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APPRAISAL REPORT IN RESPECT OF THE CHIEF EXECUTIVE OFFICER'S EQUITY-BASED INCENTIVE SCHEMES

1. Introduction

1.1 Background

Telecom Corporation of New Zealand Limited (**Telecom** or the **Company**) is listed on the main board equity security market (**NZSX**) operated by NZX Limited with a market capitalisation of $5.0 billion as at 17 August 2012 and unaudited total equity of $1.9 billion as at 31 December 2011.

Telecom was formed in 1987 out of the telecommunications division of the New Zealand Post Office, a government department.

On 30 November 2011, the Company demerged into 2 separate publicly listed companies:

- Telecom – a retail services provider
- Chorus Limited – a network services operator.

1.2 Chief Executive Officer Remuneration

Appointment of Chief Executive Officer and Managing Director

Telecom announced on 23 April 2012 that it had appointed Simon Moutter to the role of Chief Executive Officer and Managing Director of Telecom.

Mr Moutter commenced in the role on 13 August 2012.

Remuneration Package

Mr Moutter and Telecom entered into an employment agreement dated 22 April 2012 (the **Employment Agreement**). Mr Moutter's remuneration consists of a mixture of fixed remuneration plus short term and long term incentive remuneration. The key components of his remuneration package for the 2013 financial year are set out below. The remuneration package will be reviewed annually.

Base Remuneration		Annual Performance Incentive		Performance Equity Incentive		Long Term Incentive
$1,350,000 p.a.	+	Target value: $750,000 p.a.	+	Target value: $600,000 p.a.	+	Target value: $1,000,000 p.a.
		Maximum value: $1,312,500 p.a.		Maximum value: $1,050,000 p.a.		

p.a.: per annum

Annual Performance Incentive

Mr Moutter's remuneration package includes an annual short term performance incentive in the form of $750,000 in cash if he meets the targets (the **Targets**) set by Telecom's board of directors (the **Board**).

The annual short term performance incentive cash payment may increase if Mr Moutter significantly exceeds the Targets, up to a maximum of $1,312,500 per annum (being 175% of the target value).

The short term performance incentive payment will be pro rated for the 2013 financial year from 13 August 2012.

Performance Equity Incentive

Mr Moutter's remuneration package also includes an annual performance equity incentive in the form of redeemable ordinary shares with a target value of $600,000 for achievement of the Targets (the **Performance Equity Scheme**).

The value of the award under the Performance Equity Scheme may increase if Mr Moutter significantly exceeds the Targets, up to a maximum of $1,050,000 of redeemable ordinary shares per annum (being 175% of the target value).

The award under the Performance Equity Scheme will be pro rated for the 2013 financial year from 13 August 2012.

Long Term Incentive

Mr Moutter will also be eligible for a long term incentive of $1,000,000 annually in the form of share rights with a zero exercise price (the **Performance Rights Scheme**).

The ability for any share rights to vest (and then be exercised to acquire ordinary shares) and the number of share rights that will vest following the end of the vesting period is dependent on meeting performance hurdles to be determined by the Board (the **Performance Hurdles**):

- of the share rights granted in 2012, 50% will be eligible for vesting after 2 years and 50% after 3 years
- share rights granted in 2013 and subsequent years will be eligible for vesting after 3 years from the date of grant.

Mr Moutter will also receive a one-off grant of share rights in September 2012 with a value of $750,000 (the **Additional Rights Grant**) which will also be issued pursuant to the Performance Rights Scheme. This grant vests in 2 tranches:

- the first half after 12 months
- the second after 24 months.

We refer to the Performance Equity Scheme and the Performance Rights Scheme collectively as the **CEO Share Schemes**.

Annual Review of Remuneration

Mr Moutter's total remuneration will be reviewed at the end of the 2013 financial year (effective 1 July 2013) and at the end of each financial year thereafter. The target values and amounts set out above apply for the 2013 financial year and subsequent payments and grants may be based on revised target values in line with any future adjustment to Mr Moutter's remuneration package and components.

1.3 Regulatory Requirements

Listing Rule 7.3.1 of the NZSX Listing Rules states that no Issuer shall issue any Equity Securities unless the precise terms and conditions of the specific proposal to issue those Equity Securities have been approved by separate resolutions (passed by a simple majority of votes) of holders of each Class of Quoted Equity Securities of the Issuer whose rights or entitlements could be affected by that issue.

