

October 11<sup>th</sup> 2024



## **Chorus Limited (CNU)**

The company will hold its Annual Shareholders Meeting at **10.00am Thursday 24 October 2024.**

It will be a virtual only meeting. You can join the meeting [at this link](#).

### **Company Overview**

Chorus is a provider of telecommunications infrastructure. The company was de-merged from Telecom New Zealand in 2011 as a condition of winning the majority of contracts for the Government's 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.

In August 2024, the company announced Neal Barclay would join the Board as an independent Director and Murray Jordan would retire after serving 9 years.

### **Current Strategy**

The immediate focus in Horizon 1 (FY25) is both cementing and leveraging the new operating model. Horizon 2 (FY26– FY29) will focus on delivering effective asset management and prudent, efficient fibre investment. Horizon 3 (FY30 and beyond) will see a single future state technology with the complete retirement of the copper network and becoming an all-fibre infrastructure business.

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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	See below.
Director share ownership	G	See below.
CEO Remuneration	G	See below.
Director Independence	G	All Directors are independent.
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	R	Virtual only.
Independent Advice for the Board and Risk Management	G	See below.

**Directors Fees:** Excellent disclosure. We note that the Board Charter states that *“the Board may pay additional fees and allowances to a Director to reflect additional services provided.”* We note, though, that no such payments were made in FY24 or in recent financial years.

The Director Fee Pool and individual Directors Fees were approved by shareholders at the 2019 ASM. During the year, the Board commissioned an independent Report from PwC and is seeking approval from shareholders to increase the Fee Pool by 17% at the ASM.

**Director Share Ownership:** Chorus’ Minimum Shareholding Policy sets the expectation on directors to hold, at a minimum, shares equal in value to one year’s director base fee (after tax). *“If not held at their date of appointment, the policy expects directors to accumulate this holding over the first three years from that date.”*

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 believes that ability is not defined solely by wealth. In this context, however, we observe that the company operates a [Minimum Shareholding Policy](#) with the Chair holding discretion to waive the requirement depending on a director’s personal circumstances.

**CEO Remuneration:** The company provides a good overview of remuneration strategy, principles and policies within the Annual Report.

**Incentives:** The CEO is paid a base salary and a short-term incentive (STI), both in cash, and a long-term incentive (LTI) by way of performance share 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 versus target for each component associated with any awards. This methodology is supported by the new [NZX Remuneration Reporting Template](#).

For both STI and LTI, the measures, weighting and achievement against targets are clearly set out in the Annual Report. We also note that the company offers clarity in terms of comparing incentives *earned/awarded* as compared with what was actually *paid/vested*.

The new CEO (formerly the COO) will receive his first LTI grant as CEO in August 2024, with the grant value equivalent to 55% of base salary, an increase from the 33% award basis for the previous CEO. Vesting is based on proportionate achievement of (absolute) total shareholder return over three years compared with Chorus' cost of capital.

NZSA notes the increased weighting towards LTI, but observes that the STI opportunity remains greater than LTI (at award). NZSA prefers a clear weighting towards LTI to align with the long-term interests of shareholders.

**Golden Parachutes:** Chorus offers best-in-class disclosure of the severance conditions and associated notice periods for the CEO in the Annual Report.

**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.

Director appointment dates range from 2015 to 2024.

**ASM Format:** NZSA prefers 'hybrid' ASM's (i.e., physical, and virtual) as a way of promoting shareholder engagement while maximising participation. The company has experienced extremely low turnouts to physical meetings in prior years, and has clearly made a trade-off in favour of cost savings. CNU's response is a clear reminder and encouragement to shareholders to maintain strong engagement with their investments.

**Independent Advice for the Board & Risk Management:** 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. 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	See below.

**Audit Rotation:** The company ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules. 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	A

**Overall approach:** Chorus has produced sustainability reports since 2021. In NZSA’s first assessment of Chorus’ environmental sustainability reporting, in 2023, we noted the Company’s strong performance when it came to sustainability disclosures, despite describing itself as being in the early stages of their environmental reporting journey.

In 2024, supplementary to their traditional Sustainability Report, Chorus have prepared their first Climate-related disclosures. In this document, Chorus builds on their previous progress, achieving well in all areas and improving their provision of external assurance. We note that the company has adopted some adoption provisions related to the CRD regime. NZSA considers this an appropriate step in the company building its capability to meet full disclosure.

NZSA policies encourage issuers to take a “broad approach” to environmental risks; this may result in disclosures that offer more insight into relevant environmental risks for the business beyond climate change. Chorus demonstrates a strong commitment to this approach.

