Memorandum

To	Murdo Beattie Cameron & Company
From	First NZ Capital
Date	19 November 2002
Re	**Project Vanilla – Long Haul Strategy**

1. Introduction

One of the options available to Air NZ to increase shareholder value under both the factual and counter factual outcomes is to scale back Air NZ's international operations.

We note that the NECG report suggests that the probability of this scenario increases under the counter factual " ... limitations on funding available from Air New Zealand Government would force a drastic scaling back of Air NZ's operations. In confidential Attachment ____, we set out our understanding of what such a scenario would entail, and its implications".

Through discussion with management of Air NZ we have been informed of some of the problems associated with this scenario. However, due to the importance of this scenario, we would appreciate if you could arrange for further clarification on a number of questions we have on this scenario.

2. Questions

2.1 Air NZ often highlights the relatively weaker return of its international operations using a "bubble diagram" comparing NOPBT against assets employed. We are awaiting the underlying data however have performed a high-level calculation using FY03 route group profitability forecasts to analyse the potential impact of scaling back Air NZ's long haul operations.

Based on our analysis this would significantly improve the return on Air NZ's assets employed, even after reducing NOPBT by an arbitrary amount of 30% to reflect the loss of feeder traffic and fixed cost re-allocation. From our discussions with Air NZ Management we understand that this is overly simplified however this is a calculation likely to be performed by a number of people outside the airline industry reviewing the need for the JAO.

What are the key issues associated with reducing the international asset base. We understand the aircraft is currently either owned or leased, but presumably aircraft can be scaled back by attrition?

2.2 We understand that approximately of domestic bookings are sourced from international flights/bookings. What other negative factors would there be on domestic earnings?

2.3 To mitigate the reduction of international "feed" resulting from withdrawing from unprofitable international routes, could Air NZ code-share with other Star Alliance members to secure the "feed" for domestic operations? If not, why?

2.4 What factors affect the ability to reduce the operating cost base

2.5 It has been mentioned to us that operating less than 747 aircraft is inefficient. This is due to difficulties arising from scheduling and maintenance. What other inefficiencies are there?

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2.7 Does the proposed JAO with Qantas have any effect on Air NZ's ability to significantly scale back its long haul operations?

2.8 Who has prepared the Confidential Information NECG refer to? Can we obtain a copy of this?

2.9 We understand other airlines have tried to "shrink", but without success. Can you please provide the names of these airlines.