NZSX Listing Rule 6.2.2(b) requires an Appraisal Report to be prepared where a meeting will consider a resolution where more than 50% of the securities to be issued will be acquired by directors of the Issuer.

Mr Moutter, who was appointed to fill a vacancy on the Board, retires and offers himself for election as a director at the Company's annual meeting.

Listing Rule 10.14 of the ASX Limited (**ASX**) Listing Rules states that an entity must not permit a director of the entity to acquire securities under an employee incentive scheme without the approval of holders of ordinary securities of the acquisition.

ASX Listing Rule 10.14 requires that the notice of meeting to obtain approval must comply with ASX Listing Rule 10.15A which mandates a number of disclosures such as the maximum number of securities that may be acquired and the formula for calculating the number of securities to be issued.

1.4 Annual Meeting of Shareholders

Shareholders will vote on 2 ordinary resolutions in respect of the CEO Share Schemes at Telecom's annual meeting of shareholders on 28 September 2012:

- the issue to Mr Moutter during the 3 year period to 27 September 2015 of in total up to 1,000,000 shares in Telecom under the Performance Equity Scheme (comprising redeemable ordinary shares and, where contemplated by the scheme, ordinary shares) (*resolution 5*)

- the issue to Mr Moutter during the 3 year period to 27 September 2015 of in total up to 2,500,000 share rights to acquire Telecom ordinary shares under the Performance Rights Scheme (*resolution 6*).

Only the Company's shareholders not associated with Mr Moutter (the **Non-associated Shareholders**) may vote on the resolutions.

1.5 Purpose of the Report

The directors of Telecom not associated with Mr Moutter (the **Non-associated Directors**) have engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Appraisal Report on the fairness of the CEO Share Schemes in accordance with NZSX Listing Rule 6.2.2(b).

Simmons Corporate Finance was approved by NZX Market Supervision on 9 July 2012 to prepare the Appraisal Report.

Simmons Corporate Finance issues this Appraisal Report to the Non-associated Directors for the benefit of the Non-associated Shareholders to assist them in forming their own opinion on whether to vote for or against the resolutions in respect of the CEO Share Schemes.

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the fairness of the CEO Share Schemes in relation to each shareholder. This report on the fairness of the CEO Share Schemes is therefore necessarily general in nature.

The Appraisal Report is not to be used for any other purpose without our prior written consent.

All references to $ are to New Zealand dollars.

2. Evaluation of the Fairness of the CEO Share Schemes

2.1 Basis of Evaluation

NZSX Listing Rule 1.7.2 requires an Appraisal Report to consider whether the consideration and the terms and conditions of the CEO Share Schemes are fair to the Non-associated Shareholders.

There is no legal definition of the term *fair* in New Zealand in either the NZSX Listing Rules or in any statute dealing with securities or commercial law.

In our opinion, the CEO Share Schemes will be fair to the Non-associated Shareholders if:

- the shares issued to Mr Moutter under the CEO Share Schemes represent a fair level of incentive remuneration to Mr Moutter when viewed as part of his total remuneration package
- the terms and conditions of the CEO Share Schemes are fair
- there are no material negative impacts on the Non-associated Shareholders.

We have evaluated the fairness of the CEO Share Schemes by reference to:

- the rationale for the CEO Share Schemes
- the value of the CEO Share Schemes to Mr Moutter
- the terms and conditions of the CEO Share Schemes
- the impact of the CEO Share Schemes on shareholding levels
- the impact of the CEO Share Schemes on Telecom's share price.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.

2.2 Opinion on the Fairness of the CEO Share Schemes

In our opinion, after having regard to all relevant factors, the consideration and the terms and conditions of the CEO Share Schemes are fair to the Non-associated Shareholders.

