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The Commission has received submissions from several interested parties following the FPP price determination on the 2nd of July 2014. L1 Capital(L1) believes several of these submissions have mischaracterised the debate in relation to broadband prices in NZ and present our reasoning below.

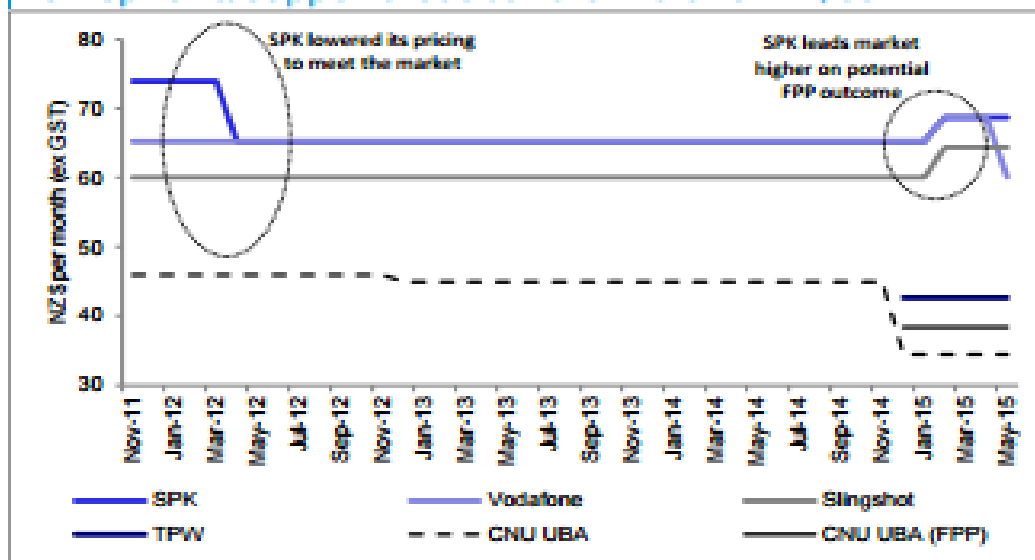
L1 notes that several parties have chosen to attack the Commission's draft pricing and call for lower charges without any substantial evidential basis rather than working within the Commission's submission process. L1 can only assume that these efforts are an attempt to subvert or unfairly influence the outcome. In doing so these parties ignore the very real impact that their retail practices have had on consumer prices.

Following the 2nd of December draft determination, the wholesale monthly line charge fell from \$44.98 to \$38.39, a saving of \$6.59 for retail service providers, but higher than the IPP decision. Despite this, Spark, Vofafone and Callplus have all **raised** prices on their broadband plans by circa \$4, with Spark first signalling an intention to raise prices in December 2014 and Vodafone following in January 2015. **Importantly, prices did not fall around the time of IPP decision as RSP's have claimed.** The only time prices have fallen is when Spark lowered its prices to meet the market price before the announcement of the UBA price reduction in December 2012 and Vodafone as a temporary promotion in May 2015. As a result gross margins have expanded for all RSP's. This is clearly seen on the chart below from a Deutsche Bank May 18th 2015 report. **The RSP's have enjoyed circa \$9 of extra gross margin per user per month since the Commission's draft FPP decision in December 2014.**



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Figure 9: Vodafone has recently dropped its entry level homephone/copper broadband bundle to NZ\$69



Source: Company data, Deutsche Bank estimates

We note that the Commission has suggested previously that it was concerned about the economic impact of backdating on competition, particularly for service providers. We would observe that service providers seem to be doing very well and are rewarding shareholders. Spark has announced a special dividend since the Commission's July decision of 3 cents per share which we estimate equates to roughly the amount of backdating that would be payable to Chorus just for the December 2014 instalment.

We reproduce the table from our August 2015 submission which highlights that RSP's are extremely well capitalized and it is very hard to justify how a one-time payment will impact their ability to invest: Below we reproduce the financials of the three largest RSP's in NZ alongside Chorus.

	Market Capitalisation	EBITDA	Dividend Paid	Stock Buybacks	Total Shareholder Returns	Net Debt	Net Debt/EBITDA	Broadband Market
	12/08/2015	2014A	2013-2014	2013-2014	2013-2014	2014A	2014A	Share
	\$NZD m	\$NZD m	\$NZD m	\$NZD m	\$NZD m	\$NZD m		Approx.
Spark NZ	5,100	936	602	282	884	562	0.55x	50%
Vodafone NZ(1)	134,000	700	150	0	150	n/a	1.10x	30%
M2 Slingshot/Orcon	2,162	179	58	n/a	n/a	254	1.6	10%
Chorus	1,080	649	0	0	0	2100	3.20x	n/a

Note: Vodafone Market capitalisation relates to parent group VOD.L

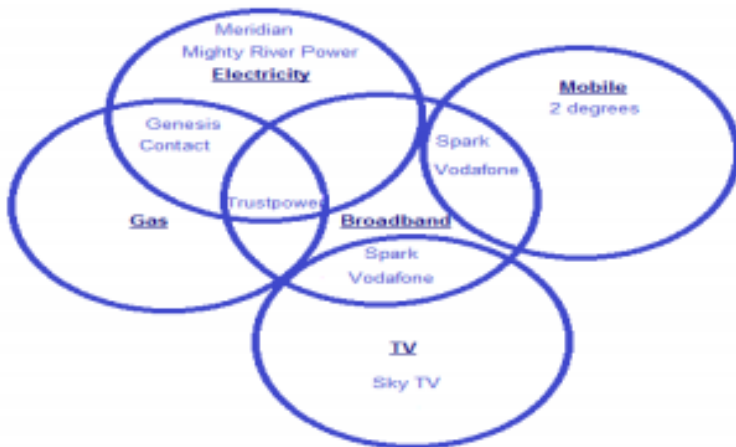


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The margin uplift of the RSP's does not benefit end users and has a far larger impact on retail prices than changes in wholesale tariffs.

The Commission does not have the regulatory power to set prices at the consumer level. **However by setting a wholesale price which is realistic and reflects real world assumptions, Commission will drive fibre adoption and create increased competitive tension in the telecommunications market, resulting in lower retail prices than under current market structure.** Setting wholesale prices appropriately will in all likelihood increase competitive customer churn in the industry as many consumers consider fibre services for the first time. Additionally the adoption of fibre products will drive widespread adoption of next generation fibre services further increasing benefit to end users. The graph below highlights all the potential new entrants under UFB (Source Deutsche Bank).

Figure 2: ...now adjacent industries looking to use Broadband to grow customers/lower churn



Source: Deutsche Bank

Trustpower (#5 NZ electricity retailer with c.12% residential electricity share) is one of the innovative new entrants which has focused on using UFB to drive competition. Although Trustpower has only 3% of existing broadband market it has circa 10% of all UFB connections. (Deutsche Bank May 18th 2015 report). The result has been an ability to bring lower retail prices to end consumers. Trustpower is currently offering the lowest rate for broadband services in the first year of contract as an incentive to switch.



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Conclusion

The Commission's draft determination has used an impossibly high efficiency standard not anchored on real world data. We call on the Commission to use actual costs and precedent in establishing trenching rates, LFI, operating costs, capital contributions and backdating, rather than continue to rely on what increasingly appear to be hypothetical rollout assumptions. In using these assumptions the Commission has added additional risk to TSLRIC process and raised the cost of capital for LFC's and for Chorus as they continue to invest in its rural copper network. This is to the detriment of end users who will have reduced ability to switch to new and innovative services as well as delaying competition from new entrants who will ultimately have the most direct impact on lowering retail prices.

Signed:

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