

October 11th 2022



Chorus Limited (CNU)

The company will hold its Annual Shareholders Meeting at **10.30am Wednesday 26 October 2022.**

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 responsible for building approximately 75% of the new fibre optic network.

In November 2019 it completed UFB1 the first stage rollout to 28 major towns and cities. The second stage rollout UFB2 to 150,000 homes and businesses will be completed by the end of 2022. Fixed line connections are 1.3 million, broadband connections are 1.18 million with 959,000 fibre connections, reflecting the move from fixed line and the increase in fibre connections.

The company has announced that Chair Patrick Strange will retire at the ASM and be replaced by Mark Cross.

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

Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	G	Excellent disclosure.
Director share ownership	G	See below.
Executive Remuneration	G	See below.
Golden parachutes/handshakes	A	Not disclosed if these or similar payments are offered.
Director Independence	G	All Directors are independent.
Board Composition	A	See below.
Director Tenure	G	See below. All Directors have served less than 9 Years.
ASM Format	G	
Independent Advice for the Board	G	See below.

Director 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 FY2022.

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 reduces the pool of available directors, may compromise independence and removes the ‘market signal’ associated with share purchases.

The timeframe 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 2021), the 3-year total shareholder return will need to be 6.2% CAGR to August 2024. NZSA notes that the first LTI tranche for the CEO (awarded in FY20) will be assessed during the FY23 year with possible re-testing in FY24.

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.

Golden parachutes/handshakes: In the interests of transparency, NZSA believes there should be explicit disclosure around the severance terms associated with the CEO, including whether specific termination payments are offered.

Board Composition: 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.

Director Tenure: 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.

For Chorus, all directors have been appointed between 2015-21, showing a strong commitment to the managing risks associated with succession

Independent Advice for the Board: 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.

Audit

NZSA assessment against its key policy criteria is summarised below:

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

Audit Rotation: 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. The company has confirmed that FY22 is the first year for the current auditor.

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
Dividends and Imputation	G	Good disclosure.
Capital Raise process	n/a	<i>n/a if no capital raised</i>
Takeover or Scheme	n/a	<i>n/a if no takeover</i>

Chorus's share price rose from \$6.55 to \$7.56 (as of 27th September 2022) over the last 12 months – a 15% increase. This compares very favourably with the NZX 50 which declined by 14% in the same period. The capitalisation of CNU is \$3.4b placing it 18th out of 130 companies on the NZX by size and makes it a large company.

Metric	2022	2021	Change
Revenue	\$965m	\$947m	2%
EBITDA	\$675m	\$649m	4%
NPAT	\$64m	\$47m	36%
EPS ¹	\$0.143	\$0.105	36%
PE Ratio	53	62	
Capitalisation	\$3.4b	\$2.9b	15%
Current Ratio	0.50	0.44	15%
Debt Equity	4.68	5.18	-10%
Operating CF	\$570m	\$556m	3%

Cash flow (cps)	\$1.28	\$1.24	3%
NTA Per Share ¹	\$1.83	\$1.75	4%
Dividend Per Share ¹	\$0.35	\$0.25	40%

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

All the metrics we measure improved for CNU during the 2022 financial year. This improvement was reflected in the share price, underpinned by regulatory certainty. Chorus shares have bucked the declining market.

Revenues were up 2% to \$965m and NPAT increased by 36% to \$64m providing shareholders with EPS of \$0.143.

Operating cashflows were up by 3% to \$570m and these (or to be more precise the expectation of these), are the driver for the valuation of Chorus. Measured in cent per share, operating cashflows were \$1.28.

NTA per share is \$1.83 and CNU trade at a large 313% premium to their NTA.

Of note it is interesting to see that dividends paid by CNU are in excess of EPS, with the dividend policy based on operating cashflow. Chorus had large cash flows but also a very large depreciation expense (\$335m). Depreciation is a non-cash item and affects EPS, but not the ability to fund the dividend payment. Chorus' practice implies that it believes it has the ability to replace assets at a rate less than depreciation or alternative seek additional funding when required.

Dividend payments increased by 40% to \$0.35.

Due to the low EPS and tax payments dividends are not imputed.

CNU have relatively high debt levels with their debt equity ratio at 4.68 (5.18). Two items called Crown Funding and Crown Infrastructure Partners Securities comprise \$1,522m of non-current liabilities. In addition, interest bearing debt decreased slightly to \$2,132m. Total non-current liabilities are \$4,323m. This is large when compared to total equity of \$1,029m.

CNU [provided guidance](#) for FY23, when announcing their FY22 results. This guidance is subject to no material changes in regulatory or competitive outlook. Earnings guidance is similar to FY22, but projected capital expenditure is lower. Dividend guidance has also been lifted however no imputation credits are expected in the short to medium term.

- EBITDA: \$655 to \$675m million
- Capital Expenditure: \$410-\$450 million
- FY23 dividend guidance of 42.5 cents per share
- FY24 a minimum dividend of 47.5 cents per share

Resolutions

1. To re-elect Mark Cross as an Independent Director.

Mark Cross was appointed to the Board in November 2016. He was Chair of Milford Asset Management, retiring 1 July 2022 and is currently a board member and investment committee chair of Accident Compensation Corporation (ACC) and director of Xero. He is also a former director of Z Energy, Genesis Energy and Argosy Property.

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

2. To re-elect Sue Bailey as an Independent Director.

Sue Bailey was appointed to the Board in October 2019. She has worked for Telstra, Virgin Mobile and most recently for Optus where she was a member of the executive leadership team. From 2010 to 2013, Sue was the CEO for Virgin Mobile Australia, a fully owned subsidiary of Optus. Prior to that, she was a Senior Vice President at Virgin Mobile USA with Telstra where she held a range of marketing and product roles. She is a director of CareFlight and a member of the Australian Institute of Company Directors.

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

3. To elect Will Irving as an Independent Director.

Will Irving is the Chief Strategy and Transformation Officer at NBN Co Limited in Australia, the company established to design, build, and operate Australia's wholesale broadband access network. Prior to that, he held wholesale and retail customer sales and service roles as Interim CEO of Telstra InfraCo, Group Executive of Telstra Wholesale and Group Managing Director of Telstra Business. Prior to his commercial management roles, he was Group General Counsel of Telstra.

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

4. 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 **10.30am Monday 24 October 2022**.

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

The Team at NZSA