The basis for our opinion is set out in detail in sections 2.3 to 2.11. In summary, the key factors leading to our opinion are:

- the rationale for the CEO Share Schemes is sound. The Performance Equity Scheme and the Performance Rights Scheme seek to provide long term equity incentives to Mr Moutter which align his interests with those of the Non-associated Shareholders

- the overall remuneration level for Mr Moutter appears to be reasonable
- the terms and conditions of the Performance Equity Scheme are reasonable:
  - the issue of equity in the form of redeemable ordinary shares aligns Mr Moutter's interests with those of the Non-associated Shareholders
  - the Targets (assuming they are similar to those adopted in recent times) represent a reasonable basis upon which to evaluate Mr Moutter's performance and to determine the level of incentive award
  - the redeemable ordinary shares are subject to a 2 year restrictive period where Mr Moutter cannot dispose of the shares
  - the redeemable ordinary shares can be redeemed by Telecom in certain circumstances if Mr Moutter ceases to be employed by the Company
  - the Performance Equity Scheme will only have value to Mr Moutter to the degree that the Targets are met. To the extent that the Targets are not met, then Mr Moutter will derive reduced value from the scheme
- the terms and conditions of the Performance Rights Scheme are reasonable:
  - the issue of equity in the form of share rights aligns Mr Moutter's interests with those of the Non-associated Shareholders
  - the Performance Hurdle (based on relative total shareholder return (**TSR**) for the 2012 grant) is an appropriate basis upon which to determine whether the share rights vest
  - the vesting period of up to 3 years after each grant date provides a suitably long term incentive period
  - the Performance Rights Scheme will only have value to Mr Moutter if the Performance Hurdles are met. In the event that the Performance Hurdles are not met, then no share rights will vest and Mr Moutter will derive no value from the scheme
- the Additional Rights Grant is not subject to meeting any Performance Hurdles. Accordingly it represents a one-off grant of $750,000 of share rights to Mr Moutter, with 50% of the share rights vesting one year after their grant and the remaining 50% vesting 2 years after their grant. Accordingly, Mr Moutter will not derive any economic benefit from the Additional Rights Grant until at least one year after their grant
- the potential dilutionary impact of the CEO Share Schemes on Non-associated Shareholders is negligible at 0.19%
- the shares issued under the CEO Share Schemes are unlikely to have any material impact on Telecom's share price or the liquidity of its shares
- if the resolutions in respect of the CEO Share Schemes are not approved, then each right/entitlement will be paid in cash at the equivalent value. The cash payments will be subject to the same terms and conditions to which any equity would have been subject and will be paid at the same time as any rights/entitlements in respect of equity would have vested.

2.3 Rationale for the CEO Share Schemes

In general terms, companies provide equity-based long term executive incentive remuneration to tie executives' remuneration to the annual and long term performance of the company and to align the interests of the executives with those of shareholders. Key perceived benefits to the company include:

- equity-based long term executive incentive remuneration helps to attract and retain top executives
- it enables executives to build equity ownership in the company
- executives' interests are more closely aligned with shareholders' interests.

There has been growing criticism in New Zealand and abroad in respect of the equity-based incentive remuneration. The criticisms centre around:

- the lack of performance hurdles and/or inadequate explanation of performance hurdles
- the length of term for the equity-based incentive remuneration being too short and hence not aligning with shareholder interests
- already generous remuneration for executives.

In structuring Mr Moutter's remuneration package, the Board aimed to create an appropriate balance between the fixed and variable components so that a substantial proportion of Mr Moutter's remuneration related to his performance and that of the Company. The Board also ensured that a significant proportion of Mr Moutter's remuneration package would be paid through the issue of equity securities to align his interests with those of the Non-associated Shareholders.

In our view, the rationale for the CEO Share Schemes as a component of Mr Moutter's remuneration package is sound:

- it is designed to align the interests of Mr Moutter with those of the Non-associated Shareholders, with just under half of his annual remuneration package being payable in the form of equity
- it forms an integral component of Mr Moutter's variable remuneration, which represents almost two thirds of his total remuneration package
- it aims to provide a long term incentive, thus aiding in the retention of Mr Moutter.

2.4 Mr Moutter's Remuneration Package

Although the focus of our evaluation is primarily on the CEO Share Schemes, consideration needs to be given to the overall level of remuneration for Mr Moutter.

A summary of Mr Moutter's target annual remuneration for the 2013 financial year (before proration) is set out below.

Mr Moutter's Target Annual Remuneration for 2013 Financial Year

	Cash ($000)	Equity ($000)	Total ($000)	Total %
Fixed remuneration	1,350	–	1,350	36.5%
Variable remuneration				
Annual performance incentive	750 [1]	–	750	20.3%
Performance Equity Scheme	–	600 [2]	600	16.2%
Performance Rights Scheme	–	1,000 [3]	1,000	27.0%
Total	750	1,600	2,350	63.5%
Total remuneration	2,100	1,600	3,700	100%
- %	56.8%	43.2%		

1 Based on 100% of target value
2 Based on 100% of target value
3 Excluding the Additional Rights Grant

The annual performance incentive and Performance Equity Scheme amounts are before any proration (to reflect that Mr Moutter did not commence in the role until 13 August 2012) and are based on the Targets being met (but not exceeded).

