2019/20 Annual review of Air New Zealand Limited

Report of the Transport and Infrastructure Committee

March 2021

Contents

Greg O’Connor
Chairperson

Air New Zealand Limited

Recommendation
The Transport and Infrastructure Committee has conducted the annual review of Air New Zealand Limited for 2019/20, and recommends that the House take note of its report.

About Air New Zealand

Air New Zealand is the national airline and operates domestic and international passenger transport and cargo. It is a public company listed on the New Zealand and Australian stock exchanges. The Crown is the major shareholder, owning 51.9 percent of the shares in the company. The Crown also holds the Kiwi Share, a single share that does not carry general voting rights but requires the Crown's consent for certain actions. This is designed to maintain Air New Zealand's status as a substantially New Zealand-owned and controlled company.

An independent, eight-member board governs Air New Zealand, chaired by Dame Therese Walsh. Greg Foran was appointed chief executive in February 2020 following Christopher Luxon's departure from the position in September 2019. In 2019/20, the executive team was reduced from nine to six members, reflecting COVID-19's effects on the airline.

Financial overview and audit results

The Auditor-General issued a standard audit report, and is satisfied that the information he audited fairly reflected the company's activities for the year and its financial position at the end of the year.

On 25 February 2021, the airline released its 2021 Interim Financial Report with updated figures.

As at 30 June 2020, the net assets of Air New Zealand were $1.318 billion with cash and cash equivalents of $438 million. The 2021 interim report notes that, as at 31 December 2020, the net assets of Air New Zealand are $1.266 billion with cash on hand of $174 million. This is a decrease of $264 million since 30 June 2020.[1] This balance shows the continued impact of significantly reduced customer sales due to border restrictions.

The Auditor-General reported that the airline's operating revenue for 2019/20 was $4.8 billion. The 2021 interim report records the half-year operating revenue as $1.2 billion, a 59 percent decline on the prior six-month period. It primarily consists of passenger revenue, which totalled $708 million in contrast with $4.960 billion in 2019.

Air New Zealand's operating expenses declined by 12 percent to $4.052 billion, with the largest saving coming from fuel and aircraft operations due to the continuing effect of

[1] The 2021 Interim Financial Report can be found here: https://p-airnz.com/cms/assets/PDFs/air-nz-2021-interim-financial-report.pdf.

COVID-19. Air New Zealand managed the "cash burn" (capital used to run its day-to-day operations) by reducing staffing levels by 30 percent, cancelling the 2020 interim dividend, deferring $700 million in capital expenditure, and reducing operating costs (by operating fewer flights). Air New Zealand has also confirmed in its 2021 interim report that there will be no interim dividend for the 2021 financial year.

These cost reductions have reduced the cash burn from around $175 million between April and June 2020 to an average of $79 million between September 2020 and January 2021.

Air New Zealand has announced it is carrying out a strategic capital structure review, to be completed in early 2021. It then expects to proceed with raising equity capital by 30 June 2021. The Crown has confirmed to Air New Zealand that, subject to Cabinet being satisfied with the terms of the proposed equity capital raising, it would participate in it to maintain a majority shareholding in Air New Zealand.

COVID-19's effect on Air New Zealand

We heard that July to December 2019 went well, with a profit made for those six months. The COVID-19 pandemic began to affect the company's operations in January to March 2020. Government-imposed travel restrictions and border closures in New Zealand and other key jurisdictions negatively affected financial performance and cash flow.

To help the airline respond to the effects of COVID-19, the Government provided a support package to Air New Zealand, comprising the following:

- a $900 million standby loan facility (discussed below)
- $113 million in wage subsidies (including the wage subsidy, the extension to the wage subsidy, and the resurgence wage subsidy), of which $75 million was received in 2019/20
- an aviation support package (managed through the Ministry of Transport), including:
  - financial support to pay passenger-based government charges and airways-related fees ($27 million was received by Air New Zealand in 2019/20)
  - a grant to supply international airfreight services worth $21 million (International Airfreight Capacity scheme, discussed below).

While there are challenges, Air New Zealand said it was fortunate to have a strong domestic business. It stated that it is back to around 80 percent of where it was before COVID-19.

Crown standby loan facility

We were interested in the structure of the loan facility. We understand that the $900 million loan is structured in two tranches, which have interest rates at 7 to 9 percent. The first tranche is $600 million with an interest rate of 7 to 8 percent, and the second is $300 million with a 9 percent interest rate. The interest rates will increase by 1 percent if the loan remains after 12 months (27 May 2021). The current drawn-down balance is $350 million (as at 25 February 2021). Refunds, fixed asset purchases, and debt and lease payments were offset by the loan.

The airline has short-term liquidity available of just over $700 million, consisting of $174 million cash and $550 million of undrawn funds on the Crown facility.

Comparison with Qantas' international operation

We were interested in how this compared with the finance secured by Qantas from the Australian Government. In particular, we note that it received a loan of just over A$1 billion at 2.75 percent interest over 10 years, which is much lower than the interest rates secured by Air New Zealand.

Air New Zealand commented that each international airline is in a different situation, with a different context as to how COVID-19 was being handled. It said the Government provided the standby loan facility at a time of need, and the interest rate was part of the negotiation at the time. Air New Zealand acknowledged that it has a significant loan facility but said that, unlike other airlines, it has not needed to source more funds. Air New Zealand added that it has tried to draw down as little as possible of the loan. It has focussed more on raising capital to restructure so it does not need to use the facility. We noted Qantas stopped international passenger flights.

