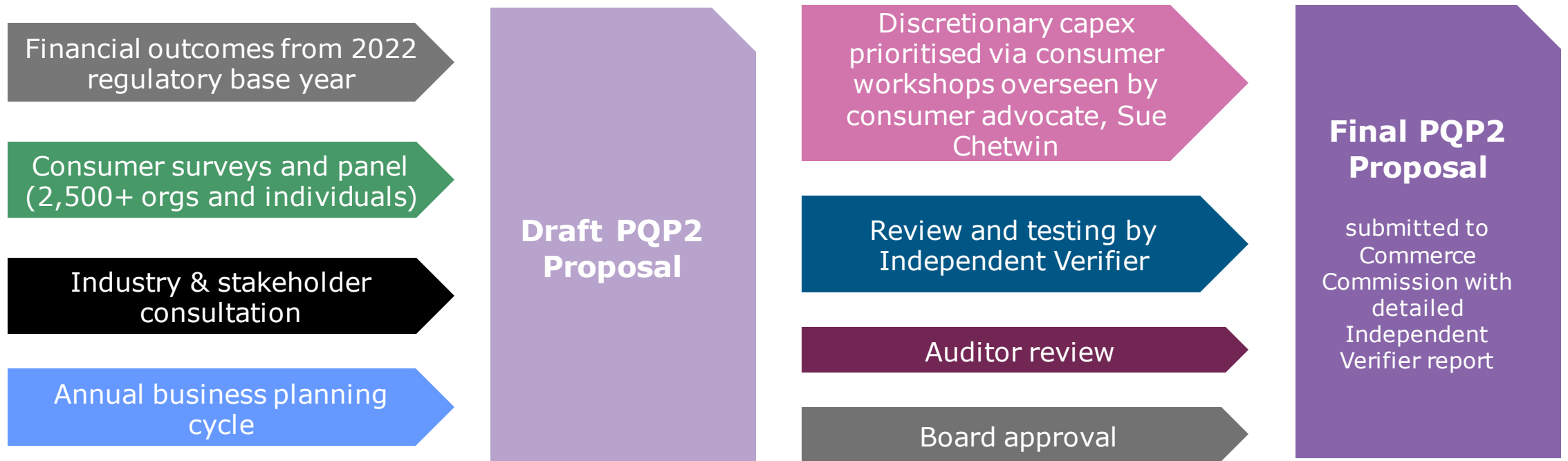


*RBI is Rural Broadband Initiative

1. Limited XGS-PON investment in RP1. Broader rollout as technology matures.
2. Greenfields investment is gross amount including customer contributions.
3. Communal rollout cost only.

How we developed our PQP2 proposal

Extensive end-user and stakeholder inputs overlaid by Independent Verification



Long-term investment requires certainty

To ensure good outcomes for end customers and fair returns for investors, we need...