The level of annual variable remuneration from the annual performance incentive and the Performance Equity Scheme can vary from nil (based on the Targets not being met at all) to 175% of the target values:

- annual performance incentive – nil to $1,312,500
- Performance Equity Scheme – nil to $1,050,000.

Key features of the remuneration package are:

- approximately one third of the total target remuneration package is fixed remuneration and the remainder is variable
- just under half of the total target remuneration package is payable in equity with the remainder payable in cash.

In setting the remuneration package, the Board obtained advice from PricewaterhouseCoopers (**PwC**) on remuneration levels for CEOs of similar sized organisations. In its report entitled *CEO Market Remuneration Assessment Report* dated 1 May 2012 (the **PwC Remuneration Report**), PwC opined that the proposed remuneration package for Mr Moutter was reasonable. PwC considered the level of base remuneration to be reasonable and the mix of fixed and variable remuneration to be largely consistent with comparator companies. A summary of the advice provided by PwC to the Board is included in the notice of meeting.

The structure of Mr Moutter's performance-related variable remuneration components means that his remuneration is likely to vary significantly from year to year. His remuneration will be disclosed each year in Telecom's annual report. Historically, the level of disclosure in respect of the chief executive officer's remuneration has been comprehensive, with detailed explanations of the terms of the remuneration components and a breakdown of the remuneration component amounts.

2.5 Terms of the Performance Equity Scheme

Overview

The terms of the Performance Equity Scheme are set out in the explanatory notes on pages 4 and 5 of the notice of annual meeting (the **Explanatory Notes**). They are not included in detail in this report so as to avoid repetition.

The objective of the Performance Equity Scheme is to reward Mr Moutter for achieving specified target levels of performance during a financial year (ie the Targets). This component of his remuneration is structured in the form of the issue of redeemable ordinary shares so as to link it to the long term performance of the Company.

The maximum number of shares to be issued to Mr Moutter over the 3 year period to 27 September 2015 for which shareholder approval is sought is 1,000,000 shares. This includes all redeemable ordinary shares and any ordinary shares to be issued.

Assuming the Performance Equity Scheme is approved by the Non-associated Shareholders, the first issue of redeemable ordinary shares under the Performance Equity Scheme will occur in September 2013, following determination by the Board of the actual incentive award achieved in respect of the 2013 financial year and the announcement of Telecom's results for the 2013 financial year.

Subsequent grants of shares will be at the discretion of the Board (within the context of the approval granted by Non-associated Shareholders) and may be made in September of each year but in no case will shares be issued later than 3 years after the date of the 2012 annual meeting (unless a further shareholder approval is obtained).

Our evaluation of the key terms of the Performance Equity Scheme is set out below.

Redeemable Ordinary Shares

The redeemable ordinary shares have the same rights and terms as the ordinary shares except that during the restrictive period (discussed below) they can be redeemed (ie acquired from Mr Moutter and cancelled by Telecom) for a nominal consideration of $1 in certain circumstances.

The redeemable ordinary shares will automatically reclassify into ordinary shares at the end of the specified period to which the trading restrictions apply.

Targets and Determination of Incentive Award

The amount of any incentive award under the Performance Equity Scheme will depend on the Board's evaluation of Mr Moutter's performance measured against the Targets. The Board will prescribe the Targets for each financial year in consultation with Mr Moutter.

If Mr Moutter achieves the Targets in any financial year, he will be entitled to an incentive award equal to the annual target value of the Performance Equity Scheme. The annual target value for the 2013 financial year is $600,000. The amount of the incentive award will be adjusted up or down in line with assessed over or under performance. The maximum pre tax value of the incentive award is capped at 175% of the annual target value.

The Targets for the 2013 financial year have not been set as at the date of this report. Historically, the Targets have included overall financial targets (such as EBITDA), specific performance objectives based on Telecom's business and strategic plans and other criteria relating to corporate governance, reputation, effective leadership and management.

