New Zealand Shareholders Association Inc.

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Many Investors, One Voice

20 October 2023

Chorus Limited (CNU)

The company will hold its Annual Shareholders Meeting at **2.00pm Wednesday 8 November 2023.**

The location is **Chorus' Wellington office Aon Centre Level 10, 1 Willis Street Wellington.**

You can also join the meeting online here.

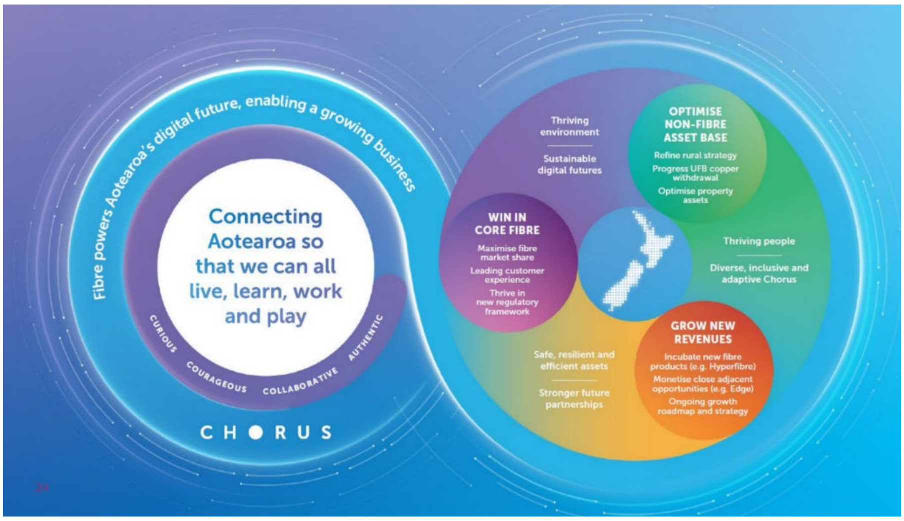
Company Overview

Chorus is a provider of telecommunications infrastructure. The company was demerged from Telecom New Zealand in 2011 as a condition of winning the majority of contracts for the Governments Ultra-Fast Broadband Initiative. It is the owner of the majority of telephone lines and exchange equipment and was responsible for building approximately 75% of the new fibre optic network. With development largely complete, it is now focusing on developing new revenue streams and optimising remaining non-fibre assets.

Current Strategy

The company's vision is "*Connecting Aotearoa so we can all live, learn work and play*," supported by three key strategic priorities:

- Win in core fibre
- Optimise the non-fibre asset base
- Grow new revenues



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Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

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Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	**Assessment**	**Notes**
Directors Fees	G	See below.
Director share ownership	G	See below.
Executive Remuneration	G	See below.
Golden parachutes/handshakes	G	See below.
Director Independence	G	All Directors are independent.
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	G	Hybrid meeting.
Independent Advice for the Board and Risk Management	G	See below.

Directors Fees: Excellent Disclosure. The Board Charter states that "*The Board may pay additional fees and allowances to a Director to reflect additional services provided.*," a position not generally supported by NZSA (with some significant exceptions). We note, though, that no such payments were made in FY23 or in recent financial years.

The Director Fee Pool and individual Directors Fees were approved by shareholders at the 2018 ASM. This year, the Board decided to increase fees by 5% to partly reflect inflation since that time. The increase is within the current Fee Pool so no further increase is being sought from shareholders at this time. The Regulatory Sub-Committee has been disbanded as this is no longer required so the impact will be a net decrease in total fees.

The Board will commission an independent report on fees in 2024.

Director Share Ownership: Directors are expected to accumulate the equivalent of one year's fees over their first three years. While NZSA encourages share ownership by independent Directors, it does not support compulsion as this may reduce the pool of available Directors, may compromise independence, and removes the 'market signal' associated with share purchases.

The time frame of three years to achieve the target implies a 33% purchase rate, meaning that a board applicant would require existing wealth to serve on the Board. NZSA does not believe that ability is not defined solely by wealth. In this context, however, we observe that the Chair holds discretion to waive the requirement depending on a director's personal circumstances.

Executive Remuneration: The CEO is paid a base salary and a short-term incentive (STI) in cash and a long-term incentive (LTI) by way of share performance rights.

NZSA encourages fulsome disclosure in relation to any incentive payments made to the CEO, including disclosure of measures (or measure 'groups'), weightings, targets, and the level of achievement for each measure component.

Chorus provides thorough disclosure of this methodology, for both STI and LTI. We are pleased to note that the threshold for the LTI award is based on an 'absolute' shareholder return.