We were interested to hear that Air New Zealand approached global lenders. However, with the constantly shifting markets at the time in the airline's view the Government was the best option for it.

International Airfreight Capacity scheme (IAFC)

On 30 April 2020, following a tender process, Air New Zealand was awarded a grant to supply international airfreight services to the Government. It was initially for the period up to June 2020, but was then extended to 30 April 2021. This ensured the supply and delivery of imports and exports during the COVID-19 pandemic and enabled the airline to undertake more than 1,400 cargo flights. In its 2021 interim report, the airline states that the IAFC contributed to the increase of cargo revenue by 91 percent, to $373 million.

We heard that, as part of this scheme, Air New Zealand also operated repatriation flights to provide support in the response to COVID-19. In addition, it undertook domestic charter flights to support quarantine activity. Air New Zealand said that these flights contributed to a vital cash flow during a time of limited international passenger revenue.

Staff cuts tough on everyone but some staff have returned

Air New Zealand has made significant changes to its operations in order to manage the effects of COVID-19. This included a 30 percent reduction of staff, approximately 4,000 people, at a cost of $140 million in redundancies. The redundancies affected all parts of the organisation, with greater reductions in airports and the international cabin crew workforce.

We asked how Air New Zealand is going to bring in a culture of wellbeing once there is a fully functioning service when the borders open. Air New Zealand referred to its new company-wide reset strategy called "Kia Mau", which comprises five foundational pillars. One of the pillars is "people". It acknowledged that bringing people back will be critical, and noted that they had already started returning. Recently, 140 staff (out of 170 contacted) from the A320 crew returned to work. It had also created the Āwhina Charitable Trust to support staff who were affected financially. The trust provides one-off grants to employees who are in financial hardship due to COVID-19 and are struggling to meet their day-to-day living costs.

We were told that through the chief executive there is regular contact and good relationships between the executive team and the various unions within the sector. The chief executive meets with the unions once every 10 to 12 weeks.

Air New Zealand said jobs were affected at all levels of the organisation. The executive team was reduced by 30 percent. Also, salaries for the chief executive and executive team, and the directors' fees, were reduced by 15 percent to 30 June 2021.

Sustainable aviation fuel

We were pleased to hear that that Air New Zealand is committed to reducing its carbon footprint while continuing to focus on making the operation as fuel-efficient as possible.

Two noticeable areas of change have been:

- ensuring that the average life of the fleet is low because newer aircraft are more energy efficient
- reducing the use of in-flight plastic and engineering.

The "Kia Mau" strategy includes "sustainability" as one of its five pillars. We note with interest that the airline has a goal of being carbon neutral by 2050. Its membership of the International Air Transport Association also comes with a goal of bringing down carbon emissions.

The airline is also exploring new technologies. We heard that sustainable aviation fuels are critical to bringing down carbon emissions. We were told it is also a key factor to the long-term survivability of the airline. The airline is committed to using sustainable aviation fuels over time. A challenge is that these fuels cost two to three times more than traditional fuels. The accompanying infrastructure to these fuels will need close collaboration and investment from the public and private sectors as well as new policy settings to attract investment and ensure long-term industry competitiveness.

Planning for a post COVID-19 world

We were told that Air New Zealand relies on the borders opening for two-thirds of its revenue. Therefore, its medium-to long-term priorities are to innovate and grow the airline when the borders open. Another is to build back the network. It hopes to use customer loyalty and stimulate travel on Tasman and Pacific Island routes.

In the longer term, the airline expects to be smaller, with a particular focus on the Pacific Rim.

Air New Zealand's work for the Royal Saudi Arabian Navy

Air New Zealand confirmed that, from 2019, its gas turbines unit did work for the Royal Saudi Arabian Navy. Work on the navy's engines came to the attention of Air New Zealand's chief executive in late January 2021. We heard that, once this contract came to the chief executive’s attention, Air New Zealand terminated the work immediately.

We asked why the airline did not respond to media requests once this controversial contract became public knowledge, and a focus of criticism. Air New Zealand admitted there were internal communication issues it was working through before being able to comment in a public forum.

In response to the situation, the airline confirmed that an internal review of its processes was under way. The board has also commissioned an external review by PwC New Zealand. In addition, the airline and the Ministry of Foreign Affairs and Trade are engaging a Queen’s Counsel to review the technical aspects relating to the company’s licensing requirements.

We look forward to the results of these reviews.

Appendix

Committee procedure

We met on 11 February and 18 March 2021 to consider the annual review of Air New Zealand Limited. We heard evidence from Air New Zealand and received advice from the Office of the Auditor-General.

Committee members

Greg O'Connor (Chairperson)
Paul Eagle
Hon Julie Anne Genter
Shanan Halbert
Christopher Luxon
Dr James McDowall
Hon Mark Mitchell
Terisa Ngobi
Helen White

Golriz Ghahraman replaced Hon Julie Anne Genter, and Hon Michael Woodhouse replaced Christopher Luxon for this review.

Advice and evidence received

We received the following documents as advice and evidence for this annual review. They are available on the Parliament website, www.parliament.nz, along with a transcript of our hearing.

Office of the Auditor-General (Briefing on Air New Zealand Limited).

Air New Zealand (Responses to written questions).