Assuming the Targets for the 2013 financial year are similar to those adopted in past years, we are of the view that they represent appropriate bases upon which to evaluate Mr Moutter's performance and determine the level of incentive award to be paid to him under the Performance Equity Scheme.

Number of Shares Issued

The number of redeemable ordinary shares issued will be calculated by dividing the value of the incentive award by the volume weighted average market price (**VWAP**) of Telecom's ordinary shares reported on the NZSX for the 20 trading days immediately preceding the effective date of issue of the redeemable ordinary shares.

The shares are subject to the trading restrictions discussed below.

Trading Restrictions

Mr Moutter cannot transfer, assign or otherwise dispose of the redeemable ordinary shares for a specified period following their issue.

The redeemable ordinary shares issued in respect of the 2013 financial year cannot be sold or otherwise disposed of for a 2 year period following their issue in September 2013.

The Board may specify longer or shorter restrictive periods for subsequent issues.

In our view, the restrictive period of 2 years (following the initial performance period of one year which determines the amount of the award) is a suitable mechanism to aid in the retention of Mr Moutter and to align his interests with those of the Non-associated Shareholders.

Redemption of Shares

During the period in which the restrictions on disposal apply, the redeemable ordinary shares can be redeemed for an aggregate consideration of $1 in certain circumstances where Mr Moutter's employment ceases. These circumstances are explained on page 5 of the Explanatory Notes.

This redemption feature ensures that Telecom can recover the shares if Mr Moutter ceases to be entitled to some or all of the shares during the relevant period.

Remuneration May be Paid in Cash

The Board may, in its sole discretion, determine that 100% of the incentive award will be received by Mr Moutter in cash instead of shares. Furthermore, if shareholder approval of the Performance Equity Scheme is not obtained, 100% of the incentive award will be received by Mr Moutter in cash instead of shares.

2.6 Terms of the Performance Rights Scheme

Overview

The terms of the Performance Rights Scheme are set out in the Explanatory Notes on pages 6 and 7. They are not included in detail in this report so as to avoid repetition.

The objective of the Performance Rights Scheme is to link a portion of Mr Moutter's remuneration with the long term performance of Telecom and thereby align his interests with those of the Non-associated Shareholders through the grant of share rights.

The ability of any of the share rights to vest and the number of share rights that will vest following the end of the vesting period is dependent on achievement of the Performance Hurdles.

Two grants will be made under the Performance Rights Scheme in 2012:

- Mr Moutter will receive the annual long term incentive award of $1,000,000 of share rights in respect of the 2013 financial year
- Mr Moutter will also receive the Additional Rights Grant, being a one-off grant of $750,000 of share rights.

The maximum number of share rights to be issued to Mr Moutter over the next 3 years to 27 September 2015 for which shareholder approval is sought is 2,500,000 share rights.

Assuming the Performance Rights Scheme is approved by the Non-associated Shareholders, the first grant of share rights is expected to occur in October 2012, with an effective date of 14 September 2012 to align with the Company's normal cycle of annual equity grants.

Subsequent grants of share rights will be at the discretion of the Board (within the context of the approval granted by the Non-associated Shareholders) and may be made in September of each year but in no case later than 3 years after the date of the 2012 annual meeting (unless a further shareholder approval is obtained).

Our evaluation of the key terms of the Performance Rights Scheme is set out below and the evaluation of the key terms of the Additional Rights Grant is set out in section 2.7.

Share Rights

Each share right provides the entitlement to acquire one Telecom ordinary share on exercise for no cash consideration.

The share rights are effectively zero exercise price options (often referred to as ZEPOs) which grant Mr Moutter the right to acquire Telecom shares at a nil cost exercise price upon specific performance conditions being met.

Given that the share rights have a zero exercise price, it is virtually certain that all share rights that vest will be exercised irrespective of the Telecom share price at the vesting date.

Number of Share Rights Granted

The Performance Rights Scheme provides a grant to the value of $1,000,000 to Mr Moutter at the start of each financial year (generally in September), with vesting of the share rights being contingent on the Performance Hurdles being met over the vesting period.

The number of share rights granted will be calculated by dividing the value of the grant by the VWAP of Telecom's ordinary shares reported on the NZSX for the 20 trading days immediately preceding the effective date of the grant of the share rights.