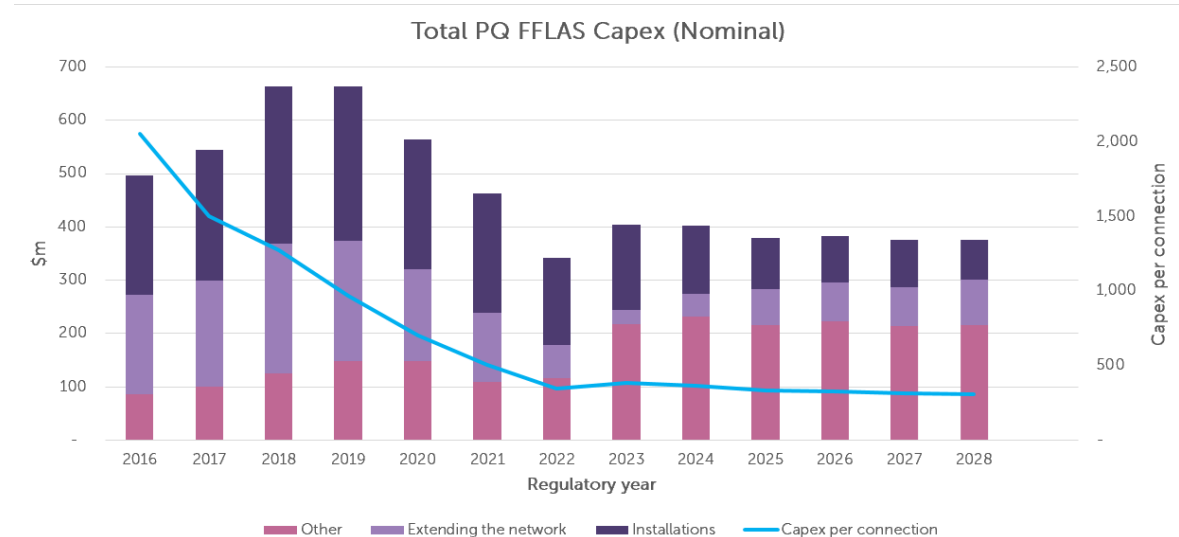
- 1.** To know regulatory settings won't be interpreted or changed in a way that undermines a fair return.
- 2.** Confidence the government's wholesale fibre network model isn't being undermined by large vertically integrated retailers who unfairly favour their own wireless networks.
- 3.** A regulatory process that has the flexibility to allow for the dynamic nature of the telecommunications industry. (e.g. changing market conditions that diminish the business case, or government policy/funding that helps accelerate or reshape investment)



Capital expenditure proposal

We propose capex of \$1.5 billion (nominal) over PQP2

- > our proposal includes allowances for discretionary capex (e.g. network expansion and resilience) and these are subject to pricing, market and regulatory developments that we'll continue to assess in the lead-up to and during PQP2.
- > capex per connection is forecast to decline, after it increased slightly in 2023 largely due to COVID-related project deferrals



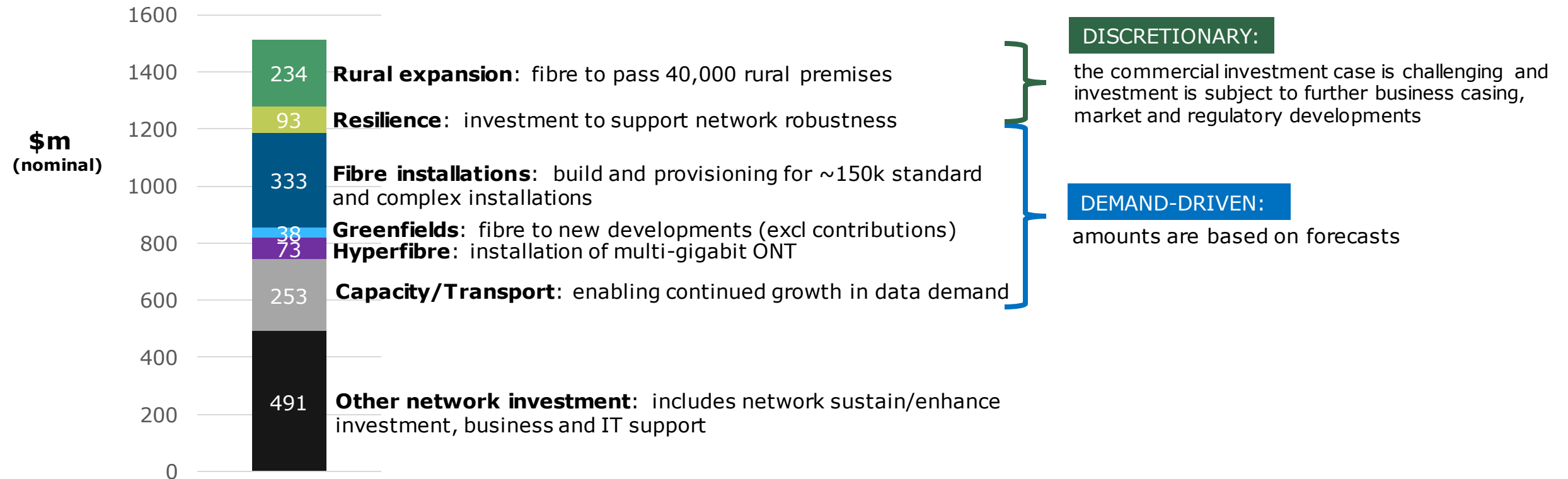
> **The capex amounts on slide 10:**

- are actual capex for the 2022 calendar year and H1 2023, with forecast capex to 2028
- exclude capex spend for FFLAS in LFC areas and other non-FFLAS capex
- include forecasts for installation volumes, with a wash-up mechanism to address variations in demand
- are net of capital contributions
- are nominal with the following actual and forecast inflation

