

CONFIDENTIAL



FULFILLING THE NATIONAL BROADBAND PROMISE

December 2008

Discussion Document

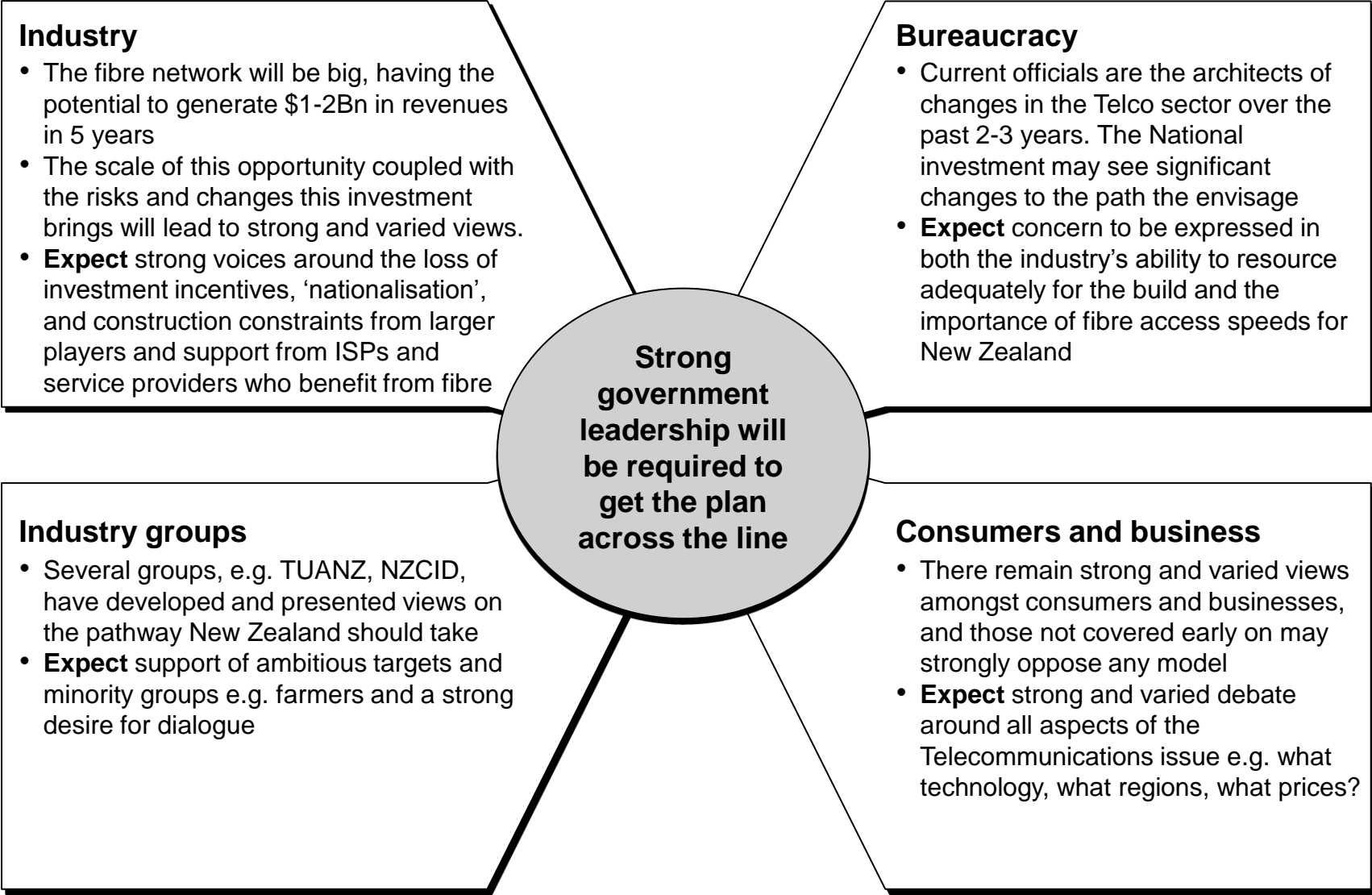
SUMMARY MESSAGES

- 1. Stick to your guns:** The National end game is possible with the proposed funds and within the proposed timeframe and examples are already in place.
- 2. Entrenched and well resourced opinions prevail:** The Telco industry, industry groups, the bureaucracy and the public have strong opinions and many have much at stake.
- 3. Watch the minefield:** National must pick its way around three critical issues – Telecom alignment, the regulatory framework and the investment structure
- 4. First cab off the rank:** National should identify the engagement team leader before end of 2008 and should plan for the first truck roll in Jan 2010.

