

CONFIDENTIAL



Investment in broadband in New Zealand

How to build a Billion dollar business in three easy steps

Discussion Document

SUMMARY OF TODAY'S DISCUSSION

Significant change in broadband

- Broadband demand growth and government intervention will radically change the Telco industry over the coming decade

A growth platform for lines companies

- For lines companies this change creates an investment opportunity in an unregulated market that will be of similar size to the current lines business (\$1-2bn in revenues)

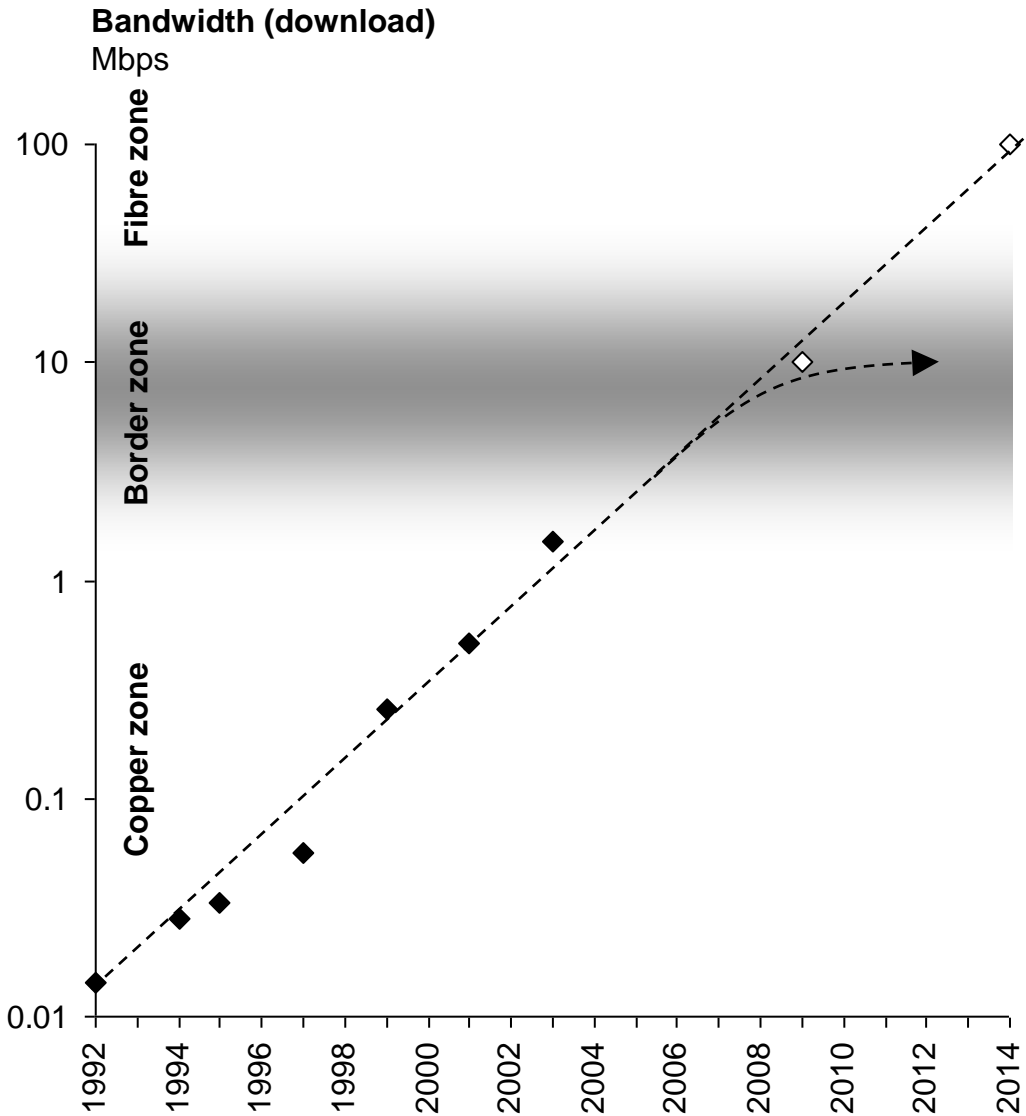
Competitors are circling

- There are other credible players who may beat lines companies if they don't position themselves well

Next steps should be discussed today

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IF WE CONTINUE ALONG THE HISTORICAL BANDWIDTH PATH, NEW ZEALAND WILL NEED SIGNIFICANT NEW INVESTMENT IN NEW INFRASTRUCTURE



Projected demand path if Moore's Law continues

Telecom proposed investment path*

The potential gap between projected and proposed drives the opportunity

* Telecom has promised to provide 10 Mbps to 80% by 2012

Source: NZCID/HiGrowth Project.

BOTH LABOUR AND NATIONAL WILL INVEST TO OFFSET RISK BUT NATIONAL'S PLAN WILL CHANGE THE GAME QUICKLY



Description of government intervention

- Investment of \$1.5bn into accelerated deployment of FTTP over the next 6 years to 75% of people
- Government may take an equity stake in investments into fibre networks
- Must be open access

Implications

- Radical change to industry structure due to scale and focus of investments (an average of \$1,250 per premise connected with fibre to the premise)
- \$250-300m per annum



- Investment of \$500m over 5 years into a variety of funds includes \$325m of contestable funds for open access networks
- This investment is a one-time grant with no return requirements and preference for open access

- Incremental investment into copper and fibre under the current industry structure
- \$60-70m per annum