2022	2023	2024	2025	2026	2027	2028
1.0000	1.0541	1.0815	1.1033	1.1264	1.1475	1.1702
7.17%	5.41%	2.59%	2.02%	2.10%	1.87%	1.98%

Key elements of proposed \$1.5bn investment

Majority of investment is discretionary or linked to demand



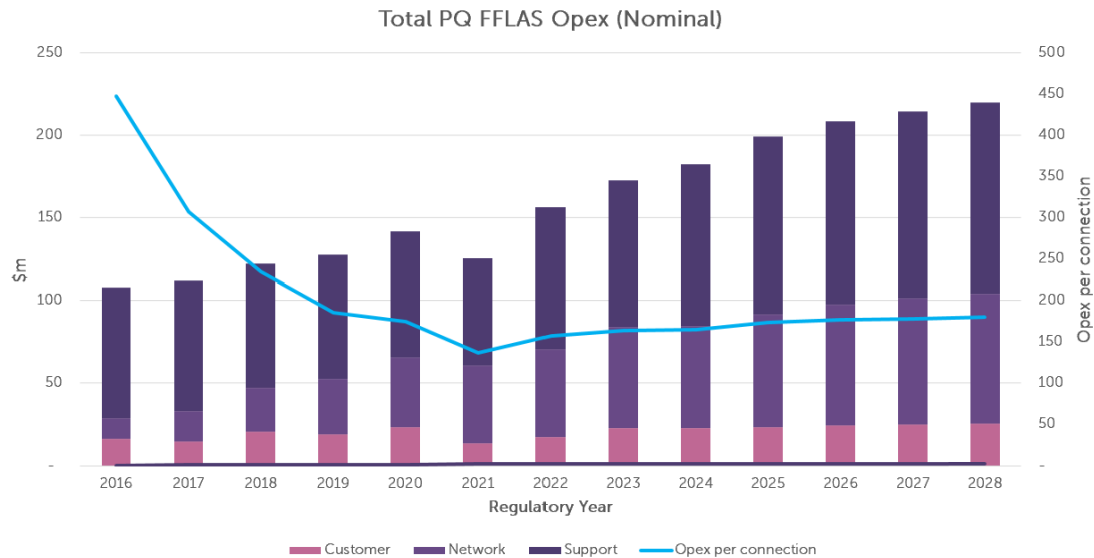
Capex by regulatory category

Capex categories	Sub-categories	2022 (actual)	2023	2024	2025	2026	2027	2028
Extending the network	▪ Augmentation	4.8	7.9	32.2	58.1	61.6	64.0	73.6
	▪ New property developments	21.3	19.8	10.7	9.0	10.4	8.2	10.3
	▪ UFB communal	34.7	-0.3	-	-	-	-	-
Installations	▪ Complex	2.1	3.6	3.4	3.4	3.4	3.4	3.4
	▪ Standard	162.1	155.7	124.9	93.0	85.0	85.8	72.0
IT and support	▪ Business IT	11.8	21.0	21.1	19.5	22.2	21.9	19.1
	▪ Corporate	4.1	0.9	0.6	1.5	2.4	2.0	8.6
	▪ Network & Customer	23.0	25.8	27.6	27.9	27.8	26.8	26.1
Network capacity	▪ Access	18.0	52.3	51.1	29.2	33.5	39.9	32.2
	▪ Aggregation	19.1	26.3	27.2	22.9	23.0	18.0	20.6
	▪ Transport	11.2	22.8	25.4	27.9	27.7	19.6	15.0
Network sustain & enhance	▪ Field sustain	10.5	24.7	30.1	33.0	33.5	36.7	35.8
	▪ Relocations	2.9	5.3	5.0	5.0	5.1	5.3	5.4
	▪ Resilience	2.8	13.9	15.7	19.8	23.1	20.3	30.2
	▪ Site sustain	13.4	24.6	28.0	29.8	24.9	24.5	23.5
Total (excluding capital contributions)		341.8	404.1	403.0	380.1	383.6	376.3	375.7