1. STICK TO YOUR GUNS: THE NATIONAL END GAME IS POSSIBLE AND EXAMPLES ARE ALREADY IN PLACE

| 75% of NZ in 6 years: It can be done | If done well, government funding of \$1-1.5bn is ample | Telecom is not the only game in town | A snapshot of the future is already in place |
|--|---|--|---|
| <p>Roll out rates are reasonable</p> <ul style="list-style-type: none"> • Lines companies can work on rollout rates of 500-1,000 premises per field-technican person per year for a typical overhead urban rollout (based on estimated team size and rollout rate per team) • Additional planning, home connection and project management resources are required <p>Labour needs can be met</p> <ul style="list-style-type: none"> • The National promise of 75% (1.2m premises) of premises in five to six years will require 500-1,000 well coordinated rollout staff. This assumes most of the deployed fibre running overhead • These people will likely be sourced from the civil construction sector that has an increasing surplus as a result of the downturn in the construction industry | <p>The cost is in the fibre rollout</p> <ul style="list-style-type: none"> • Typically 70-80% of an underground fibre deployment is dedicated to cabling <p>Passing 1.2m homes (75%) will cost ~\$2.4bn to \$3.6bn</p> <ul style="list-style-type: none"> • Our research suggests the cost of passing an average suburban premise (to the curb) served by overhead lines is ~\$1,000 • Connecting from the curb to the premise will cost \$1,000-\$2,000 <p>The private sector will contribute materially to this</p> <ul style="list-style-type: none"> • Under the right regulatory and commercial model, that leverages community cost benefits, a large proportion of this investment will come from private sector and capital markets • We estimate only less than 20-25% of the build cost is non-commercial provided community is engaged | <p>Lines companies have low deployment costs</p> <ul style="list-style-type: none"> • Deployment costs will be 30-50% of those under a Telecom rollout or non-Lines Company rollout <p>Strong balance sheets and Telco skills are available</p> <ul style="list-style-type: none"> • Lines companies (28 total) have an enterprise value of \$8bn, strong balance sheets and a desire to invest in complementary businesses. • Telco capabilities are available from TelstraClear, Vodafone and other emerging players <p>Community involvement will drive change</p> <ul style="list-style-type: none"> • Offshore experience shows community involvement drives uptake. Communities can rally the participants needed • Lines Co's are owned by their communities and councils have significant influence and can collectively drive uptake and reduce costs | <p>A snapshot of the future is already in place</p> <p>Northpower in Whangarei is a good NZ model</p> <ul style="list-style-type: none"> • Northpower, a lines company, is at the early stages of a rollout that could be replicated nation wide • This open-access network sees strong competition develop between retailers e.g. Vodafone, Telstra <p>Singapore's new model could deliver National's promise</p> <ul style="list-style-type: none"> • Singapore has just signed off on an open access model with a consortium including Singtel, power companies and international experts • This National model has many parallels to the New Zealand pathway |

