Question and Answer

Geoff Zame
Deutsche Bank

Thank you. Geoff Zame, Deutsche Bank. Paul, congratulations anyway on a very disciplined result. It's really been a lot of belt tightening in that second half. The belt tightening seems to have been taken to extremes this week with the abstinence from sex campaign, but all the same. I just wanted to touch on the UFB costs. There's obviously a wide range of cost out there in terms of the separation. I'm really just looking at cash cost, not the non-cash cost. But can you sort of help us think about, where the chunks of value will be, where the cash burn is going in terms of the overall cost you expect over the next sort of -?

Paul Reynolds

Geoff, I can't. This scheme booklet will be out soon and that will show you how these businesses are looking. But I can't give you any forward-looking statements. I'm precluded from doing that, as you know.

Geoff Zame
Deutsche Bank

Okay, that's okay, got to ask the question all the same. Sorry, the next question was probably more for Mark Ratcliffe, just interested to know whether you've started down the path of pursuing partnerships with those areas that you're not engaged on?

Paul Reynolds

Mark?

Mark Ratcliffe

Yeah. Hi, Geoff. The answer is, yeah, we're talking to all of the parties that were successful in other parts of the country, enabled down the Christchurch the Royal Network in the Hamilton area. And those are a mixture of commercial arrangements or potential opportunities to deepen partnerships there, but we'll talk about more about that in the Scheme Booklet.

Geoff Zame
Deutsche Bank

Right. And just finally for me, you we talk about futures mobile and fiber things. Can you perhaps touch on the future of mobiles in terms of what that path looks like with LTE and things, and what the plan is there in the next sort of 12 to 24 months?

Paul Reynolds

Look, I think that over the next 12 to 24 months you're going to see the mobile industry - the issues continue to be dominated by data, 3G data towards the end of that period, clearly with release of the spectrum and we don't know on what basis the government will release the spectrum or how any allocation process will work. But it's pretty certain that we will go through yet another technology upgrades, initially probably as a part of the 3G technology, but LTE is coming. Of course we're filing for that. The hard detail is knowing detail of the Government's plans and how we participate in the allocation process. And it will be beyond your period of 24 months before there's any substantial impact in the New Zealand market. But hey Geoff, as you know, this is nothing new. The telecoms industry goes through massive technology shifts and changes and rebuilds every two or three years depending on the sector. This is what we do and boys are well in top of it and ready to go.

Geoff Zame
Deutsche Bank

Thanks.

Paul Reynolds

Thank you. Up the back there I think.

Kim Vinnell
TVNZ

Hi. Paul, Kim from TVNZ. You talk about squeezing costs; about staff cutting credit cards, that sort of thing, but you can only do that once, I mean, there is only so much fat that you can trim. What comes next? What's after that? Is there going to be more job losses other than what's sort of been indicated?

Paul Reynolds

Look, you can only do cut credit cards once, but I wouldn't like to - anybody to take the impression that the cost reductions here came from cutting out credit cards as such. That's a symbolic gesture that costs are really important to our business, to any business. We've got to be efficient. The key drivers have actually been looking at processes right first time, focusing extremely hard on how the business units work together and what the rest of the industry to deliver either provides or repairs to services really expeditiously for customers.

That's enabled us to reduce costs right across the piece. We've also been very hard at our contracts that we're seeing. We have massive what you call those contracts in the business. Dave Havercroft and his team in T&SS have looked at those in priority order. And we are - as customers are with us, we are negotiating really hard in those contracts and in some cases through renegotiation or through taking the business back into telecom, taking tens of millions of dollars of our cost base. There will be more of those to come up. There is more contracts to be renewed in the future. We'll look at more. The processes, new processes, putting them in seamlessly effectively and continuing to take - targeting ourselves to improve our failure costs by 30% a year, that's just going to take costs out of this business, getting it right first time, all flowing through on better services for customers, more reliable services for our customers, more utility in those services, faster, at lower cost, they're getting lower prices too.

Kim Vinnell
TVNZ

And just one more from me, slightly off topic, but we haven't had the chance to ask you yet, the Abstain for the Game campaign, do you think that did any sort of brand damage to Telecom?

Paul Reynolds

Hey, we feel like the best man at a wedding. He just told a slightly risqué joke, that was hilarious to his mates last night, but the bride's relatives didn't like it one bit. That's what it says. And what can you do in those situations? Say sorry and move on. But in a corporate sense given the width of what Telecom does across New Zealand and in other markets, get it in context, the big thing that our customers want is value, they want great devices, they want great services at the corporate level, they want us to be reliable and we are progressing in all of those things. That's what underpins our brand.