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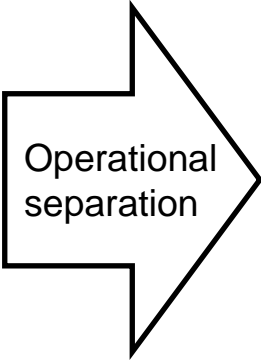
THE TELCO INDUSTRY STRUCTURE IS UNDERGOING SIGNIFICANT CHANGE AND THE FINAL STRUCTURE IS UP FOR GRABS

FIXED LINE

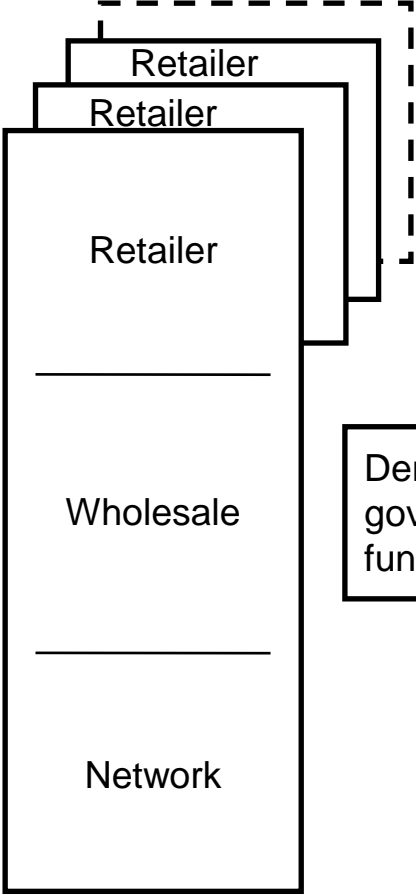
Old vertically integrated Telco



Before 2008



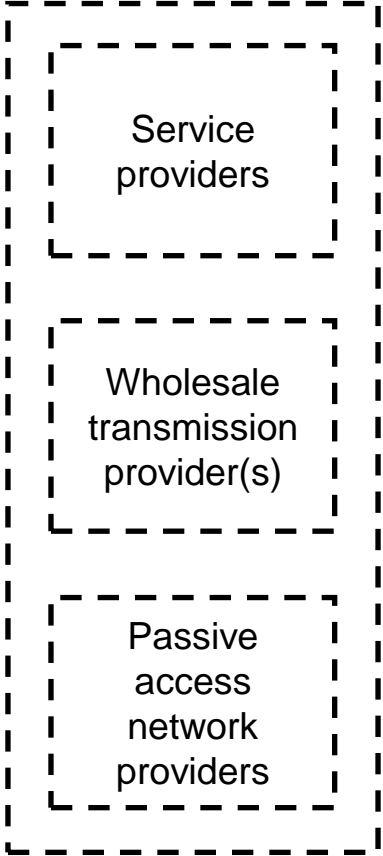
Currently partially/disaggregated



2008-??



Future Fibre Telco Model??



2008-??

THE OPPORTUNITY FOR LINES COMPANIES IS TO PLAY A ROLE IN THE MULTI-BILLION DOLLAR FIBRE INVESTMENT

	Fibre Telco Model	Descriptions	Capital requirements	Asset life
<p>Naturally competitive environment</p> <p>↑</p> <p>Natural monopoly</p>	Service providers	<ul style="list-style-type: none"> • Companies who sell services directly to consumers or who offer value to consumers • Examples include Telecom Retail, TelstraClear, Kordia, Skype, Google 	• Tens to hundreds of millions	• 2-5 years
	Wholesale transmission provider(s)	<ul style="list-style-type: none"> • Companies who 'light' the fibre and provide basic functionality (Layer 2/3) • No dedicated companies in New Zealand but North Power and Vector are doing this 	• Tens of millions	• 5-10 years
	Passive access network providers	<ul style="list-style-type: none"> • Companies that own 'dark fibre', ducting and overhead access rights • Examples are Vector in Auckland, Citylink, Telecom 	• Billions related to deployment costs	• 20-40 years