2. ENTRENCHED AND WELL RESOURCED POSITIONS PREVAIL



3A. WATCH THE MINEFIELD: THREE INTERRELATED ISSUES MUST BE CONSIDERED FROM THE START

| | Issue description | Path to resolution |
|---|---|--|
| Telecom – Competitor or collaborator? | <p>Telecom has expressed no public interest in moving away from their current cabinetisation plan and has expressly said 'no' to open duct / fibre. They have two broad options:</p> <ul style="list-style-type: none"> 1. Compete: If Telecom continue, their access network (CopperCo) will be overbuilt by the National fibre network and hence drive national value destruction through replication 2. Collaborate: If Telecom choose to collaborate and align their capital programme with National's plan, a more efficient rollout will result | <ul style="list-style-type: none"> Scenarios for Telecom collaboration include: <ol style="list-style-type: none"> Sale: sale of CopperCo to a new Fibre vehicle Retirement: staged retirement of CopperCo in collaboration with the fibre investment vehicle(s) CopperCo as fibre vehicle: structural separation and ongoing ownership of CopperCo by Telecom. CopperCo then undertakes fibre rollout in partnership with stakeholders e.g. Lines companies, government Telecom should be engaged to explore each scenario as a priority. Scenarios and their CopperCo valuations should be developed in a collaborative manner Telecom no longer holds veto rights |
| What changes will be made to the regulatory framework? | <p>New Zealand should create a long term and stable environment that balances private sector and consumer needs.</p> <ul style="list-style-type: none"> 3. Regulatory body: The appropriate 'owner' of this regulation must be decided e.g. Com. Com., MED, other? 4. Existing obligations: Removing or changing Telecom's existing obligations must be considered as part of the migration to a new model 5. New regulations: The fibre asset will be a natural monopoly. A decision must be made on whether to regulate at all, to provide a regulation grace period or to keep a 'watching brief' | <ul style="list-style-type: none"> Future regulations must be shaped to make investment today attractive while providing 'clawback' options to avoid new participants gouging Commercial models should first be explored and then regulatory / legal intervention to support these models should be developed |
| What is an appropriate investment structure | <p>Government faces two questions:</p> <ul style="list-style-type: none"> 6. What form will government investment take (equity, debt, revenue/underwrite) 7. What form will the investment vehicle(s) take (centralised/ decentralised) | <ul style="list-style-type: none"> Identify willing participants and ask what structure and magnitude of support would be needed For each form a view on government investment per connection provided |

Other issues such as other existing asset owners, definition of FTTP (e.g. does it include the consumer equipment?) and technology selection (architecture and stack ownership model) are important but considered secondary to those above

3B. WATCH THE MINEFIELD: RESOLVING THESE ISSUES WILL TAKE A STRONG CROSS FUNCTIONAL TEAM

Telecom – Competitor or collaborator? # of options*
4+

What changes will be made to the regulatory framework? 12+

What is an appropriate Investment structure 6+

• The number of scenarios is daunting
• Real work must be done and structured conversations with stakeholders held to prioritise and progress these issues

288+ options

These complex issues cannot be solved in a government vacuum. Each of the issues is a function of the different decisions made by stakeholders outside of government control. A taskforce / working group must be established to liaise with selected parties and iteratively develop a range of options. This might initially be very light (1-2 people) but could reasonably be expected to ramp up.

Group characteristics: Strong leadership and focus on creating a path to National’s clearly stated and measurable objectives that will demonstrate success in 24-36 months. The group must be a true cross functional team with aligned and clearly incentivised objectives, a comfort for ambiguity and a drive for outcomes. Members must provide a mix of commercial and government relations experience

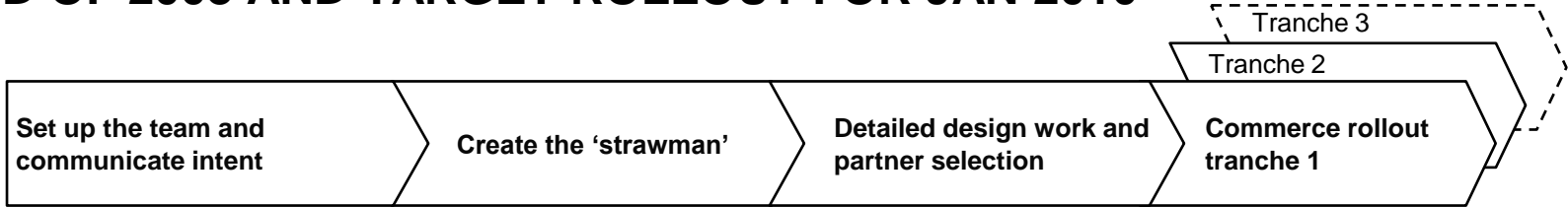
Group capabilities: The taskforce must comprise a group of skills that will allow options to be evaluated. Skills include:

- Commercial : Understanding of different available models, international experience, current market participants and their commercial drivers / constraints
- Capital markets: Skills to ensure to further damage to capital markets perception of New Zealand and assist in structuring the new model and transition from the old.
- Telco/technical: Expertise in different deployment models, their pros and cons and experience from other nations or regions
- Legal/regulatory: Expertise in the identification and development of regulatory and legal issues around monopoly networks in telecommunications. Knowledge of industry participants
- Government: Liaising with selected government stakeholders requires a team member with strong relationships and understanding of government process coupled with a drive for outcomes

Outcomes: To be determined during scoping. Options include an RFP process (similar to Australia), a series of discrete options for industry consideration / consultation or a preferred model.

