YARRA
CAPITAL MANAGEMENT

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To Whom It May Concern:

Re: Consultation on the Chorus PQP2 Draft Expenditure Decisions

About Yarra Capital Management

Yarra Capital Management (**YCM**) is a leading independent, privately owned active Australian fund manager, with approximately $21bn of assets under management. YCM offers its clients access to style-neutral Australian equities solutions and fixed income capabilities including core fixed income, hybrids, credit, macro and RMBS. Through its partnership with the Nikko Asset Management Group, Yarra also provides access to a range of international equity products.

Yarra serves the Australian institutional and retail markets, and its Australian investment products are accessed from various international markets, including Japan and New Zealand

YCM's investment in Chorus

Chorus Limited (**Chorus**) is a New Zealand regulated communications infrastructure company, owning New Zealand's largest fibre optic broadband network and with a regulated asset base of NZ$5.7b. Chorus has made fibre available to 1.5 million New Zealand addresses, of which 1.05 million are active.

The core of YCM's investment thesis in Chorus is based on the long-term sustainability of its cash flows, which are supported by regulatory certainty. Our investment in Chorus is premised on:

1. The quality of Chorus' fibre network and the long-term role it will play in the New Zealand economy by enabling ever growing data requirements at fast and affordable rates; and

2. A stable regulatory environment given the long development period of the regulatory framework and settings leading up to Chorus' first regulatory pricing period (RP1).

Our response to the Chorus PQP2 Draft Expenditure Decisions

As genuine, long-term investors in Chorus – and Australasian listed infrastructure more broadly – we are disappointed that the Commerce Commission has, in our view, unnecessarily introduced further uncertainty into Chorus' regulatory outcomes. Constant tinkering with regulatory settings and 'left field' changes to regulatory expenditure allowance undermine investor confidence and, ultimately, raise the cost and availability of capital to the sector.

As Chorus entered the process for its second regulatory pricing period (RP2) we were encouraged that the Commerce Commission and Chorus had agreed to appoint an independent third-party consultant to verify the company's baseline and proposed operating expenditure. We were also pleased to learn that the outcome of this review was to find that Chorus' proposed expenditure demonstrated "financial discipline". We therefore find it shocking that the Commerce Commission has seemingly ignored the findings of this independent report that the Commerce Commission itself sanctioned.

The Commerce Commission has a long-established history of dismissing individual datapoints from offshore markets put forward as evidence by the companies it regulates in various regulatory processes. We were therefore dismayed to see that the Commerce Commission has based its view of what constitutes efficient operating expenditure for Chorus off a theoretical (not actual) market review by the

UK communications regulator Ofcom. The application of arbitrary forward looking efficiency factors is completely divorced from the economic reality of managing any business and we would suggest there are limited precedents for this level of efficiency gain anywhere in the New Zealand economy over the last three years. Dismissing detailed and independent analysis of Chorus' asset in favour of an arbitrary, theoretical foreign benchmark significantly raises the spectre of sovereign risk for investors in New Zealand's regulated assets.

Our understanding and expectation of the regulatory building block model is that efficiency gains that are realised by a company during a regulatory period will be shared between regulated entities and consumers. This is a well-established framework across Australia and New Zealand and has proven to serve consumers in these countries well by incentivising ongoing efficiency. By dismissing the very analysis that confirms the efficiency of Chorus' operating cost base as, the Commerce Commission has removed the incentive for ongoing efficiency gains. In turn this make Chorus less attractive to equity investors and will impact New Zealand consumers since investors will be less likely to support ongoing investment by Chorus in its network.

The issues created by the Commerce Commission's approach on operating expense benchmarking have been compounded by a frankly non-sensical approach to the apportioning of shared costs between Chorus' copper and fibre networks. Chorus' copper connections have been rapidly declining, with the trend only accelerating in recent years. The trend is such that it is likely that at some point during RP2 that Chorus will have zero copper connections within its fibre zone.

The Commerce Commission's draft proposal blatantly ignores the economic reality of Chorus' copper/fibre mix (ie. revenue) and the rapid trend of copper disconnections. Given the draft outcome saddles one business with too much expense and the other not enough, this clearly would place material pressure on both Chorus' copper and fibre businesses. What remains of the copper business is rendered uneconomic and the level of cost cutting implied for the fibre business places at risk the delivery of services, which could hardly be seen as being in the best interests of consumers.

We appreciate the opportunity to make this submission and would welcome the opportunity to discuss these matters in more detail.

Yours sincerely,

[redacted]

Head of Australian Equities