Vesting Period

The Board sets the period after which share rights are eligible for vesting at the time each grant is made:

- for the grant in the 2013 financial year:
  - 50% of the share rights will be eligible for vesting on the second anniversary of the grant (14 September 2014) and
  - 50% of the share rights will be exercisable on the third anniversary of the grant (14 September 2015)
- for subsequent grants the Board will specify that share rights will be eligible for vesting on the third anniversary of the grant.

In our view, the vesting of the share rights between 2 and 3 years after their respective grant dates is an appropriate period to ensure that the Performance Rights Scheme provides a suitable long term incentive to Mr Moutter.

Performance Hurdles

2012 Performance Hurdle Based on Relative TSR

The number of share rights that vest under the Performance Rights Scheme is subject to meeting the Performance Hurdles that the Board will determine each year.

For the share rights to be granted in 2012, the Performance Hurdle is Telecom's TSR relative to a comparator group of the companies which comprise the NZX50 index.

TSR is a measure of the combination of share price appreciation and dividends paid over a defined period.

Reasonableness of Performance Hurdle

The Board's objective is to align Mr Moutter's long term incentive remuneration with Telecom's performance. There are a variety of measures to assess a company's financial performance. TSR is one such measure. Others include return on equity, return on capital employed and growth in earnings per share (**EPS**).

TSR focuses on returns whereas EPS reflects growth more than returns (because it does not fully take into account the cost of capital employed to generate those earnings).

We have reviewed a range of executive remuneration packages for listed companies in New Zealand and Australia, as well as research on long term incentive plans in overseas companies. The majority of companies use either TSR or EPS (or a combination thereof) to set performance hurdles or set exercise prices for options. In doing so, companies use either relative performance hurdles (eg TSR benchmarked against the TSR of a basket of comparable companies or growth in EPS benchmarked against price indices such as the Consumer Price Index or Retail Price Index) or absolute performance hurdles (eg TSR and/or EPS growth based on predefined growth levels). In some circumstances where companies use more than one performance hurdle, they combine a relative performance hurdle (eg TSR) with an absolute performance hurdle (eg EPS growth).

In our view, the use of relative TSR is an appropriate performance hurdle for the Performance Rights Scheme. While more sophisticated performance measures could be implemented (eg a combination of relative and absolute TSR or a combination of TSR and EPS growth benchmarked on a relative basis), we believe the benefits of the simplicity and transparency of using relative TSR more than outweigh any benefits that may be gained from a more complex multi-measure approach.

The Board will determine the Performance Hurdles to apply each year. We note that under the terms of the Performance Rights Scheme, the Board has discretion to grant share rights with no performance hurdles.

Testing and Re-testing

If Telecom's TSR is below the 50th percentile of the TSR of the comparator group over the relevant period, then none of the share rights in a tranche will vest at that point in time.

If Telecom's TSR is equal to the 50th percentile of the TSR of the comparator group over the relevant period, 40% of the share rights in a tranche will vest and become exercisable. This will increase on a straight line basis such that 100% of the share rights in a tranche will vest and may be exercised if Telecom's TSR is at or above the 85th percentile of the TSR of the comparator group over the relevant period.

Testing of whether the Performance Hurdle has been met will occur at the end of the vesting period of the grant. If the maximum Performance Hurdle is not met, there will be a re-test 12 months later using the same methodology. Under the re test:

- if the percentage of share rights that would be exercisable on the re-test is greater than the percentage that were exercisable on the initial test date, then that percentage of additional share rights will become exercisable following the re-test
- if the percentage is lower on the re-test date, no additional share rights will be exercisable.

If no share rights become exercisable on the initial test date, then a maximum of 50% of the share rights can be exercised if the Performance Hurdle is met at the re test. Any un-exercisable remaining share rights will lapse.

Share Rights Lapse Upon Termination of Employment

Mr Moutter's non-vested share rights lapse immediately upon termination of his employment, except in certain circumstances as explained on page 7 of the Explanatory Notes.

Share rights that have vested continue to be exercisable after termination of Mr Moutter's employment for any reason for a period of 3 months, after which they lapse.

Cash Payment Alternative

The Board may, in its sole discretion, determine that a cash amount equal to the value of the shares can be paid instead of the share rights converting into ordinary shares.

2.7 Terms of the Additional Rights Grant

The Additional Rights Grant is a one-off grant of $750,000 of share rights to Mr Moutter on the same terms as other share rights under the Share Rights Scheme except that:

- no Performance Hurdles apply
- 50% of the share rights will be exercisable on the date one year after grant
- the remaining 50% will be exercisable on the date 2 years after grant.