Kim Vinnell
TVNZ

Yeah.

Paul Reynolds

Getting it right in the community -

Kim Vinnell
TVNZ

Right.

Paul Reynolds

Which we do.

Kim Vinnell
TVNZ

But you've got to admit that the campaign sort of hit a bit of a sour note?

Paul Reynolds

We've had three days where that's been awkward, no question. And we just said stop this, move on.

Kim Vinnell
TVNZ

And just finally, what was the advice from Kevin Roberts once he started noticing this backlash, was it -

Paul Reynolds

I haven't spoken to Kevin Roberts about it at all, so let's move on. Another question in the room?

Andrew Patterson
RadioLIVE

Mr. Reynolds, Andrew Patterson, RadioLIVE. Telecom recently came in at the very bottom in a corporate RESPECT Index at New Zealand's top 25 companies. You said in your presentation that you have been successful in engaging with your customers and yet 25th place out of 25 would suggest that you haven't been successful in engaging successfully with the broader public. After the latest problems with the Rugby World Cup marketing campaign, how do you account for this current situation and doesn't it ultimately reflect on your leadership as Chief Executive of the company?

Paul Reynolds

Look, the key driver for us is do customers buy our products and services, do they want our products and services, are they buying more of our products and services? And what we see in these results is they are. We are - customer satisfaction is up, customers are getting more for less, and across mobile, across broadband, across ICT, we're achieving our goals as a business. That's what my responsibility as a Chief Executive is to do. And if you take these results in comparison with telcos like us across the world, this is a very credible set of results that I'm proud as a Chief Executive to recommend to my board, to our customers and to our shareholders. So, take a - I'll take a question from analysts, this is a shareholder call, we'll take a question from analysts. Is there anymore in the room?

Unidentified Analyst

Good morning. Look, I just had really two questions because the - just looking at the asset impairment and the non-cash write down of $297 million, the two questions that I had on that is that if I'm looking at over the last few years, Telecom's, its CapEx to sales ratio has been over 20%. You've had a significant amount of it driven by both competitive pressures, but also from regulatory pressures. I just wondered if you had - you spoke of wastage, can you put a number around the amount that has been spent as a result of operational separation that's now been overturned as a consequence of the UFB?

Paul Reynolds

Nick, do you want to have a go at that answer?

Unidentified Analyst

Because I would suggest it's probably more than $297 million.

Nicholas J. Olson
Former Chief Financial Officer

Look, there's no doubt we have spent an enormous amount on operational separation over the last three or four years. And I - and a lot of the cost is actually not obvious. It actually comes down to the friction on the organization, operationally separate units. So, the burden has been significant. And I think the best way to answer that question is to say what's happened as we have been released from the shackles of that and you see it in the result. What you see is for the last three years we've been defending shareholder value by essentially being as compliant as we possibly could through delivering undertakings. And what you see in this result is actually 8,500 people setting their minds to actually increasing long-term shareholder value.

Now, to me, that difference is night and day, and it's also shown - I think we had a low of $1.73 last year in the dark days and we're hovering around $2.50 today. That's a really significant lift in market capitalization. I think actually that probably represents the value that's possible for a free and fast moving corporate entity that isn't down by regulation.

Unidentified Analyst

Are we likely to see any write-down on the actual copper asset itself? I mean, most of this is related to the product development in the IT systems that will put in place through regulation. But given that we're moving to the fiber environment, are you anticipating that?

Nicholas J. Olson
Former Chief Financial Officer

No, there won't be any write-down of this nature. We capture in asset lives and it will be captured in depreciation over time. And there is an annual review of asset lives, it's a very rigorous review.

Paul Reynolds

Okay. Any more market questions in the room? Let's go to online.

Operator

Thank you. And the first question comes from Sameer Chopra of Merrill Lynch. Please go ahead, Sameer.

Paul Reynolds

Hi, Sameer.

Sameer Chopra
Merrill Lynch

Good morning. I had two questions probably both for Nick. The first one is the $257 million impairment, does this reduce ongoing depreciation in the business, are these short lived assets, which you would have been running through as a D&A charge going forward that you aren't going to anymore?

Nicholas J. Olson
Former Chief Financial Officer

Yes and look, I don't have the exact average life of those assets, but three to four years would be a reasonable estimate. Yes, and it will positively impact depreciation.

Sameer Chopra
Merrill Lynch

Great. And the second one was just looking at the Retail business, other OpEx has come down quite significantly down from sort of $195 million level down to $157 million, I was wondering what's driving that other OpEx down?

Nicholas J. Olson
Former Chief Financial Officer

I'd like to take the touch actually on that one, Sameer. I just don't have that off the top of my head, I'm sorry.