WITH 50% UPTAKE BROADBAND REPRESENTS A 12-18% RETURN ON INVESTED CAPITAL

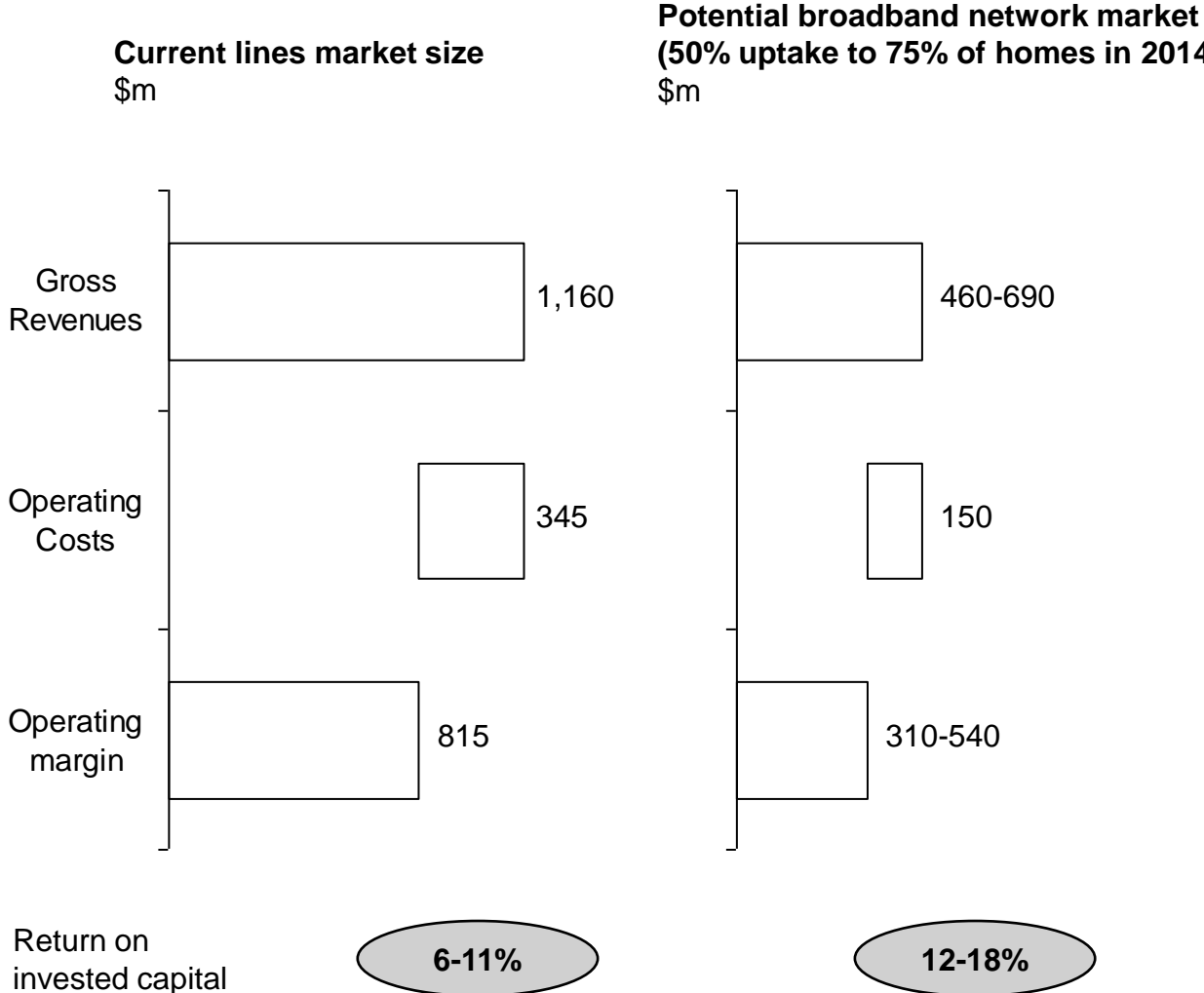
EXAMPLE

Net revenue / premise / year			\$300-480
	ARPU / premise / mth	\$80-100	Telecom average revenue per user
-	Services cost / premise / mth	\$10-20	Cost for provision of basic internet connectivity and voice
-	OPEX / premise / mth	\$10	Operating costs estimate
	Gross revenue / premise / mth	\$50-80	
X	Penetration premises passed	50%	Based on international examples e.g. Neunen, Netherlands
EBIT / premise / year			\$220-400
	Net revenue / premise / year	\$300-480	
-	depreciation	\$80	Assume 25 year life for passive elements
Cash flow / premise / year			\$234-360
	EBIT / premise / year	\$220-400	
-	Tax	\$66-120	30% corporate tax
+	depreciation	\$80	

Cash return on capital			12-18%
	Capital investment / premise	\$2,000	Assumes urban FTTP overhead model, no CPE
	Cashflow / premise / year	\$234-360	



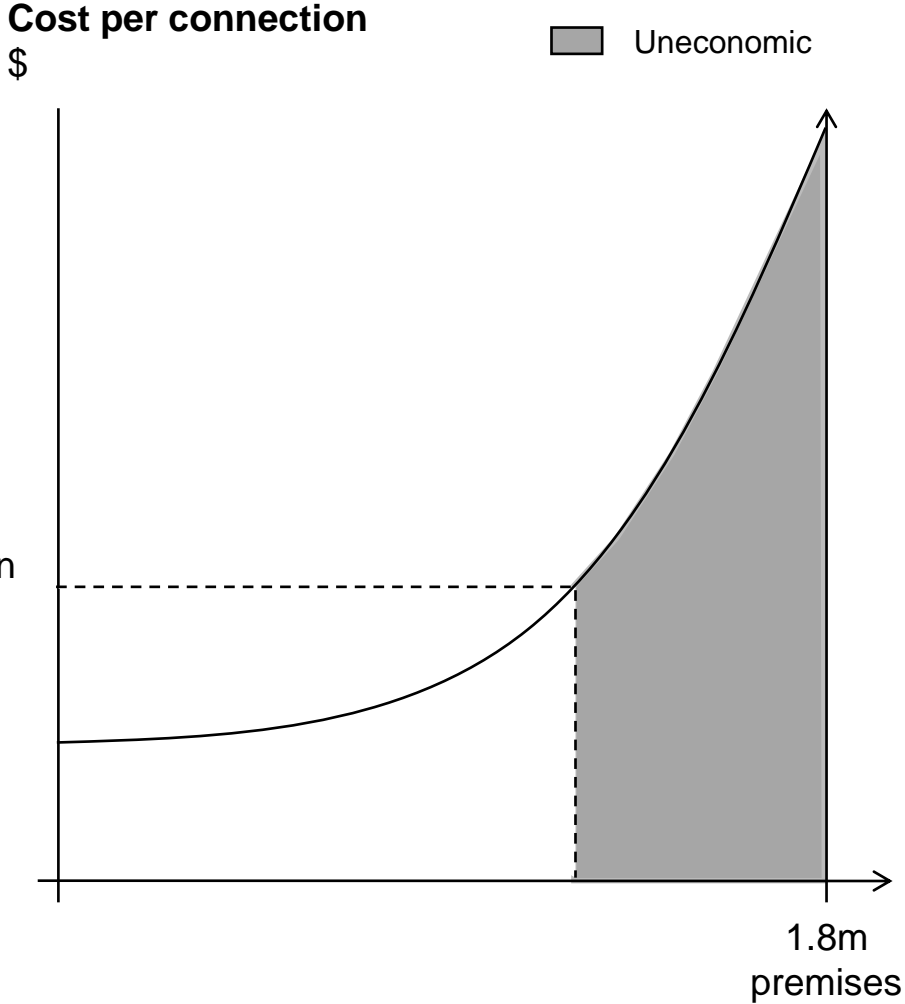
BROADBAND IS ONE OF THE LARGEST AND HIGHEST RETURN INVESTMENTS LINES COMPANIES CAN CONSIDER