Regulatory capex categories	Sub-categories	Description	Financial reporting capex categories
Extending the network <i>(communal infrastructure)</i>	▪ Augmentation	Infill within existing footprint or extension to new communities	Other fibre connections & growth
	▪ New property development	New subdivisions, business parks	Other fibre connections & growth
	▪ UFB communal	UFB programme rollout	UFB communal
Installations <i>(connecting communal network to the ONT, including provisioning and incentive costs)</i>	▪ Complex	Installations for specific business requirements	Fibre connections & layer 2
	▪ Standard	Most installation work, including backbone for multi-dwelling units and rights of way	Fibre connections & layer 2, customer retention costs
IT & Support <i>(IT and corporate capex)</i>	▪ Business IT	Supporting business activities	Common - IT
	▪ Corporate	Sundry investment and product development	Common - Other
	▪ Network & customer	Supporting network or customer activities	Common – IT, Fibre products & systems
Network capacity <i>(ongoing investment in network electronics and systems to optimise for capacity growth and lifecycle needs)</i>	▪ Access	Enabling connections to fibre	Fibre connections & layer 2
	▪ Aggregation	Link access networks to RSP points of interconnection	Fibre connections & layer 2
	▪ Transport	Optical transport network to carry data medium/long distances	Fibre connections & layer 2, Other fibre connections & growth
Network sustain & enhance <i>(investment in physical network assets)</i>	▪ Field sustain	Assets outside of network sites (e.g. poles, fibre, terminators)	Other fibre connections & growth
	▪ Relocations	Roading authority, undergrounding programmes and 3 rd party requests	Other fibre connections & growth
	▪ Resilience	Diversity, robustness or contingency investment to keep the network running	Other fibre connections & growth
	▪ Site sustain	Investment in network buildings, including power and cooling.	Common – building & engineering services

Operating expenditure proposal

We propose opex of \$842 million (nominal) over PQP2



- > our proposal is based on a base-step-trend (BST) economic analysis using 2022 as the base year:
 - BST is used by regulated businesses to produce medium to long term forecasts of efficient opex
 - we expect financial/volume outcomes in the 2023 year to be considered in the Commission's process through 2024
 - opex per connection remains largely flat at ~\$180 per annum despite growth of the fibre network
- > we propose updating cost allocators (May Info Disclosure) and changing to a revenue allocator, for corporate labour and some IT operating costs, to reflect fibre's dominance of Chorus' business activity (e.g. fibre was 83% of total connections at 30 Sept)
- > recent market trends, such as accelerated copper withdrawal, should result in greater allocation of shared costs to fibre

> **The opex amounts on the following slide:**

- are actual opex for the 2022 calendar year and H1 2023, with forecast opex to 2028
- exclude pass through costs (e.g. local body rates and regulatory levies) which would need to be added to align with Chorus' reported opex categories
- are nominal (see slide 8 for inflation assumptions)

Opex by regulatory category

Opex Categories	Sub-categories	2022 (actual)	2023	2024	2025	2026	2027	2028
Customer	▪ Customer operations	-6.4	-5.9	-7.3	-7.9	-8.2	-8.3	-8.6
	▪ Product, Sales & Marketing	23.9	28.8	30.0	31.4	32.4	33.3	34.2
Network	▪ Maintenance	28.5	33.9	33.4	36.6	38.6	40.0	41.1
	▪ Network operations	16.6	19.4	19.3	21.2	22.5	23.4	24.1
	▪ Operating costs	7.8	7.6	9.2	10.7	12.5	13.2	13.3
Support	▪ Asset management	21.6	21.2	24.2	25.9	26.7	27.3	28.0
	▪ Corporate	41.3	44.9	49.0	55.0	57.2	59.0	60.4
	▪ Technology	23.1	22.4	24.7	26.4	26.6	26.6	27.3
TOTAL (excluding pass through costs)		156.4	172.4	182.5	199.3	208.3	214.4	219.9
Pass through costs		\$15.8	\$15.5	\$18.6	\$19.4	\$20.0	\$20.6	\$21.1