Sustainability Governance: The company provides a board skills matrix in their 2024 Annual Report which gauges Board experience in seven key areas, although none specifically relate to sustainability. They do dedicate human resources to sustainability issues by way of their Sustainability Team

Strategy and Impact: Chorus describe their sustainability strategy as accelerating climate mitigation and adaptation through various measures, such as measuring and reducing their impact, understanding climate scenario analysis and keeping their network resilient through understanding their climate risks. They demonstrate this through their evidence of capital investment to support their mitigations - and are in the minority of companies that have also disclosed an environmental transition roadmap.

Risk and Opportunity: Chorus identify their environmentally related risks as physical and transitional risks. Their coverage of their responses to their identified risks is good, although we note the limited focus on ‘opportunity’.

Metrics and Targets: Chorus disclose their GHG Emissions profile across Scope 1 to 3 with a good breakdown of contributors to their emissions. They also disclose multiple other environmental metrics with a detailed breakdown. Accordingly, they have also disclosed a wide range of science-aligned environmental performance targets.

Assurance: While Chorus has made progress by seeking external assurance, it is limited to just their GHG Inventory and not the entirety of their climate-related disclosures.

### 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

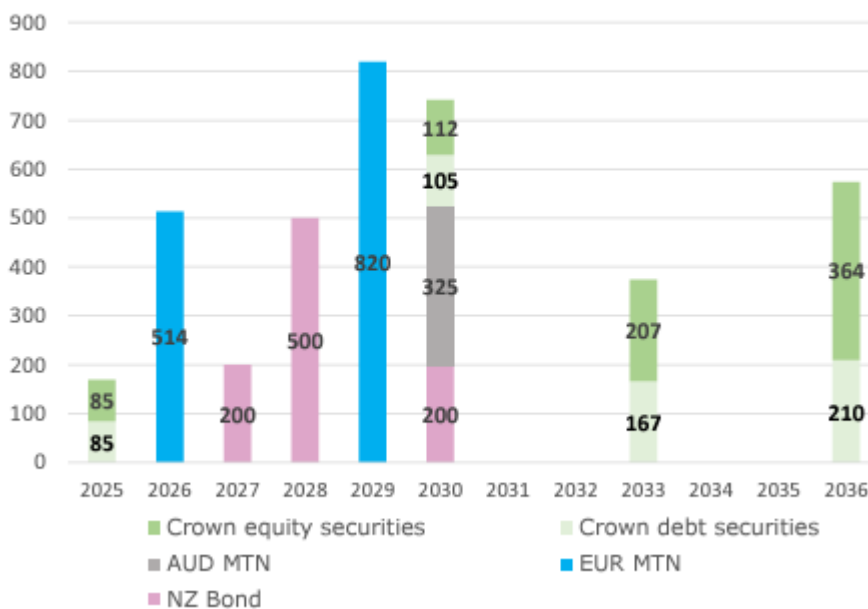
Policy Theme	Assessment	Notes
Capital Management	G	A clear prioritisation of cash generation – see commentary below
Takeover or Scheme	n/a	

**Capital Management:** From disclosures, it is clear that the company has spent some time on its future capital management strategy, as it changes focus from ‘builder’ to ‘operator’.

CNU have relatively high debt levels, with their *debt-equity* ratio at 6.15 (4.80), inflated by two items related to Crown Funding and Crown Infrastructure Partners Securities comprising \$1,485m of non-current liabilities. It is important to note that this funding does not attract interest – although the first principal repayment is due in FY25.

Interest bearing debt increased to \$2,626m during FY24, mostly to fund growth as the company moves from ‘builder’ to ‘operator’. Total non-current liabilities are \$4,631 - relatively large when compared to total equity of \$841m, but more useful to consider in the context of the interest-free funding and Chorus’ role as a relatively stable utility service provider. The company’s debt maturity profile (below) highlights the 10-year repayment and/or debt rollover profile.

### Debt maturity profile



Dividends paid by CNU are in excess of EPS. Chorus has large cashflows, but also very large depreciation expenses (\$374m). Depreciation is a non-cash item and affects EPS, but not the ability to fund the dividend payment. Dividend payments are based on 70-90% of Free Cashflow – an increase from the prior range of 60-80%. They increased by 12% to \$0.475 and are expected to increase again in FY25. Due to the low EPS and minimal tax payments, dividends are **not** imputed.

Chorus could look to alternative and more tax efficient means of returning excess cash to shareholders. The share buyback program which was operating last year is no longer in place, although NZSA did express some concern at the concurrent operation of both a buyback and dividend reinvestment plan. We note the DRP has ceased, and the company has explicitly highlighted the potential for share buybacks or discretionary growth capex in investor presentations.