Assuming the Performance Rights Scheme is approved by the Non-associated Shareholders, the Additional Rights Grant is expected to occur in October 2012, with an effective date of 14 September 2012.

The number of share rights granted will be calculated by dividing $750,000 by the VWAP of Telecom's ordinary shares reported on the NZSX for the 20 trading days immediately preceding the effective date of the grant of the Additional Rights Grant.

In our view, the Additional Rights Grant has the characteristics of a sign-on bonus for Mr Moutter. We are advised that the rationale for the Additional Rights Grant is to partially compensate Mr Moutter for entitlements he is foregoing from this previous employer and, by virtue of delivering this compensation in the form of equity, to create more immediate exposure for Mr Moutter to Telecom's share price performance. The quantum of the grant represents approximately 20% of Mr Moutter's total target annual remuneration for the 2013 financial year and approximately 56% of his base remuneration.

However, the grant is not paid in cash but in share rights which do not vest immediately. Accordingly, the Additional Rights Grant has an element of long term incentive to it as Mr Moutter will not derive any economic benefit until at least one year after the grant.

2.8 Impact on Shareholding Levels

Share Capital and Shareholders

Telecom currently has 1,856,780,364 fully paid ordinary shares on issue, held by 37,292 shareholders as at 17 August 2012.

We are advised that as at 13 August 2012, Mr Moutter does not have any legal, beneficial or non-beneficial interest in any shares in the Company.

Maximum Number of Shares

Shareholder approval is being sought for the issue of a maximum of 3,500,000 shares under the CEO Share Schemes in the 3 years to 27 September 2015:

- in total up to 1,000,000 shares under the Performance Equity Scheme
- in total up to 2,500,000 shares under the Performance Rights Scheme.

Shareholding Control

Assuming the maximum of 3,500,000 shares are issued to Mr Moutter under the CEO Share Schemes and no other shares are issued by the Company, there will be 1,860,280,364 shares on issue. Mr Moutter will hold 3,500,000 shares, representing 0.19% of the shares on issue.

In our view, Mr Moutter's maximum potential shareholding of 0.19% will have no material impact on his ability to exercise shareholder voting control.

Dilutionary Impact

Assuming the maximum of 3,500,000 shares are issued under the CEO Share Schemes, this will result in the Non-associated Shareholders' proportionate shareholdings in the Company being diluted by 0.19%.

We do not consider this level of dilution to be of any significance to Non-associated Shareholders.

2.9 Impact on Share Price and Liquidity

Share Price

We consider the existence of the CEO Share Schemes will not have a material effect on the Company's share price as the dilutionary impact of the CEO Share Schemes is not significant.

Liquidity

Telecom's shares are one of the most actively traded shares on the NZSX with the total volume of shares traded on the NZSX in the past year equating to approximately 160% of the total shares on issue.

In our view, the CEO Share Schemes will not have a positive or negative effect on the liquidity of Telecom's shares:

- the size of the pool of shares held by the Non-associated Shareholders will not change as a result of the CEO Share Schemes
- the shares to be issued to Mr Moutter under the CEO Share Schemes are subject to vesting conditions and trading restrictions.

2.10 Accounting Issues

Accounting for the CEO Share Schemes shares will be governed by the requirements of New Zealand Equivalent to International Financial Reporting Standard 2 *Share-based Payment*.

The total expense to be recognised in Telecom's Income Statement will be the fair value of each CEO Share Schemes share (using techniques consistent with generally accepted valuation methodologies for pricing financial instruments) multiplied by the number of shares which are expected to vest. The fair value of each share will be established as at the grant date, which will be the date of shareholder approval. The total value of shares granted will be determined by multiplying the fair value of each share by the number of shares initially granted.

2.11 Implications of the Resolutions not being Approved

In the event that either resolution 5 or 6 in respect of the CEO Share Schemes is not approved, then, under the terms of the Employment Agreement, each right/entitlement will be paid in cash to Mr Moutter at the equivalent value but subject to the same terms and conditions to which any equity would have been subject. The cash equivalent will be payable at the same time as any rights/entitlements in respect of equity would have vested.