Operating expenditure categories

Regulatory opex categories	Sub-categories	Description	Financial reporting opex categories
Customer	▪ Customer operations	Demand driven activity (e.g. call centre and projects)	Labour
	▪ Product, Sales & Marketing	RSP relationships, activity to attract and retain end users	Labour, Other
Network	▪ Maintenance	Reactive, recoverable and preventative work	Network maintenance
	▪ Network operations	Network operations centre and associated support	Labour, IT, Other network costs
	▪ Operating costs	Leases, electricity, security and building costs	Electricity, Other network costs, Property maintenance
Support	▪ Asset management	Investment, programme, contract and property management	Labour, Other
	▪ Corporate	Corporate functional units, office expenses	Labour, Insurance, Consultants, Other
	▪ Technology	Non-capitalised business, customer and network IT	Labour, IT, Other

Dear Commissioners and stakeholders

The Chorus board and shareholders are pleased to share Chorus' fibre investment plans with you.

These plans cover the years 2025 to 2028 (called 'PQP2'). They reflect what our end-users have told us matters most – increasing resilience of and access to fibre, while maintaining the current high quality of service and keeping fibre affordable.

Consumers expect digital infrastructure to be accessible, reliable and affordable, just like other essential utility infrastructure.

The recent pandemic and extreme weather events have shown Kiwi homes and businesses to be more reliant than ever on fast and reliable broadband connections. Cyclone Gabrielle proved fibre services were less likely to be interrupted and faster to be restored than the copper network.

Fibre is superior to other broadband technologies – it is the fastest, most reliable and lowest emissions broadband service. This is recognised by the major fibre deployment and upgrade programmes underway in virtually every developed economy.

We want to bring the benefits of fibre to as many New Zealanders as possible, consistent with our purpose "to connect Aotearoa so we can all live, learn, work and play." This purpose is at the heart of our plans (the 'PQP2 proposal'), which we now present to the Commerce Commission for review.

Meet demand, invest for the future and grow the network

Our proposal is to maintain the current high quality of service and a congestion-free network, even as data use doubles and more people connect to our network. We will do this while improving the resilience and sustainability of our services, extending the network to give more New Zealanders access to fibre, and preparing for the next generation of broadband technology.

After extensive stakeholder testing and careful balancing, we propose total capital investment of \$1.3 billion and total operating expenditure of \$0.7 billion over PQP2. This will enable us to:

- make our services more resilient, especially for those living in smaller communities, to major seismic, weather or other network impacting events. This is essential given increased consumer reliance on broadband as an essential enabler of daily life
- extend the fibre network to make world class fibre services available to 40,000 premises where it is not currently available. A report we commissioned from the New Zealand Institute of Economic Research calculated a \$16.5 billion benefit for rural homes and businesses over the next decade if they all had high-capacity broadband
- continue to meet demand for fibre by carrying out 150,000 new installations on our network (this includes installations in our current network footprint and where we expand the network)

- future-proof our network by making Hyperfibre available to those who need it. Hyperfibre is the fastest broadband available in Aotearoa and uses technology that is becoming the default for new fibre deployments globally. It makes up a small but growing share of our services and we need to support it to make sure we do not fall behind other countries in our access to leading connectivity
- invest prudently in solar generation, to improve sustainability and reduce energy costs
- all supported by efficient operating expenditure, which declines slightly per connection over the regulatory period.

Telecommunications is much more dynamic than other utility sectors - evolving technology, policy and macroeconomic developments have a significant influence on our investment decisions. To invest in the network, we need to have confidence in our ability to earn an appropriate return over time. This is why key areas of discretionary capex remain subject to pricing, market and regulatory developments that we will continue to assess in the lead-up to and during PQP2.

