Stock exchange listings: New Zealand (NZX: AIR) / Australia (ASX: AIZ) / ADR (OTC: ANZLY)

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26 May 2020

Air New Zealand liquidity and 2020 earnings update

Air New Zealand is today providing an update on its actions to reduce cash burn, as well as earnings expectations for the 2020 financial year following the precipitous decline in demand for air travel that has resulted from the outbreak of Covid-19.

Liquidity position

Prior to the outbreak of Covid-19, Air New Zealand was in a strong position with a resilient balance sheet and short-term liquidity of more than $1 billion. The airline has no financial covenants on new or existing debt facilities and no significant debt maturities until 2022. The airline has taken and will continue to take swift and decisive action to preserve and enhance liquidity and minimise cash burn.

As previously disclosed to the market, once the initial restrictions for international travel into New Zealand were announced in March 2020, Air New Zealand moved quickly to secure a loan facility of up to $900 million with the New Zealand Government, to bolster liquidity and provide the airline with sufficient flexibility to respond to a range of potential demand recovery scenarios.

As at close of business 25 May 2020, short-term liquidity is approximately $640 million, which does not include any funds from the $900 million loan facility with the Government.

“We have not yet needed to draw down on the government loan facility, as we continue to utilise all available levers to reduce our cash burn and right-size the business to reflect the expectation that, for some time, our airline will be smaller than it was pre Covid-19” says Chief Financial Officer Jeff McDowall.

The airline has already implemented a number of actions across every aspect of its cost base and capital expenditure portfolio, including:

- Labour reductions of approximately 30 percent, or 4,000 employees, which is expected to drive annualised savings of $350 to $400 million
- Suspension of all short-term incentive schemes for the 2020 financial year
- Reduction of the Executive team by 30 percent
- A 15 percent reduction in the salary of the Chief Executive and Executive team, together with a 15 percent reduction in Director fees through to December 2020
- Institution of a hiring freeze and voluntary leave options
- Deferral or cancellation of almost $700 million in expected capital expenditure to December 2022, including deferrals of planned A321 NEO deliveries
- Decision to ground the airline’s Boeing 777-200 and 777-300 fleet until at least the end of calendar 2020

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- Reductions across all other areas of the airline's cost base including cancellation of all non-essential spend, reduction in leasing costs and modification of various vendor and supplier terms.

As a result of the above actions, Air New Zealand expects to reduce its average monthly cash outflows by approximately $50 million to $60 million[1] for the 2021 financial year.

"Like all businesses at this time, we find ourselves facing an environment where revenues will be a small fraction of what we are accustomed to. Over the course of the last few months we have acted at pace to implement both short-term and structural cost saving measures to adapt to this new environment, and we will continue to seek out further opportunities to consolidate facilities, reduce capital spend, review fleet composition, supply chain costs and adjust our labour base further.

"We know that demand for air travel will eventually rebound, so we are cognisant of striking the right balance between removing cost from the business and ensuring the airline is in a strong position to ramp up as demand recovers" says Mr McDowall.

2020 Earnings update and outlook

The airline had a solid start to the 2020 financial year, however market conditions deteriorated dramatically in early March as the spread of Covid-19 began to extend globally. That led the airline to confirm on 9 March 2020 that it was withdrawing any full year earnings guidance.

"Across March and April, Air New Zealand reduced its network capacity by more than 95 percent as demand declined to almost zero following the implementation of the New Zealand government's travel restrictions[2]. The recent move to Alert Level 2 has been a welcome reprieve, allowing us to get the domestic engine turning again, however it is clear that it will take some time for demand to return to pre-Covid levels. We are preparing for a scenario in which the airline is still 30 percent smaller than pre-Covid levels in two years' time" says Mr McDowall.

For the second half of the 2020 financial year, Air New Zealand's network capacity is expected to be approximately 50 percent lower than the prior comparative period, driven by a reduction of approximately 90 percent in the fourth quarter. In light of this and the fact there was very little revenue coming in during Alert Levels 3 and 4, the airline is now expecting to report an underlying loss for the 2020 financial year.

Given there is still a high degree of uncertainty regarding demand for air travel under New Zealand's Alert Level 2, the period of time in which social distancing will be required on the aircraft

[1] Refers to gross cash outflows related to fixed operating costs, investing and financing activities and does not assume any benefit from passenger revenues given uncertainty with forecasting demand due to Covid-19.
[2] A summary of the New Zealand Government's Covid-19 alert system consisting of four levels is available at covid19.govt.nz/alert-system/covid-19-alert-system. Under this system Alert level 4 imposes the greatest level of travel restrictions.

and the timing of a shift to Alert Level 1, the airline will not be providing specific 2020 earnings guidance at this time.

