PARADICE
INVESTMENT MANAGEMENT

2nd September 2016

Telco Review Team
Communications Policy
Ministry of Business, Innovation and Employment
PO Box 1473
WELLINGTON

To Whom It May Concern,

We refer to your "Options Paper" release dated 12 July 2016. Paradice Investment Management ("PIM") is pleased to provide a submission in response to this release.

PIM is a Fund Manager with offices in Sydney, Denver and San Francisco that manages $11.9bn NZD in Equities in the form of 3 Australian based funds (with mandates to invest in Australian and New Zealand equities) and a Global Mid and Small Cap Fund. PIM was established in March 2000 and is wholly owned by its staff members. We have a track record in all of our products of providing superior risk adjusted returns for our clients.

PIM has been an active investor in New Zealand equities for the last decade. We currently hold $340m NZD in New Zealand based equities, including an investment in Chorus. We are also major investors in many Australian based regulated infrastructure assets.

Infrastructure assets are clearly an important part of any economy and are long duration in nature. In order to attract our investment dollars we feel that a number of factors are important for these assets:

- There must be certainty in the regulatory environment and outcomes.
- There must be consistency in the way that they are regulated.
- They must generate a fair return relative to their true cost and market asset values.
- Any regulation and reviews must be dealt with in a timely manner.
- Most importantly, the assets shouldn't be subject to any major surprises or shocks which generate significant volatility around those assets.

In this context it is worthwhile looking to the approach adopted within the Australian regulated infrastructure environment. In this case we have seen the consistent adoption of a building block based model which has gradually been honed over the years to produce consistent and expected outcomes in returns for all of the various assets. It is a testament to the current system that we have recently seen a number of resets of listed regulated assets take place without significant share price volatility being attached to them.

The recent Australian experience has been in contrast to the experience of the regulation of the Chorus copper assets over recent years where we have seen:

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- A drawn out timeframe that lasted almost 4 years.
- Consistent changes in methodology.
- Inconsistent interpretations of the pricing and recoupment impacts around changes in this methodology.
- Questionable assumptions around the valuation applied to the Copper network.
- Huge share price volatility around what should be a stable infrastructure investment.

From a PIM perspective we only made our investment in Chorus after the release of the draft FPP prices in December 2014. Prior to this we did not view the stock as being investment grade due to the considerable uncertainty and ambiguity that we had seen in the regulation process. Another example of unnecessary uncertainty being created was the proposed regulation changes to a single buyer model for the electricity market. This showed a lack of consideration for the cost of capital, as an asset, depreciated or not, should deliver a suitable return on its underlying market value.

In regards to the coming regulation of the fibre network we would make the following observations:

- A clear and well defined framework for the process should be provided as soon as is feasible in order to provide certainty to investors. The drawn out process that took place with the copper network should be avoided at all costs.
- The framework should be based on a building block model and should draw from the learnings of the process for regulating the copper network.
- The model should provide a consistent treatment and predictability whereby investors are able to make assessments around returns based on the current economic settings which should produce a similar outcome to the final regulatory outcome.
- The starting point for the Regulated Asset Base ("RAB") is the key to the process. The government should determine the RAB upfront as part of this process or be very clear on how it is to be implemented so as to avoid price shocks and achieve the price stability referred to in the discussion document.
- The RAB should be realistic rather than set under theoretical best possible case conditions. By 2020 the network would have just been completed under a process whereby construction was outsourced by competitive tender, hence the actual cost to build the network should be a reasonable proxy for this component of the overall RAB.
- Any existing assets that have been contributed to the building of the network need to be included in that RAB calculation. In particular, given the copper network will continue to service a large part of the community, it is important that due valuation and returns be allowed for this asset in order to encourage continued investment here.
- Investors need to achieve a return on these assets that is attractive in the given market environment. If an acceptable return on the assets is not allowed than as shareholders we would find it difficult to support the company's ongoing investment in the network.
- The outcome of the process should not be politicised. Investors, who have effectively funded the build, should not then have their funding gifted to consumers. Any move in this direction would likely have dire consequences for any future funded publicly infrastructure spending in New Zealand.

PIM very much appreciates the opportunity to participate in this submission. Should you have any enquiries please contact me on +612 8227 7407 or matthew.riordan@paradice.com.au.

Yours sincerely,

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