Sameer Chopra

Merrill Lynch

Great. Yeah, yeah.

Nicholas J. Olson
Former Chief Financial Officer

I will get the IR guys to take that up with you after the call.

Sameer Chopra
Merrill Lynch

No problem. If I can just one last one, just on mobiles, in terms of current trends in mobiles, are the ARPUs on the customers that you are signing up better than historical ARPU, I'm just trying to understand what's the run rate looking back on mobile?

Alan Gourdie

(inaudible) Gourdie speaking. Yes, if you're referring to the migration of customers from CDMA to XT.

Sameer Chopra
Merrill Lynch

That's right, yes.

Alan Gourdie

Yes. So, the ARPUs on the XT customers are significantly higher because of the migration onto smartphones and the data use and indeed roaming use on those devices. So the reality is that around about 75% of our existing current CDMA base have an ARPU of $20 or less and so what we're seeing as customers migrate onto XT with the smartphones is higher usage on a user per user basis, but as Paul has pointed out, we're also attracting higher-value customers particularly in that 75% plus bracket where growth has been about 10% and across this business in the Gen-i corporate space.

Sameer Chopra
Merrill Lynch

Great. Thank you so much, and congratulations on the result. Take care.

Unidentified Company Representative

Yes.

Operator

The next question comes from Laurent Horrut of JPMorgan. Laurent, please go ahead.

Laurent Horrut
JPMorgan

Thank you. Good morning, guys. Two questions for me. The second half '11 costs were down 7% which was really good result. I was just wondering what's the impact of the deconsolidation of AAPT within that, and the exchange rate going your way also on that, I was just looking for a bit more of a like-for-like kind of normalized DCT sort of cost run rate.

And second question is if you just could - I know you don't want to put the FY12 guidance, but how do you see sort of the consumer environment in New Zealand and how it filters through your revenue outlook for FY12? I'm just not after some specific numbers, just generally speaking, how do you see the revenue environment?

Unidentified Company Representative

Okay, so first part on the exchange rates and the AAPT cost reductions, Nick.

Nicholas J. Olson
Former Chief Financial Officer

Yeah, I am sorry, Laurent. Can you just repeat the first question for me?

Laurent Horrut
JPMorgan

Yeah, just on the cost side, so your costs year-on-year they are down 7% and I suspect that some of that was a bit helped by the deconsolidation of AAPT in the half versus last year, and the exchange rate also going your way over the period. So, I am just looking for if you normalize for these two elements what would have been the sort of year-on-year cost run rate?

Nicholas J. Olson
Former Chief Financial Officer

Well, look, like I'd say, I think we'll take that one offline. I think actually that's probably more macro material.

Paul Reynolds

Let me - firstly, I don't think the AAPT sale was in anyway the driver of the cost story, Laurent. And within AAPT the guys again did a fantastic job in the second half in reducing the cost of the AAPT business, so their share of that's coming through here, but it's in no way a driver of results. In terms of bellwethers of the New Zealand's economy, there's been a lot of commentary on that recently in households and businesses and debt positions and so forth. We are seeing really good demand for mobile broadband ITT products and services, but at sharper prices. So whereas mobile usage is going up, particularly broadband is going up significantly, we think the market in New Zealand is growing at about 1% and that's actually less than some other markets, so we are fighting for our share of the total market growing about 1%.

Corporate is looking for better value and I think Gen-i being successful in winning share of the IT service is actually growing as a market as a whole. So that's the way we see it, so there is growth, it's less than before and that's because customers are getting more for the dollar than ever before and I think our focus on customer is helping us to do well in those tight market conditions.

Laurent Horrut
JPMorgan

Okay. Paul, just a follow-up if you don't mind, just on the revenue side, is it in line within Gen-i's revenue that seems to be particularly soft for quite some time there on the data side, so what's driving that softness there?

Paul Reynolds

The data side on Gen-i, please Chris, do you' want to comment on that?

Chris Quin

Hi Sameer, it's Chris Quin speaking. Sorry, we've moved on, yeah. The managed data line in the Gen-i, I think it's basically being the price competition and the shift from copper to fiber that's being driving the revenue picture in there. This year has seen a slowing in the decline and a build back in our value of our managed data services in there. So that's what's causing that trend in that line.

Paul Reynolds

Did that answer your question, Laurent.

Laurent Horrut
JPMorgan

Yeah, it does. Thank you.

Paul Reynolds

Okay. Next question.

Operator

The next question comes from Greg Main of First New Zealand Capital. Please go ahead, Greg.

