



Mark Verbiest
Chairman
Telecom Corporation of New Zealand Limited
Level 2
Telecom Place
167 Victoria St West
Auckland

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Telecom Chief Executive Officer remuneration benchmarking

Dear Mark

Background

During May 2012 we were asked to provide Telecom Corporation of New Zealand Limited (Telecom) with a report comparing the quantum and construct of the then proposed remuneration arrangements for a new Telecom Chief Executive Officer (CEO), to relevant comparator companies in the New Zealand and Australian markets (the Benchmarking Report). The purpose of the Benchmarking Report was to provide the Telecom board with objective information to assist it in setting appropriate market-based remuneration.

We note our Benchmarking Report only considered the quantum and construct or “mix” of the proposed CEO package relative to the market data.

As requested, we provide below a summary of the process we adopted, and our findings. We understand this will be provided to Telecom shareholders to assist with their consideration of equity arrangements which are proposed to be entered into in relation to the new Telecom CEO.

Proposed remuneration arrangements

The CEO remuneration arrangements we were requested to review for benchmarking purposes were as follows:

Fixed annual remuneration:	\$1,350,000
Target short term incentive:	\$750,000
Target deferred short term incentive (equity incentive):	\$600,000
Long term incentive (share rights):	\$1,000,000
Total target package:	\$3,700,000

We understand it is intended the equity incentive and long term incentive will be granted to the CEO annually.

In addition, we understand that the CEO will, subject to shareholder approval, also receive a one off grant of share rights to the value of \$750,000 upon commencement of his employment with Telecom, 50% of which will vest after 12 months and 50% of which will vest after 24 months. This was negotiated to compensate for entitlements forgone under the CEO’s previous employment contract, and create further alignment with shareholders.

Process adopted

In benchmarking the proposed remuneration package of the CEO role we took into account the Telecom executive remuneration policy and in particular the requirement that:

- The CEO's remuneration should be considered in the context of a "trans-Tasman" remuneration market (i.e. consideration should be given to comparators in both the New Zealand and Australian markets); and
- Fixed annual remuneration should be at the median of the market data, with upper quartile total pay for upper quartile performance.

We reviewed the remuneration arrangements and target remuneration data of chief executive officers and managing directors of Australian and New Zealand groups comparable to Telecom. In selecting comparators in both markets we took into account the relative size (in terms of both market capitalisation and annual revenues) and complexity of Telecom, its status as a high profile company listed on both the New Zealand and Australian stock exchanges, the geographic scope of the Telecom business and the regulated nature of the telecommunications industry.

All data reviewed for the purposes of this exercise was obtained from the PwC New Zealand and PwC Australia executive remuneration databases. Data in the PwC New Zealand database is obtained directly from participants in the annual PwC New Zealand executive remuneration survey (131 participant companies in 2012), and is current as at 31 March 2012. Data in the PwC Australia database is obtained from the public disclosures of ASX100 companies, and is current as at the most recent disclosures made in those companies' annual reports.

The benchmarking report provided a comparative analysis of the proposed Telecom CEO target remuneration package as compared with the target remuneration data of the CEOs of the comparators.

We also provided analysis of the relative weighting of the various components of the proposed CEO package (i.e. the construct or "mix" of the proposed package) as compared with the market data.

Benchmark findings

Quantum of package

On the basis of our work we concluded that, having regard to the Telecom executive remuneration policy and assuming appropriate performance criteria for all performance based reward elements, the quantum of the proposed package represented reasonable remuneration for the CEO of a business of the size, complexity and nature of Telecom. The basis for this conclusion was that:

- The proposed fixed annual remuneration is positioned *at approximately the midpoint of the median* comparator data of the New Zealand and Australian markets; and
- The proposed total target reward (aggregate of fixed annual remuneration, target short term incentive, long term incentive and deferred short term incentive) is positioned *below the 75th percentile New Zealand target total remuneration market data and below the Australian median total remuneration market data.*

Construct of package

We assessed the relativity of the various components of the Telecom CEO role's proposed package as a proportion of the total remuneration package and compared this construct or "pay mix" with the market data. The construct of the proposed Telecom CEO package compared favourably with the construct of the CEO remuneration packages of those companies in the data samples with short and

long term / deferred incentives, with a higher proportion of the proposed Telecom total package being allocated to deferred and long term incentives than the comparative market data, and a lower proportion to short term incentives.

One off share grant

In our view the inclusion of the one off grant of additional share rights in the proposed package does not materially alter our findings. We note that it is not uncommon for such an arrangement to be negotiated in the context of appointing a new CEO where existing entitlements are foregone as a result of the individual's change in employment.

The proposed fixed annual remuneration for the CEO remains positioned at approximately the midpoint of the New Zealand and Australian median data when taking into account the additional one off grant of share rights.

The proposed target total package for the year in which the additional one off grant is made (i.e. the total package that would be earned if incentive targets are attained) will now be marginally above the 75th percentile total target reward data for the New Zealand comparators, and below the *median* market data for the Australian comparators. The proposed target package inclusive of the additional grant remains within the parameters of Telecom's remuneration policy position assuming appropriately calibrated performance metrics.

Yours sincerely



Chris Place
Partner – Tax and Executive Reward Services
chris.g.place@nz.pwc.com
T: +64 (9) 355 8385