- In 5 years, broadband fibre could account for 50% of lines company operating margin
- These cashflows will also represent a higher return on invested capital than regulated assets
- If lines company's becomes the sole network owner, communications will match energy revenues in 5-10 years (\$1bn +)

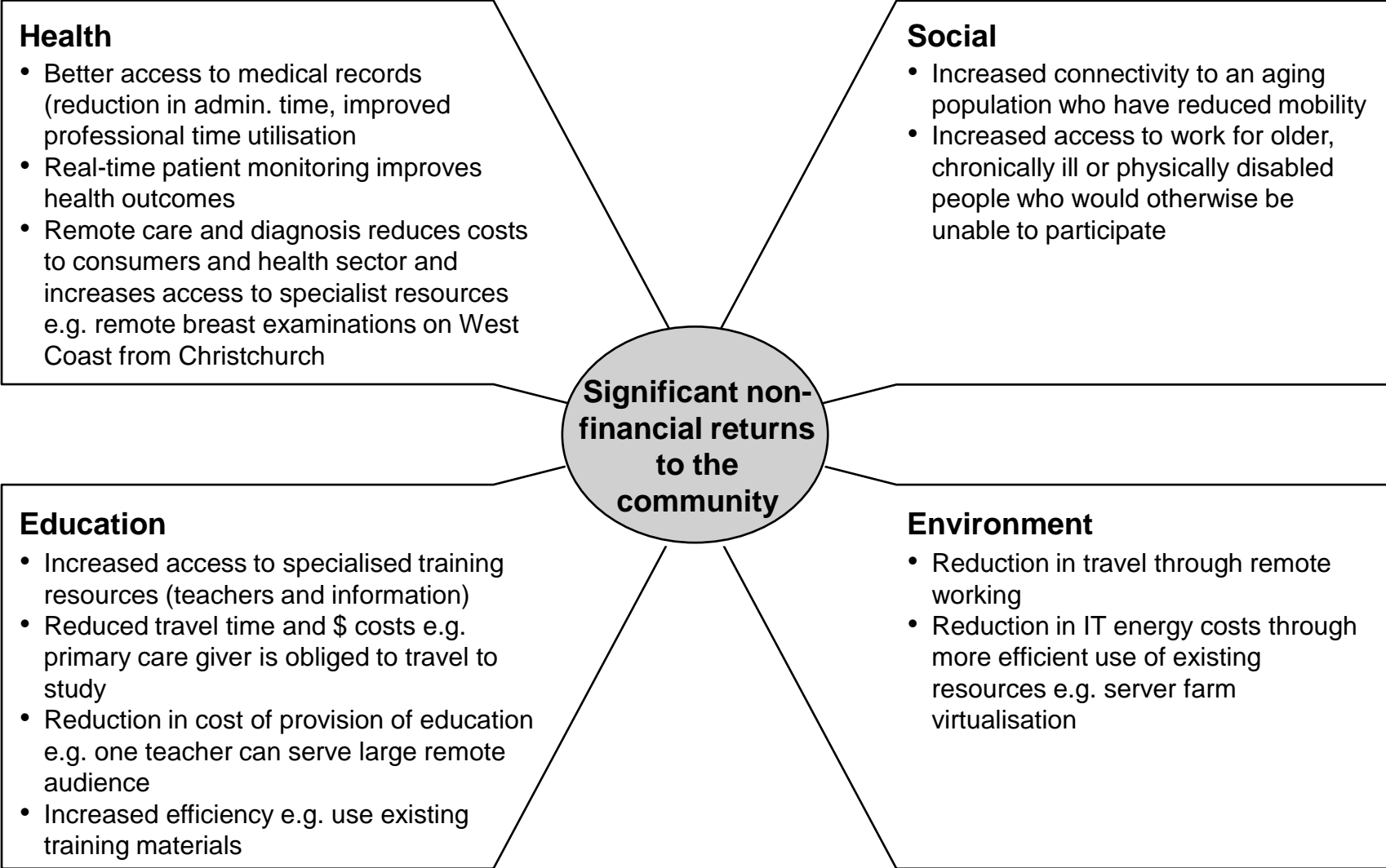
LINES COMPANIES CAN ALSO SERVE THE 'TAIL' USING EXISTING NETWORK HARDWARE

CONCEPTUAL



- A percentage of the population will likely always be uneconomic
- For these premises lines companies can leverage their existing communications infrastructure to provide wireless service

A TRULY HIGH-SPEED NETWORK CAN ALSO PROVIDE SIGNIFICANT COMMUNITY VALUE



THERE ARE ALSO RISKS INVOLVED IN THIS INVESTMENT TYPE

	Risk description	Potential mitigants for Lines Companies
<p>Overbuild and price dumping by incumbent</p>	<ul style="list-style-type: none"> • Current network owners choose to reduce price and/or overbuild e.g. Telecom’s price reduction where TelstraClear network has been deployed 	<ul style="list-style-type: none"> • Work with Telecom and government
<p>Retrospective regulatory intervention</p>	<ul style="list-style-type: none"> • Government intervention following investment risks changes to the expected return profile e.g. regulating prices or competitor behaviour 	<ul style="list-style-type: none"> • Work closely with the regulator
<p>Demand uncertainty</p>	<ul style="list-style-type: none"> • Uptake of fibre based networks and corresponding services are in their infancy globally and long term revenues per premise are unclear 	<ul style="list-style-type: none"> • Leverage government support and win the battle for high value consumers
<p>Risk to management of core business and brand</p>	<ul style="list-style-type: none"> • Investment into an adjacent network introduces capital risk against current assets and may distract management from day-to-day operations • Failure of the investment may reduce community trust faith in subsequent investments 	<ul style="list-style-type: none"> • Set up dedicated teams for new business build