Our proposal has also been stress tested by an 'independent verifier', which has provided its report to the Commission.

These are bold, but carefully considered plans that we believe will best meet Aotearoa's needs.

Our success is tied to how well we meet end-users' needs

Our success as a business, reflected in our strategy, core beliefs,¹ and our PQP2 proposal, also depends on a deep understanding of end-user and stakeholder needs. Understanding these views and ensuring the PQP2 proposal fully takes account of them is a priority for the Commission and has been a key focus for the Chorus Board.

We know that 'consultation documents' can be useful, but also that many end-users find these difficult and they are by nature not interactive. This led us to use a combination of surveys, market observation and research, and formal consultation to inform our proposal. Also, when it came to tough trade-offs, stakeholder feedback helped us prioritise investments – so our scarce capital can be directed to what matters most to end-users.

We want to acknowledge and thank:

- the more than 2,500 people, businesses, educational institutions, local authorities, iwi representatives and other parties who engaged with us as we developed and refined our PQP2 proposal
- consumer advocate (and former Chief Executive of Consumer New Zealand) Sue Chetwin, for her role in establishing and overseeing our final rounds of stakeholder engagement and acting as an independent voice for our end-users as we finalised investment and future engagement plans.

The only area where we did not adopt the option preferred by stakeholders is resilience. Stakeholders supported substantially increased resilience investment, driven by recognition of people's reliance on internet services and the social and economic benefits of connectivity, as well as the issues associated with digital exclusion.

We are still proposing a material uplift in resilience investment (doubling what we proposed for our first regulatory period) although not as much as our stakeholders wanted us to invest. The main reasons are that we are mindful of the cost impact for end-users and the risk of 'recency bias' after

¹ Described in our letter to investors, page 1 of Chorus' FY23 Annual Report [Chorus Annual Report 2021 \(nzx-prod-s7fsd7f98s.s3-website-ap-southeast-2.amazonaws.com\)](https://www.chorus.co.nz/annual-report-2021)

recent weather events. We prefer to retain the option to seek approval for additional investment over the coming years.

Chorus performance and operating environment

Chorus has a strong track record of delivery through the UFB build and, more recently, in navigating COVID-19 disruptions, severe weather events, and a critical shortage of skilled technicians. We are confident in Chorus' ability to deliver on our PQP2 proposal and that our investment plans are in line with the needs of our end-users.

Our analysis clearly shows our plans to expand the network are economic and would deliver real benefits to end-users, whilst our resilience investments are strongly supported by stakeholders.

Chorus is regulated as a monopoly but operates in an environment where our largest customers are also network competitors offering competing products that earn them higher margins. This competition constrains our prices and creates strong incentives to deliver an excellent customer experience and operate as efficiently as possible.

Capital allocation is one of our Board's most important responsibilities. The long-dated nature of our investment means that, for us to invest, we need to have confidence that end-users will utilise our infrastructure and that we will be able to earn a fair return on that investment.

To promote investment in this market context, the government and Commission need to do their part by making balanced policy and regulatory decisions across the sector:

- **For Chorus**, that means having the flexibility to recover investment over time, and removing outdated and unnecessary regulation, so we can undertake commercially challenging investments that are beneficial for end-users. This includes ensuring rules relating to copper services do not make copper revenues unsustainable and, as a result, discourage our shareholders from supporting broader investment.
- **For the retail market**, that means greater vigilance to ensure fair marketing to end-users by retailers. Current marketing practices risk directing end-users to products that will not best meet customer needs. This in turn undermines the economics of further fibre investment. Fair marketing is also beneficial for retailers, as the retail market will work best when end-users have the right information to make informed choices.

Although progress is being made to improve retail service quality and transparency, a better balance is needed between the 'belt and braces' economic and competition regulation of Chorus and the comparatively light touch obligations for retailers to market and sell broadband products fairly and transparently.

Next steps

Fibre is the best broadband technology, and we are excited about how our fibre services can enable the digital future of Aotearoa. The Chorus team looks forward to working with the Commission and our stakeholders through the consultation and evaluation process.

Yours sincerely,



MARK CROSS
CHAIR