Share performance rights supporting the LTI are awarded at a flat 33% of base remuneration, subject to testing over a three-year period. For this year's award (made in August 2022), the 3-year total shareholder return will need to be 7% CAGR to August 2025. NZSA notes that the first LTI tranche for the CEO (awarded in FY21) will be assessed during the FY24 year with possible re-testing in FY25.

We note that the maximum opportunity for CEO STI exceeds base salary, a position not generally supported by NZSA. The potential STI is 69% of the total incentives. NZSA prefers a weighting towards LTI to ensure the CEO's focus is aligned with the long-term interest of shareholders.

<u>Golden parachutes/handshakes:</u> We note the clear disclosure in the Annual Report around termination conditions and that these are standard for the position.

<u>Board Composition:</u> Whilst the Annual Report includes a 'collective' skills matrix it does not attribute skill sets to individual Directors to demonstrate who they contribute to the governance of the company.

The company does not participate in the IoD's Future Director programme designed to develop and mentor the next generation of Directors. NZSA expect NZX50 companies to participate as part of a responsibility to develop and mentor the next generation of Directors. As mitigation, however, NZSA notes that Chorus currently has three directors for whom this represents their first public company directorship.

Notwithstanding our comments related to director share ownership, the nature of the company's board indicates a commitment to thought, experiential and social diversity, with relevant experience for Chorus.

<u>Director Tenure:</u> NZSA looks for evidence of ongoing succession or 'staggered' appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

Directors' appointments range between 2015-21, showing a strong commitment to the managing risks associated with succession.

<u>Independent Advice for the Board & Risk Management:</u> NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

In both cases there are comprehensive disclosures in the Annual Report. NZSA notes the three key audit matters in the Auditors Report. The company makes thorough disclosures of strategic, climate-related, business, and financial risks, as well as the processes that support risk management. We note there is more limited disclosure of mitigations in the annual report.

We note that "*A director may, with our chair's prior approval, obtain professional advice (including legal advice) and request the attendance of advisers at Board and Board committee meetings.*" The company secretary and internal auditor have unfettered access to the Board. The Board approves the internal audit programme and operates a 'co-sourced' model for internal audit.

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Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	**Assessment**	**Notes**
Audit independence	G	Good disclosure.
Audit rotation	A	See below.

<u>*Audit Rotation:*</u> Whilst the company ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules, it does not disclose if the Audit Firm is rotated at 10 years.

Notwithstanding auditor tenure, NZSA also expects disclosure of the appointment dates of the Lead Audit Partner and Audit Firm to improve transparency for investors.

Environmental Sustainability

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	**Assessment**
Approach	G
Sustainability Governance	G
Strategy and Impacts	G
Risk and Opportunity	G
Metrics and Targets	G
Assurance	R

<u>*Overall approach:*</u> Chorus has produced their third Sustainability Report since 2021, with related areas (such as environmental governance) tightly integrated within other disclosures in the 2023 Annual Report. In the Chair's letter in Chorus' Sustainability Report, Mark Cross describes a "*climate realisation [happening] across our organisation*" and despite saying that Chorus is in the early stages of their environmental and social impact journey, the company already performs well when assessed against NZSA key Environmental Sustainability policy criteria. We observe further improvement potential in the provision of external assurance.

<u>*Sustainability Governance:*</u> While Chorus mentions the use of a skills matrix, this is not disclosed as an individual assessment in their Annual Report. Chorus does dedicate human resources to sustainability by way of multiple sustainability-related management positions as well as being part of the Telecommunications Forum Climate Change Working Group.

<u>*Strategy and Impact:*</u> The Chair's letter says, "*we recognise the climate-related risks and opportunities ahead and are now firmly focused on our resilience and adaptation to climate change, balanced with doing all we can to mitigate risks and decarbonise our business to prevent further harm*". They demonstrate this through their evidence of capital investment to support their mitigations and have also disclosed an environmental transition roadmap.

Risk and Opportunity: Chorus identifies their environmentally related risks and groups them into physical and transitional risks. Their coverage of their responses to their identified risks is good. We note that only one environmentally-related opportunity is disclosed.

Metrics and Targets: Chorus discloses their GHG Emissions profile across Scope 1 to 3 with a good breakdown of contributors to their emissions. They also disclose their waste disposal and recycling data since FY21. Chorus discloses a wide range of environmental performance targets – position supported by NZSA's assessment policies.

Assurance: No mention of verification of Chorus' GHG profile is provided, but they do disclose in the contents of their Sustainability Report that it has not been independently verified.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure
Political donations	G	No donations were made.