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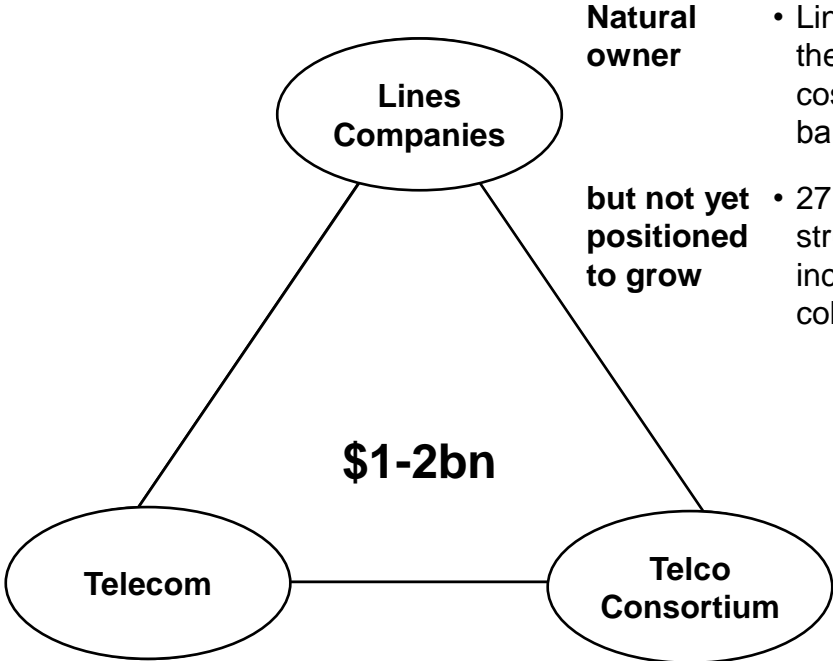
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LINES COMPANIES MUST POSITION THEMSELVES NOW TO CAPTURE THE OPPORTUNITY OVER THE COMING DECADE



Natural owner

- Lines companies are the natural owner of the monopoly infrastructure because of low costs benefits to communities and strong balance sheets, but...

but not yet positioned to grow

- 27 companies with differing shareholding structures and investment approaches increases the challenge of developing a coherent strategy

\$1-2bn

Strong current player...

but there are impediments

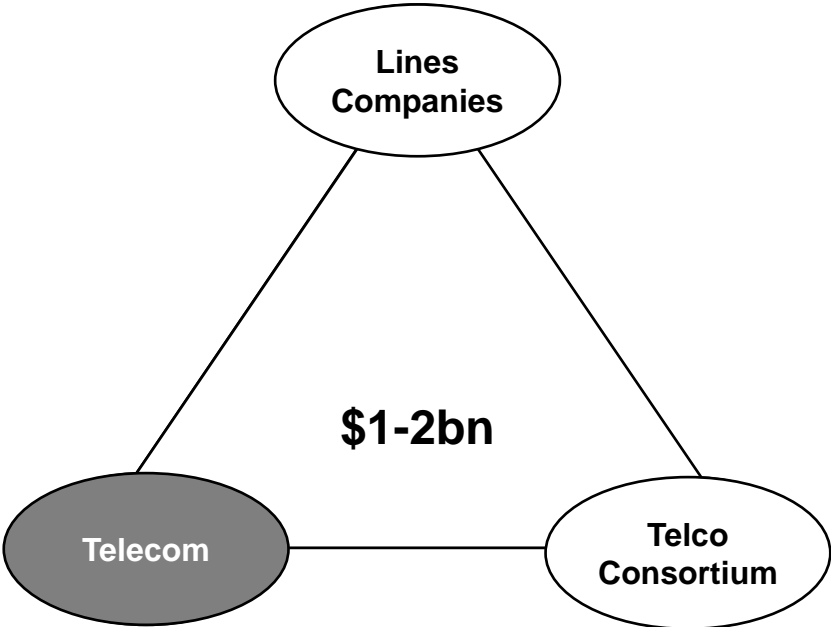
- Scale player with increasingly strong government relations, but...
- Capital committed through operational separation and...
- Capital constrained and...
- Not well structured to receive significant funding

Have caused disruption in Australia...

but no-one in sight at present

- The Australian investment programme has been impacted by an unsolicited bid from the G9 – a consortium of 9 international Telco's
- To date there is no evidence of this group or a similar group coming into play