2.12 Voting For or Against the Resolutions in Respect of the CEO Share Schemes

Voting for or against resolution 5 in respect of the Performance Equity Scheme and resolution 6 in respect of the Performance Rights Scheme is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

3. Sources of Information, Reliance on Information, Disclaimer and Indemnity

3.1 Sources of Information

The statements and opinions expressed in this report are based on the following main sources of information:

- the draft notice of annual meeting
- the Telecom 2011 annual report and half year report for the period ended 31 December 2011
- the Employment Agreement
- extracts from the Board's minutes in respect of the CEO Share Schemes
- the PwC Remuneration Report
- Telecom accounting and taxation advice in respect of the CEO Share Schemes
- share price data and shareholder data from NZX Data.

During the course of preparing this report, we have had discussions with and/or received information from the Non-associated Directors and executive management of Telecom.

The Non-associated Directors have confirmed that we have been provided for the purpose of this Appraisal Report with all information relevant to the CEO Share Schemes that is known to them and that all the information is true and accurate in all material aspects and is not misleading by reason of omission or otherwise.

Including this confirmation, we have obtained all the information that we believe is desirable for the purpose of preparing this Appraisal Report.

In our opinion, the information set out in this Appraisal Report is sufficient to enable the Non-associated Directors and the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the CEO Share Schemes.

3.2 Reliance on Information

In preparing this report we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was available from public sources and all information that was furnished to us by Telecom and its advisers.

We have evaluated that information through analysis, enquiry and examination for the purposes of preparing this report but we have not verified the accuracy or completeness of any such information or conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of Telecom. We do not warrant that our enquiries would reveal any matter which an audit, due diligence review or extensive examination might disclose.

3.3 Disclaimer

We have prepared this report with care and diligence and the statements in the report are given in good faith and in the belief, on reasonable grounds, that such statements are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial position of Telecom will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of Telecom and its directors and management. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.

We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of the report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the report or assumptions reasonably taken as implicit.

Our evaluation has been arrived at based on economic, exchange rate, market and other conditions prevailing at the date of this report. Such conditions may change significantly over relatively short periods of time. We have no obligation or undertaking to advise any person of any change in circumstances which comes to our attention after the date of this report or to review, revise or update our report.

We have had no involvement in the preparation of the notice of annual meeting issued by Telecom and have not verified or approved the contents of the notice of annual meeting. We do not accept any responsibility for the contents of the notice of annual meeting except for this report.

3.4 Indemnity

Telecom has agreed that, to the extent permitted by law, it will indemnify Simmons Corporate Finance and its directors and employees in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity does not apply in respect of any negligence, wilful misconduct or breach of law. Telecom has also agreed to indemnify Simmons Corporate Finance and its directors and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where Simmons Corporate Finance or its directors and employees are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, Simmons Corporate Finance shall reimburse such costs.

4. Qualifications and Expertise, Independence, Declarations and Consents

4.1 Qualifications and Expertise

Simmons Corporate Finance is a New Zealand owned specialist corporate finance advisory practice. It advises on mergers and acquisitions, prepares independent expert's reports and provides valuation advice.

The person in the company responsible for issuing this report is Peter Simmons, B.Com, DipBus (Finance), CFIP.

Simmons Corporate Finance and Mr Simmons have significant experience in the independent investigation of transactions and issuing opinions on the merits and fairness of the terms and financial conditions of the transactions.

4.2 Independence

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with Telecom or Mr Moutter or any conflicts of interest that could affect our ability to provide an unbiased opinion in relation to this transaction.

Simmons Corporate Finance has not had any part in the formulation of the CEO Share Schemes or any aspects thereof. Our sole involvement has been the preparation of this report.

Simmons Corporate Finance will receive a fixed fee for the preparation of this report. This fee is not contingent on the conclusions of this report or the outcome of the voting in respect of the CEO Share Schemes. We will receive no other benefit from the preparation of this report.

4.3 Declarations

An advance draft of this report was provided to the Non-associated Directors for their comments as to the factual accuracy of the contents of the report. Changes made to the report as a result of the circulation of the draft have not changed the methodology or our conclusions.

Our terms of reference for this engagement did not contain any term which materially restricted the scope of the report.

4.4 Consents

We consent to the issuing of this report in the form and context in which it is to be included in the notice of annual meeting to be sent to Telecom shareholders. Neither the whole nor any part of this report, nor any reference thereto may be included in any other document without our prior written consent as to the form and context in which it appears.

Peter Simmons
Director

Simmons Corporate Finance Limited
20 August 2012