Paul Reynolds

Hi, Greg.

Greg Main
First NZ Capital

Thank you. Hello. Yeah, just a couple of questions from me, just on that depreciation charge, obviously you had the asset write-off that you've just allowed for. But is there much still coming out of accelerated depreciation related to CDMA and other assets?

Nicholas J. Olson
Former Chief Financial Officer

Well, CDMA is all but done or done. And again, Greg, we conduct a review of asset lives between March and June, so we actually took out any accelerated depreciation by the time we get to 30 June this year. So there is nothing beyond what you see in the accounts.

Greg Main
First NZ Capital

So could we look at that second half '11 depreciation rate adjusted from maybe the asset write-down of the separation investment as a run rate for FY12?

Nicholas J. Olson
Former Chief Financial Officer

I can't give you a forward-looking statement, but I can give you a generic statement that depreciation will generally follow CapEx, so you should see those trends follow each other over time.

Greg Main
First NZ Capital

Okay, thank you. And then, just secondly on T&SS, other costs came down in that part of the business and obviously you absorbed the previous outsourcing contract that would have maybe led to some of that cost declines. But was there other - was there another driver behind why that other cost came down?

Paul Reynolds

Dave Havercroft will speak to that.

David Havercroft

Yeah, hi. It's Dave Havercroft from T&SS. Yeah, the other main drivers, as Paul talked about earlier on, which is mainly the external contracts, whether that's software contracts or service contracts where we took a very laser beam focus on the OpEx nature of those contracts and we're able to reduce them over time.

Greg Main
First NZ Capital

Okay. So, some of those related to operational separation in the regulatory requirement or they -?

David Havercroft

Not in main, no they were more around the core technologies we use for our products and services. The reductions for the operational separations have been covered under the write-down.

Greg Main
First NZ Capital

Okay. And then just lastly, is there any other update on Telecom International or is that just sort of just sitting there now?

Paul Reynolds

So, on International, we've - we're looking for the sales process, but we're focused quite hard on generate some volume in that business. Rod, do you want to make an additional comment?

Rod Snodgrass

Sure. All we're really focusing on in T&SS at this point is right-sizing the business and focusing on costs. It's a market that's in decline globally. So it's really about optimizing the cost structure and also have that business supports our retail units in terms of delivery of voice.

Greg Main
First NZ Capital

Right. But by the time I think that means you're retaining it still and it's not for sale?

Rod Snodgrass

Yes. At this stage, we think we are the natural owner.

Greg Main
First NZ Capital

Okay. Thank you.

Operator

The next question comes from Richard Eary of UBS. Please go ahead, Richard.

Richard Eary
UBS

Good morning, guys.

Paul Reynolds

Hi, Richard.

Richard Eary
UBS

Just a couple of housekeeping questions. The first one is, in the presentation, I think Nick mentioned some FX impacts positively in terms of handset procurement or equipment procurement. I'm just wondering whether you can attach a dollar value to that number.

The second one was obviously in the mobile side, which was pleasing to see a return to growth in the second half. From memory, the second half last year with a lower number due to some rebates due to XT outages. I just wonder whether you can give us a like-for-like number if you stripped out those rebates.

The third question relates to your comments around changes to UBA and UCLL rates through averaging, of which you said in the commentary it could negatively impact Chorus. I don't know whether the - not to put a dollar value around it but to say whether you think that is material or not.

And then just the last question relates to costs where you obviously have done very well on, how far through this cost process of taking things out are we regardless of the demerger?

Paul Reynolds

Let me take the last question and ask Nick to comment. Obviously, the demerger of the two new businesses will be what they will be. But, Richard, my strong sense and I think I've said this to you before, is that a business like ours looking very hard, the process efficiency and effectiveness, really focusing hard on customers and Right First Time. We don't know where the end of the line is in that, we think that if you look at examples around the world, there're certainly two or three years of it, and we're nowhere near the end of the line. So we are - we go into this year with lots of ideas to go up, which we're working on and I expect it will be next year or two and the year beyond. And I'd say cost reduction never ends, but there's a lot to go out with the right degree of focus and we're getting it.

Nicholas J. Olson
Former Chief Financial Officer

Okay. Richard, the first couple of questions, FX impacts probably related to about half the improvement in cost of sales for mobile. Secondly, look, I haven't actually done the numbers, but there were some rebates to customers in Q3 and Q4 last year that weren't hugely material, so we don't consider that a swing factor in the overall mobile performance. And UBA, UCLL, probably, what's your third question, Richard.

Paul Reynolds

The UBA, UCLL. Is there a question, Richard?