THREE SCENARIOS SERVE TO ILLUSTRATE WHAT THE WORLD MIGHT LOOK LIKE IN 5 YEARS: TELECOM WINS



Structural separation

- Telecom moves to structural separation

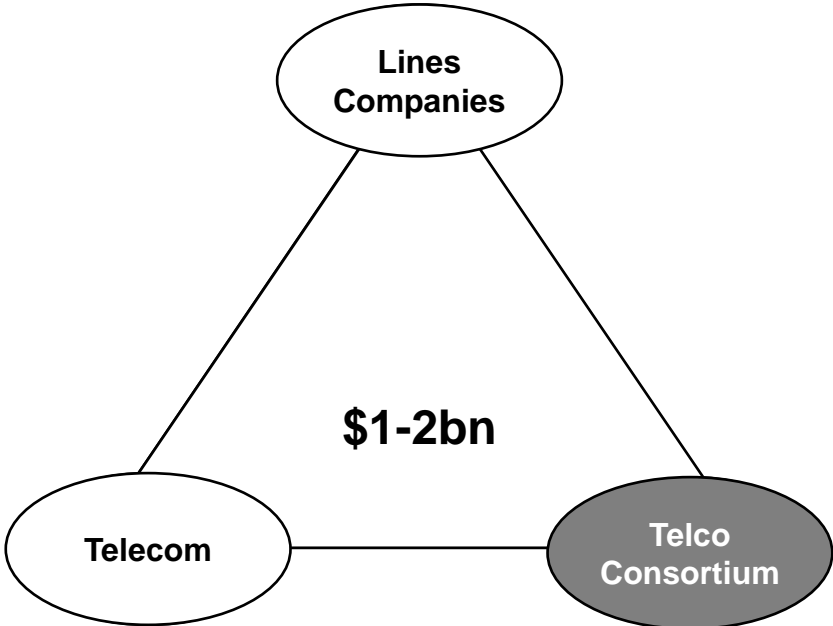
Capital reallocation

- Capital currently committed to xDSL is redirected to FTTP under government PPP

Lines companies rent poles

- Lines companies given option to lease lines to Telecom or risk overbuild

THREE SCENARIOS SERVE TO ILLUSTRATE WHAT THE WORLD MIGHT LOOK LIKE IN 5 YEARS: A THIRD PARTY WINS



Coherent group forms

- A well capitalised group of local and/or offshore investors forms

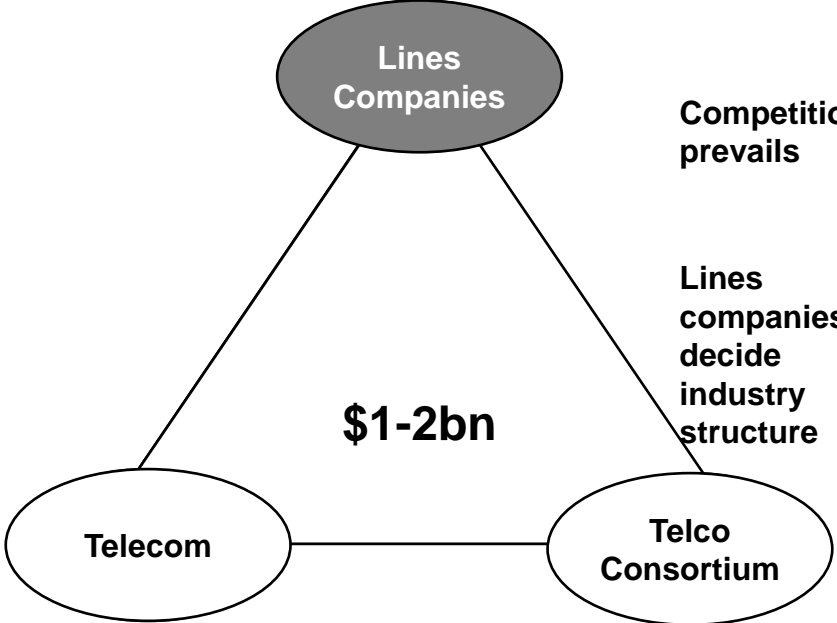
Buys Chorus

- The group buys Chorus to create a starting point for scaling

Lines companies rent poles

- Lines companies given the option to lease lines to consortium or risk overbuild

THREE SCENARIOS SERVE TO ILLUSTRATE WHAT THE WORLD MIGHT LOOK LIKE IN 5 YEARS: LINES COMPANIES WIN



Coherent framework developed

- Lines companies develop a coherent framework that suits the industry and allows for retention of identity and individual investment strategy

Competition prevails

- Lines companies compete for government funds amongst themselves only due to their strong local positioning

Lines companies decide industry structure

- Lines companies retain business, divest to natural owner or acquire relevant Chorus assets