Financial & Performance

Policy Theme	Assessment	Notes
Capital Management	G	See below.
Takeover or Scheme	n/a	

Chorus's share price fell from $7.63 to $7.40 (as of 4th October 2023) over the last 12 months – a 3% decline. This compares unfavourably with the NZX 50 which rose by 3% in the same period. The capitalisation of CNU is $3.2b placing it 18th out of 128 companies on the NZX by size and makes it a large company.

Metric	2021	2022	2023	Change
Revenue	$947m	$965m	$980m	2%
EBITDA	$649m	$675m	$672m	n/c
NPAT	$47m	$64m	$25m	-61%
EPS[1]	$0.105	$0.143	$0.057	-60%
PE Ratio	62	53	129	
Capitalisation	$2.9b	$3.4b	$3.2b	-5%
Current Ratio	0.44	0.50	0.40	-22%
Debt Equity	5.18	4.68	4.80	3%
Operating CF	$556m	$570m	$524m	-8%
Cash flow (cps)	$1.24	$1.28	$1.20	-6%
NTA Per Share[1]	$1.75	$1.83	$1.97	7%

Dividend Per Share[1]	$0.25	$0.35	$0.425	21%

[1] *per share figures based off actual shares at balance date (not weighted average)*

Revenues were up 2% to $980m and although EBITDA was comparable to last year, an increase of $20m in depreciation and an increase in finance expenses of $53m, meant *NPAT* fell 61% to $25m providing shareholders with *EPS* of $0.057. This places CNU on a rather elevated *PE* of 129.

Operating cashflows were down 3% to $524m and these (or to be more precise the expectation of these), are the driver for the valuation of Chorus. Measured in cents per share, operating cashflows were $1.20.

NTA per share is $1.97 and CNU trade at a large 276% premium to their NTA.

Of note it is interesting to see that dividends paid by CNU are in excess of EPS. Chorus had large cash flows but also a very large depreciation expense ($355m). Depreciation is a non-cash item and affects EPS, but not the ability to fund the dividend payment.

Dividend payments increased by 21% to $0.425. Due to the low EPS and tax payments, dividends are not imputed. We believe that Chorus should look to alternative and more tax efficient means of returning excess cash to shareholders. We do note Chorus are undertaking an on market buy back of shares – pleasingly, in this context, they have ceased their dividend reinvestment programme.

CNU have relatively high debt levels with their *debt equity ratio* at 4.80 (4.68). Two items called Crown Funding and Crown Infrastructure Partners Securities comprise $1,617m of non-current liabilities. In addition, interest bearing debt increased to $2,528m. Total non-current liabilities are $4,412m. This is large when compared to total equity of $1,063m.

CNU provided guidance for FY24 in a comprehensive investor presentation, when announcing their FY23 results. This guidance is subject to no material changes in regulatory or competitive outlook. Earnings guidance is higher than FY23, but projected capital expenditure is similar. Dividend guidance has been maintained however no imputation credits are expected in the short to medium term.

- EBITDA: $675 to $690m million
- Capital Expenditure: $410-$450 million (tracking to the upper end)
- FY24 - a minimum dividend of 47.5 cents per share

Chorus shares are widely held by a variety of institutions and individuals.

Resolutions

1. To re-elect Kate Jorgensen as an Independent Director.

Kate Jorgensen was appointed to the Board 1 July 2020. She is a Director of Suncorp NZ and Kiwibank. She has held senior positions as CFO of Vodafone NZ, KiwiRail, and Fletcher Building's infrastructure division. Kate is an impact coach with the Springboard Trust and was a member of the Sustainable Business Council Advisory Board. She holds a Masters in Technological Futures and a Bachelor of Business, is a Chartered Accountant of Australia and New Zealand, and a Chartered Member of the Institute of Directors.

We will vote undirected proxies **IN FAVOUR** of this resolution.

2. To re-elect Jack Matthews as an Independent Director.

Jack Matthews was appointed to the Board 1 July 2017. He was formerly CEO of TelstraSaturn and a Director of Crown Fibre Holdings. He was also CEO of Fairfax Media's Metro Division, CEO of Fairfax Digital and Chief Operating Officer of Jupiter TV (Japan). He is currently the chair of Lodestone Energy, and a former director of New Zealand Golf Network Limited, Plexure Group, The Network for Learning, APN Outdoor Group, and Trilogy International.

We will vote undirected proxies **IN FAVOUR** of this resolution.

3. That the Board is authorised to fix the auditor's remuneration for the coming year.

This is an administrative resolution.

We will vote undirected proxies **IN FAVOUR** of this resolution.

Proxies

You can vote online or appoint a proxy at https://www.investorvote.com.au/

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **2.00pm Monday 6 November 2023.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

The Team at NZSA