**Financial Summary:** Chorus's share price rose from \$7.70 to \$9.00 (as of 19<sup>th</sup> September 2024) over the last 12 months – a 17% rise. This compares favourably with the NZX 50 which rose by 11% in the same period. The capitalisation of CNU is \$3.9b placing it 17<sup>th</sup> out of 124 companies on the NZX by size and makes it a large company.

Metric	2021	2022	2023	2024	Change
Revenue	\$947m	\$965m	\$980m	\$1,010m	3%
EBITDA	\$649m	\$675m	\$672m	\$700m	4%
NPAT	\$47m	\$64m	\$25m	-\$9m	n/a
EPS <sup>1</sup>	\$0.105	\$0.143	\$0.057	-\$0.021	n/a
PE Ratio	62	53	129	n/a	
Capitalisation	\$2.9b	\$3.4b	\$3.2b	\$3.9b	22%
Current Ratio	0.44	0.50	0.40	0.37	-6%
Debt Equity	5.18	4.68	4.80	6.15	28%
Net Equity	\$948m	\$1,029m	\$1,063m	\$841m	-21%
Operating CF	\$556m	\$570m	\$524m	\$513m	-2%
Cash flow (cps)	\$1.24	\$1.28	\$1.20	\$1.18	-2%
NTA Per Share <sup>1</sup>	\$1.75	\$1.83	\$1.97	1.46	-26%
Dividend Per Share <sup>1</sup>	\$0.25	\$0.35	\$0.425	\$0.475	12%

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

**Revenues** were up 3% to \$1,010m and **EBITDA** rose 4% to \$700m, but a large tax expense of \$30m contributed to a negative **NPAT** of -\$9m giving **EPS** of -\$0.021.

**Operating cashflows** were down 2% to \$513m and these (or to be more precise, the expectation of these), are the driver for the valuation of Chorus. Operating cashflows were \$1.18 per share.

**NTA** per share fell substantially to \$1.46 and CNU trade at a large 518% premium to their NTA.

CNU provided positive guidance for FY25 in a comprehensive [investor presentation](#) when announcing their FY24 results.

- EBITDA: \$700m to \$720m
- Capital Expenditure: \$400-\$440 million
- FY25 dividend guidance of 57.5 cents per share (unimputed)

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

## Resolutions

### 1. To re-elect Miriam Dean as an Independent Director.

Miriam Dean was appointed to the Board 27 October 2021. She is a King's Counsel and independent director with experience in commercial dispute resolution and governance, with a specialty in competition, consumer, and regulatory law. Miriam also has significant experience in



the infrastructure and regulatory sectors and in leading various government and private sector inquiries and reviews. Her previous roles were Director Crown Infrastructure Partners, Chair NZ on Air, Deputy Chair Auckland Council Investments, Deputy Chair Commerce Commission. Current roles include Director Rau Paenga (Crown Infrastructure Delivery), Chair Banking Ombudsman Scheme, Deputy Chair Real Estate Institute of New Zealand; Member of several government-related advisory boards.

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

**2. To elect Neal Barclay as an Independent Director.**

Neal Barclay was appointed to the Board 26 August 2024 and is therefore required to offer himself for election. He has extensive executive experience in the electricity and telecommunications industries in New Zealand having been Chief Financial Officer, GM of Generation and Development and GM of Retail at Meridian Energy. Neal spent 13 years at Telecom New Zealand in a number of senior finance leadership roles. Neal is Chief Executive of Meridian Energy, a position he has held since January 2018. Meridian Energy is New Zealand's largest electricity retailer and generator and has a market capitalisation amongst the top two or three NZX listed companies.

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

**3. To increase the Director Fee Pool by 17% from \$1,169,042 to \$1,365,000**

The current fee pool was approved by shareholders at the 2019 ASM. The Board had commissioned PwC to prepare an independent Report and a link to this is contained in the Notice of Meeting. The Report includes comparator data from 13 companies.

We note that the proposed fee level is well above the top end of the range assessed by NZSA. However, this is artificially low due to the somewhat unique arrangements CNU has with the Crown as a funding partner. The proposed fees are more in line with expectations when this funding is included.

The Notice of Meeting states that there are no planned increases to Director Fees in FY25. The fee increase allows for more effective succession management, future inflation adjustments and 'headroom' more in line with comparator benchmarks.

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 **10.00am Tuesday 22 October 2024.**

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

**The Team at NZSA**