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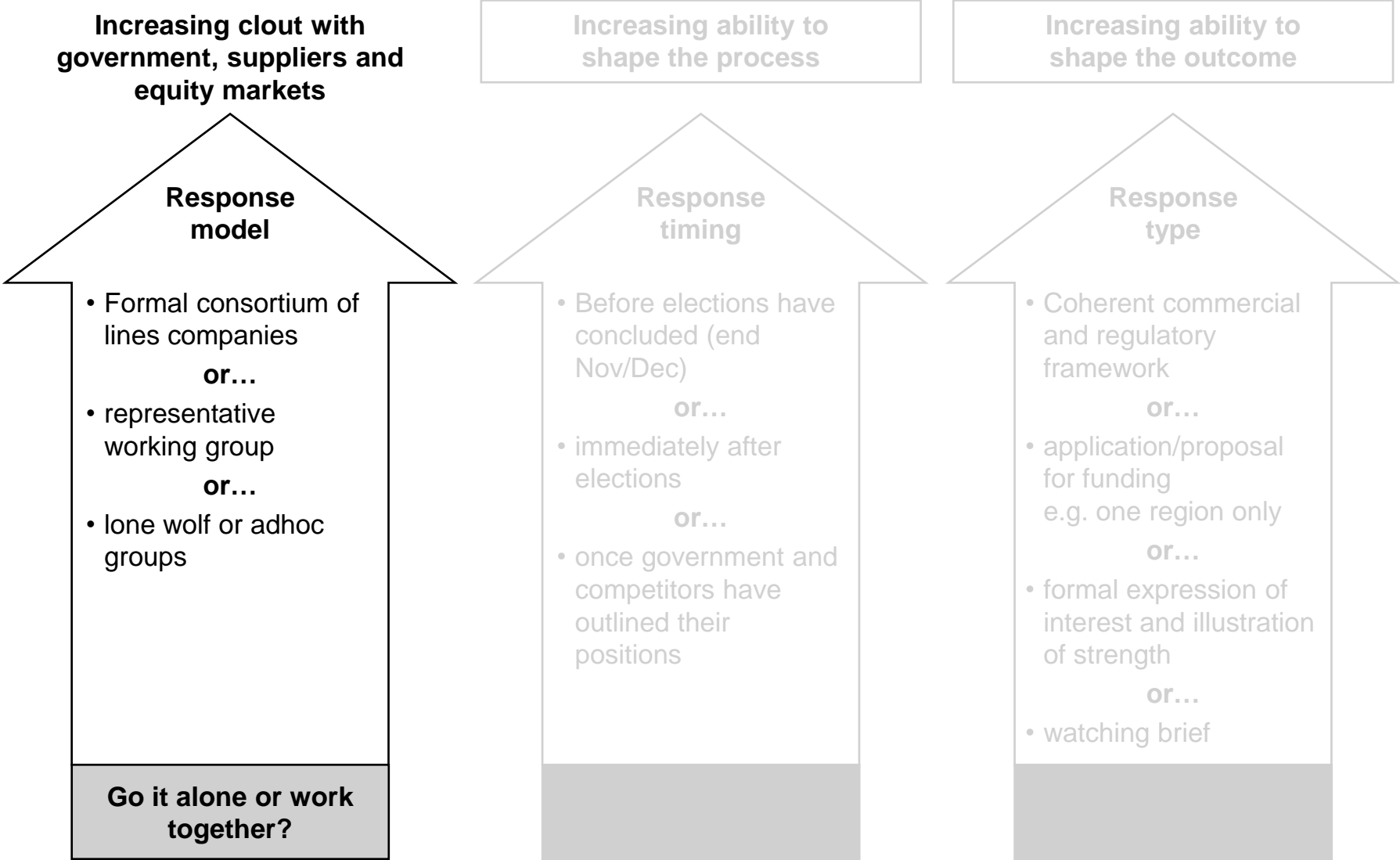
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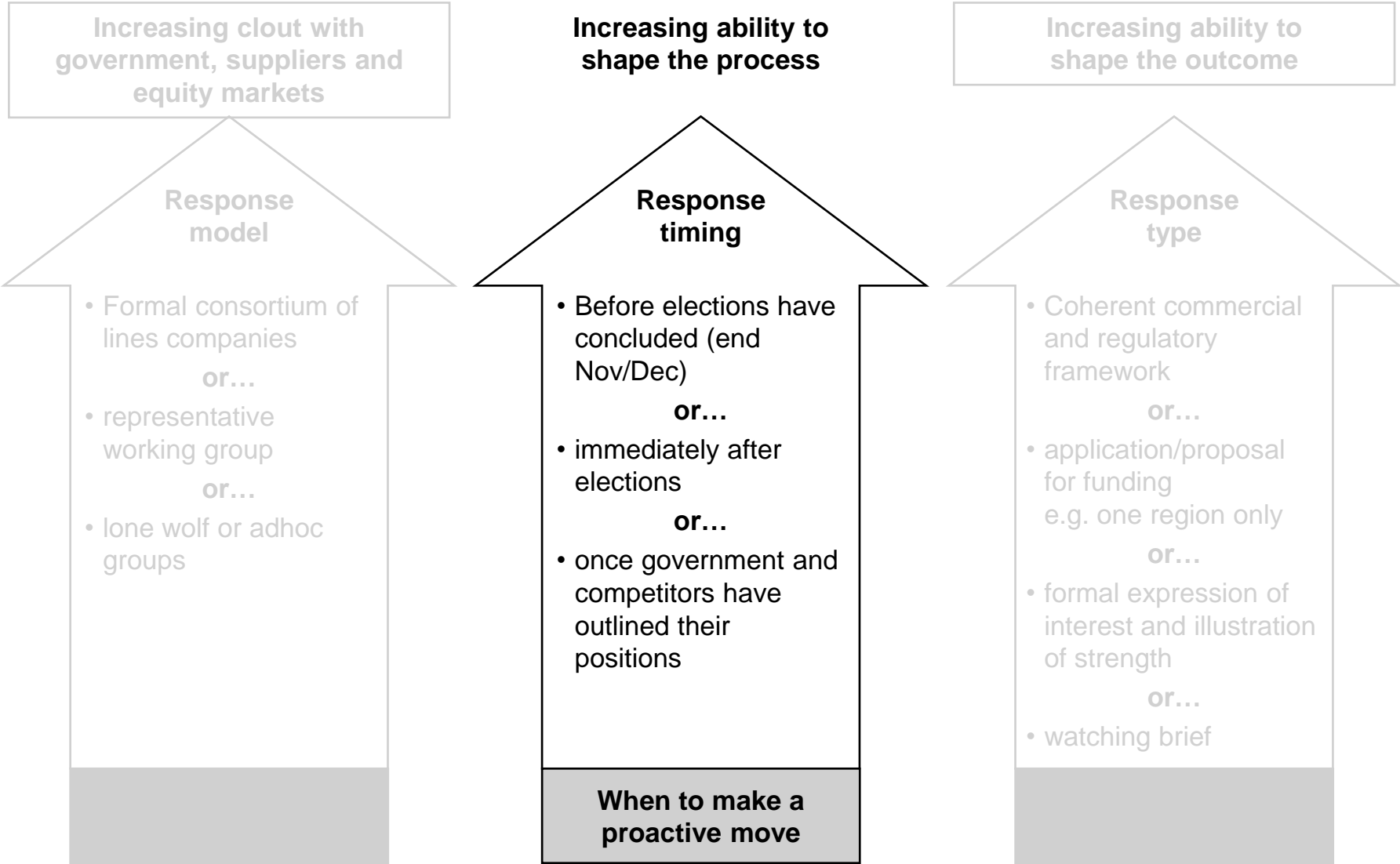
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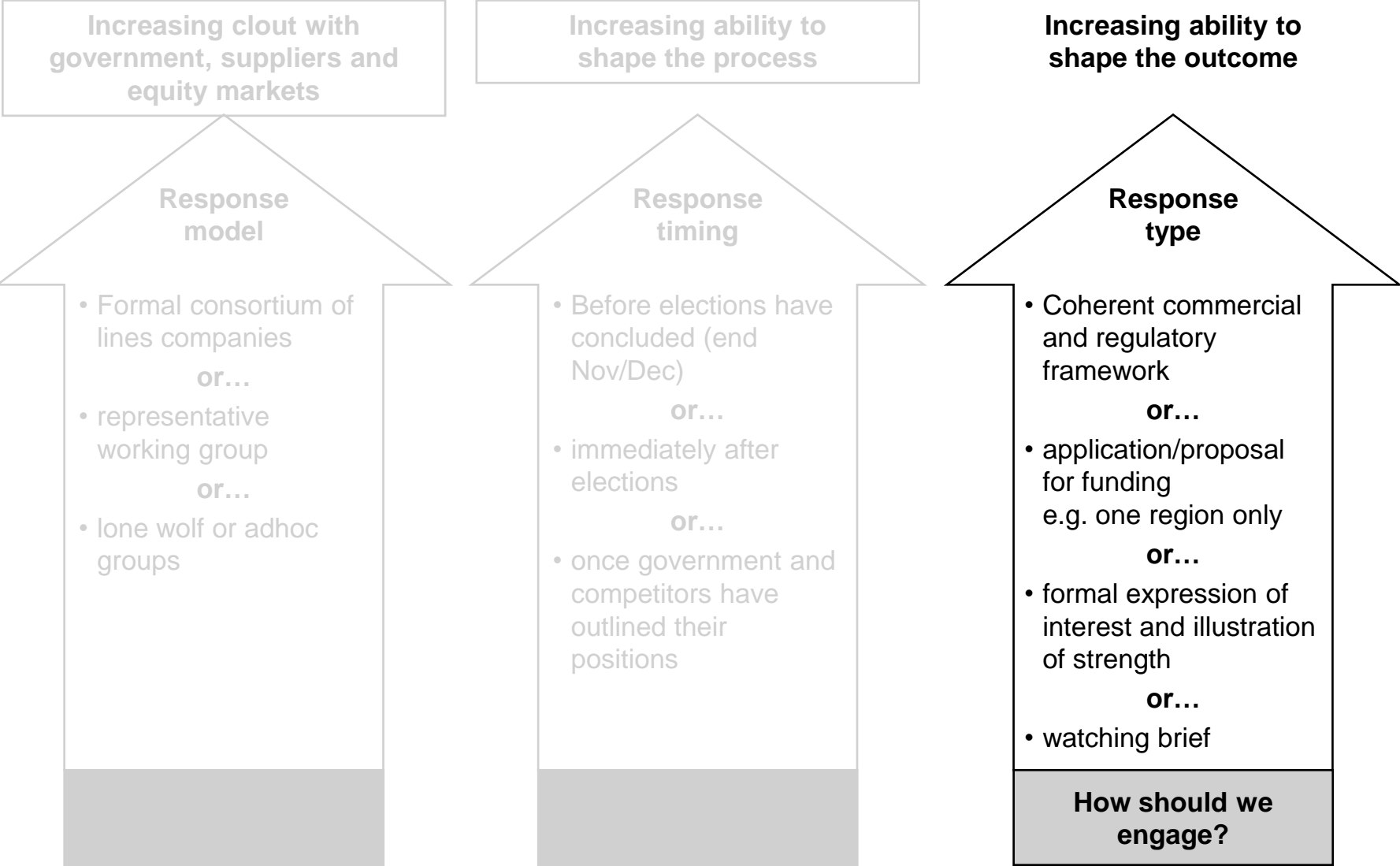
HOW SHOULD LINES COMPANIES RESPOND TO THIS OPPORTUNITY?



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HOW SHOULD LINES COMPANIES RESPOND TO THIS OPPORTUNITY?

Increasing clout with government, suppliers and equity markets

Response model

- Formal consortium of lines companies
or...
- representative working group
or...
- lone wolf or adhoc groups

Go it alone or work together?

Increasing ability to shape the process

Response timing

- Before elections have concluded (end Nov/Dec)
or...
- immediately after elections
or...
- once government and competitors have outlined their positions

When to make a proactive move

Increasing ability to shape the outcome

Response type

- Coherent commercial and regulatory framework
or...
- application/proposal for funding e.g. one region only
or...
- formal expression of interest and illustration of strength
or...
- watching brief

How should we engage?

The logo for Temple Capital Investment Specialists features the word "TEMPLE" in a large, white, sans-serif font. A small, yellow, diamond-shaped icon is positioned above the letter "M". Below "TEMPLE", the words "CAPITAL INVESTMENT SPECIALISTS" are written in a smaller, white, sans-serif font. The entire logo is centered on a teal background with a subtle grid pattern.

TEMPLE

CAPITAL INVESTMENT SPECIALISTS

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Let's talk

For an in-depth assessment of your next investment decision or for further information on our services, please call Paul Winton on +64 9 376 6581.