* Based on estimates of the number of independent, discrete decisions that could be made

4A. NEXT STEPS: NATIONAL SHOULD SELECT AN ENGAGEMENT TEAM BY THE END OF 2008 AND TARGET ROLLOUT FOR JAN 2010



| | Set up the team and communicate intent | Create the 'strawman' | Detailed design work and partner selection | Commerce rollout tranche 1 |
|------------------------------------|---|---|---|--|
| What | <ul style="list-style-type: none"> Set up a team to develop the model and act as steward to this rollout * Capabilities required include: <ul style="list-style-type: none"> Commercial Capital markets Telco/technical Legal/regulatory Government liaison Commit Y0 funding and communicate to stakeholders (Telco CEOs as a priority) | <ul style="list-style-type: none"> Extend National's principles to create a basic framework <ul style="list-style-type: none"> Commercial Regulatory Telco Engage in discussions with stakeholders to test strawman | <ul style="list-style-type: none"> Design the govt./private sector framework and capital structure (e.g. equity, grants, debt, other?) Decide if regulatory intervention is required. If so identify the best regulatory framework and owner e.g. Commerce Commission Identify possible participants and best means to engage e.g. competitive RFP | <ul style="list-style-type: none"> Rollout to identified high value areas |
| Rough timing | <ul style="list-style-type: none"> Q4 2008 | <ul style="list-style-type: none"> Q4 2008 to Q1 2009 | <ul style="list-style-type: none"> Q1 – Q4 2009 | <ul style="list-style-type: none"> Q1 2010 |
| Critical questions / issues | <ul style="list-style-type: none"> Who will lead the initiative (execution lead as opposed to Ministerial lead)? Which public and private sector specialists will be engaged and how? | <ul style="list-style-type: none"> How should the relationship with Telecom be developed? Who/what is the government regulatory body? | <ul style="list-style-type: none"> What are the rollout criteria e.g. schools first, lowest cost to deploy, political considerations? What does govt get for its dollar? What is the framework for private sector engagement e.g. RFP? | <ul style="list-style-type: none"> Decisions on the next tranche (where, what size, what partners)? |

* One option is considered on the following page

4B. A POSSIBLE FIRST STEP: THE TASKFORCE OPTION

| Description | Comments |
|--|--|
| <p>Government appoints taskforce Chair</p> <ul style="list-style-type: none"> • Government appoints a taskforce Chair to lead development and rollout of the proposal • Government works with the Chair to identify and engage a taskforce (Steering Group) | <ul style="list-style-type: none"> • Chair should be an impartial, well respected business person who has demonstrated consensus building ability and ideally has technology experience • Taskforce need to be seen as action focused deliverers |
| <p>Key industry executives briefed</p> <ul style="list-style-type: none"> • Telecom, Vodafone Telstra, selected other players briefed | <ul style="list-style-type: none"> • Should be briefed by Ministers/PM • Serves as a polite forewarning and a call to action |
| <p>Taskforce made public</p> <ul style="list-style-type: none"> • Appointment of taskforce made public | <ul style="list-style-type: none"> • National should be seen to be walking the talk and putting its bold and ambitious plan into gear • All investors in Telecommunications must have a clear view of process and intentions |
| <p>Taskforce Chair appoints taskforce team</p> <ul style="list-style-type: none"> • Taskforce appoints a taskforce of executives. This group of full time executives with varied backgrounds will live and breath this project for the next 2-3 years | <ul style="list-style-type: none"> • Team should be led by a full time CEO/GM who will be accountable for the project and report to the taskforce |
| <p>Work begins</p> <ul style="list-style-type: none"> • Work starts Q1 2009 | <ul style="list-style-type: none"> • The taskforce executives will appoint other executives and consultants as required |

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