Other significant items

On 28 January, Air New Zealand provided an initial estimate of the Other Significant Items that it expected to report in its financial results for 2020. The airline is now expecting to recognise hedge losses and impairments on some aircraft assets as a result of Covid-19. As per the airline's update on 28 January, these items are not included in the airline's calculation of underlying earnings for the 2020 financial year. These estimates have been updated in the table below to reflect current expectations, however, are still subject to further review by both the airline and its auditors.

Other Significant Items impact for the 2020 Financial Year		
	Interim impact *(as previously reported in the 2020 Interim Financial Results)*	***Estimated full year impact*** *(total expected to be reported in 2020 Financial Results subject to audit process)*
De-designation of hedges	Nil	$85 million to $105 million
Aircraft impairment charge	Nil	$350 million to $450 million non-cash charge
Reorganisation costs	$13 million charge	$140 million to $160 million
Gain on sale from airport slots	Nil	Approximately $21 million gain
Disestablishment of fair value hedges	$46 million non-cash charge	No change from 2020 Interim Financial Results total

<u>De-designation of hedges</u>

Air New Zealand's Group policy is to hedge up to 90 percent of its expected fuel consumption for the next three months, falling to a maximum of 30 percent after twelve months.

With passenger demand at historical lows, the airline sought to maximise utilisation of aircraft by operating charter and repatriation flights, as well as deploying passenger aircraft on cargo-only missions to deliver New Zealand products to other countries and bring critical medical supplies back into the New Zealand market. Despite this, there has been a substantial reduction in overall capacity, and accordingly fuel consumption, which has resulted in fuel hedge losses for the period.

These losses were partially offset by gains from closing out foreign exchange contracts relating to foreign currency operating revenues and expenditures which are no longer expected to occur.

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The net impact of these items for the 2020 financial year is currently estimated to be in the range of $85 million to $105 million. This amount will vary if there are significant fluctuations in fuel prices or foreign exchange rates.

The airline currently has un-hedged foreign currency debt as a consequence of the de-designation of revenue hedges resulting from a decline in expected foreign currency revenues. These liabilities are subject to translation risk as the liabilities are revalued each month. Gains or losses which were previously reflected in the airline's Cash Flow Hedge Reserve will now be reflected in the Statement of Financial Performance. Fluctuations in foreign currency rates preclude the airline from providing an estimated impact at this time, but any amount will be reported within Other Significant Items.

Aircraft impairment charge

Air New Zealand anticipates that global demand for international air travel will rebuild slowly. As such, the airline expects to book an impairment charge in the 2020 financial year relating to some of its Boeing 777 aircraft. The airline currently estimates a non-cash impairment charge in relation to these aircraft in the range of $350 million to $450 million, which will be partially offset by a reduction in the airline's deferred tax liability. Assessment of the impairment charge is underway as part of the 2020 annual results process and will be reviewed by the auditors. More information will be provided when the airline releases its annual results later this year.

Reorganisation costs

The airline had previously announced reorganisation costs in the range of $20 million to $25 million for the 2020 financial year. Following the swift decline in demand for air travel resulting from Covid-19, the airline has confirmed reductions of approximately 30 percent of its workforce, which is expected to bring the total reorganisation cost for the year to a range of $140 million to $160 million.

CEO commentary

Chief Executive Officer Greg Foran says that the Covid-19 pandemic has had an unparalleled impact on the aviation industry, and the future landscape of the airline will look vastly different to what it does today.

"This is without a doubt the most significant challenge our airline, and indeed the entire aviation industry, has ever faced. The implementation of domestic travel restrictions and border closures have been incredibly effective at slowing the spread of Covid-19 in a number of countries, including here in New Zealand, but they have also had a profound impact on demand for air travel.

"Throughout this pandemic, Air New Zealand's focus has first and foremost been on protecting the health and safety of our customers and our team, while also taking swift and decisive action to protect the long term viability of the airline and preserve liquidity. We are doing everything in our power to ensure Air New Zealand emerges strongly from this crisis.

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"I am extremely grateful to our team of Air New Zealanders who have remained focused on getting our business up and running again and providing the high standard of customer service and care that we are known for, through what can only be described as an extraordinarily difficult time.

“As we farewell a large number of our talented and immensely hard-working people from all areas of the business, I want to take this opportunity to thank everyone for their exceptional service to Air New Zealand.

“I also want to take this opportunity to thank our customers - we know it hasn’t been an easy time for anyone amidst this crisis. As we begin to operate more flights our immediate priority is ensuring customer safety and restoring your confidence and desire to travel. There is no playbook for the situation we are currently facing, so we need to create our own. We appreciate your patience and ongoing support of Air New Zealand as we navigate our way through this” says Mr Foran.

Conference call to be held today

Air New Zealand will host a 30-minute Q&A session for investors and analysts today at 2.00pm NZT. Participants can register for the conference call here.

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