Richard Eary
UBS

Yeah, the third question was, in the commentary in the MD&A, you talked about a move to an averaging environment and as a consequence that could have a negative impact on the performance of New Chorus. I'm just - I'm not interested in dollar values. I just wonder whether you think that that is a material impact or an immaterial impact that we need to take account of.

Nicholas J. Olson
Former Chief Financial Officer

I think that might fall into scheme booklet.

Paul Reynolds

Yeah. I think I have touched, Richard, we may or may not comment there on later, but no forward look, sorry. Next question?

Operator

The next question comes from Ian Martin of the Royal Bank of Scotland. Please go ahead Ian.

Ian Martin
Royal Bank of Scotland

Good morning, and thanks for doing this. Look, I've just got a question on corporate governance through the separation period and apologies if you've dealt with this at previous sessions that I've missed. But you've got this scheme booklet coming out and that and you're using that to talk or not talk about things that are going on at the moment that have enormous valuation implications, particularly the separation of value between Chorus and new Telecom. And so I just wonder, given you're not talking about those valuation things and they're very important, what the corporate governance process is to make sure that in the separation of assets, the separation of responsibilities, and so on that it doesn't - because the interest of management now are increasingly looking at, on one side, the valuation of Chorus and the performance of Chorus on one hand and new Telecom on the other. What's the process to ensure that Telecom New Zealand shareholders as they stand at the moment are best looked after in that separation, firstly?

And Paul, on a related matter, have you indicated what your intentions are for the post-separation period?

Paul Reynolds

Okay. Look, on the corporate governance first it is Telecom's Board's responsibility to get the best result possible in aggregate for shareholders, get the best result possible in aggregate for shareholders. So we've approached the UFB negotiations very much with that in mind and we have come to the conclusion that there is a deal there to be done. We will of course present that deal, we'll present the shape of these businesses for shareholders to make up their mind in the scheme booklet, and shareholders, that will clearly provide an awful lot of detail, and shareholders will have the opportunity to vote on that. So governance is the Board's responsibility, a responsibility to provide you with a lot of detail in the scheme booklet and you to vote if you agree with the propositions when we get to the shareholder vote piece.

Alongside that, of course, as you would find in any deal of this nature, we have hired - the Board has commissioned independent experts to review the deal in detail and ultimately we will share independent experts' report with shareholders so that they can take that into account as well as management and the Board's own views.

So we've negotiated hard for shareholders. We think you can see where that's gone so far. We continue to do the functioning of that with the same aggregate shareholder value in mind in terms of asset allocation and the precise details with CFH and government. You will get a good look at it in the scheme booklet and independent experts will also provide their view for you to have a look at. So that's the governance piece. What was the other half of your question?

Ian Martin
Royal Bank of Scotland

Are you going to be -

Paul Reynolds

What am I doing?

Ian Martin
Royal Bank of Scotland

Yeah.

Paul Reynolds

If you're in- unless you're in - if you're in any doubt at all, this is a quite enormous humongous process, no telco on the planet is dealing with these such a set of issues, I see a lot of nods in the room, such a set of issues at once. So the leadership challenge of leading Telecom up to and beyond demerger, that's what I am here for and I absolutely intend to stay here to do that. So, yeah, I'm committed to making this work fantastically well up to demerger for the - in aggregate, our shareholders and take Telecom through the other side.

Ian Martin
Royal Bank of Scotland

And I'm very glad to hear that, Paul. Thank you.

Paul Reynolds

Thank you.

Operator

There are no telephone questions at this time.

Paul Reynolds

Okay, anymore questions online, anymore questions in the room? One here.

Unidentified Analyst

I'm (inaudible). First of all, I was just wondering if you have sort of any sense yourself of what another global recession might mean for a big business like yourself here. And the other two questions are about debt hedge?

Paul Reynolds

Look, recession kind of have lots of effects; it can be long, it can be short, and the nature can be different than this. The activity at the minute is clearly mainly around governments and government debt, and the issues does affect corporates who are our customers, and does it affect consumers who are our customers. So far we are finding, as I've said already, corporates and consumers are buying lots of - telecommunication services are vital in going forward in the new world, they're not discretionary spends, but they're looking for great value. That continuing though, it depends of course on corporate success and individual's employment levels in the country. I don't see any sign of deterioration in those aspects at all. But who knows what, time will tell.

In terms of talking about debt, I'm more than happy to do it with you offline when we end here. This is a shareholder call.

Paul Reynolds

Anymore shareholder questions, market questions? If not, thank you very much.

Operator

Ladies and gentleman, this concludes the Telecom New Zealand full year financial results announcement conference call. Thank you for your participation. You may now disconnect.