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AIR NEW ZEALAND



ANSETT AUSTRALIA

14 August 2001

The Hon John Howard MP  
 Prime Minister of Australia  
 Parliament House  
 CANBERRA ACT 2601  
 AUSTRALIA

**COMMERCIAL IN CONFIDENCE**

Dear Prime Minister,

I am writing to inform you and the Australian Government of the extremely serious situation faced by the Air New Zealand Group and, more particularly, Ansett Australia in the current aviation market situation.


I am sure you are aware that Ansett has more than 15,500 employees in Australia, around half of them in Victoria. Ansett is also the largest provider of regional air services in Australia through Flight West in Western Australia; Kendell and Hazleton in NSW and southern Australia; and the recent rescue of Flight West in Queensland.

In previous meetings with you, Mr John Anderson and various Ministerial advisers, we have provided early access to the Group's financial results to be announced to the markets in three weeks' time, including very serious losses of Ansett which are being sustained only with the support of the wider Group. Ansett's regional subsidiaries too are suffering deep losses.

This situation has emerged in part due to additional competition in the Australian market, and in part due to a lack of sufficient attention in the past to costs and investment within Ansett's operations. Both factors are facts of life. However, the Air NZ Board and both Governments are now linked together in dealing with the resulting situation.

This linkage arises from the position adopted by the Australian Government in support of a proposal from Qantas aimed squarely at removing Singapore Airlines (SIA) as an investor in this Group. Whatever its merits in other contexts, Qantas's proposal appears to be unworkable in the commercial sphere where the Group's Directors must operate according to Corporations law.

The reason for this is that the Qantas proposal requires SIA to sell out of Air NZ, but SIA is not a willing seller. The Group has no ability to force divestment by a legitimate owner of shares, any more than Governments have an ability to achieve such an outcome. SIA has the agreement of the Australian and New Zealand Governments to its current ownership level. Moreover, in present circumstances, SIA is a prime force sustaining the Group in the market as Air NZ and Ansett struggle to survive the coming crisis. This crisis may well see the failure of one or more parts of the Group. Removing SIA (somehow) and replacing it with an investment by Qantas would at best be complicated, and in any event would be delayed beyond a workable time frame by competition policy considerations on both sides of the Tasman.

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I particularly wish to advise you that my Board has considered, and will consider again before the results are announced on 4 September, whether the Group's liquidity position is sufficient to enable it to meet its obligations as they fall due. While we are naturally investigating and pursuing all potential avenues for maintaining the Group's short- and medium-term viability, we remain deeply concerned that, without early resolution of the equity situation and re-capitalisation of the Group, there may be breaches of loan covenants triggering a right for lenders to demand immediate repayment of loans. There is no grace period or cure opportunity in such an event. The Directors have formed advice of this risk which is a reflection of commercial reality. In terms of Corporations law, the significance of the risk is not something that can be taken lightly by the Directors. If repayment demands emerge from lenders, the Group will not be able to repay loans without major disruption to the business. This situation is likely to be played out not over months but over the three weeks leading up to 4 September.

**Sale of Ansett to any other party is not the simple step that may have been advised to you.**

Inextricably, the fortunes of Air NZ and Ansett are tied together by the debt levels entered into to acquire the Ansett business. These debts are secured substantially through covenants in the manner described above. If Ansett were able to be sold (by no means a certainty), Air NZ would need to write down the value of the asset to the level of the price achieved. The likely outcome, equally impossible to sustain, would again be irretrievable breaches of Air NZ's loan covenants.

There is a further factor which is not being given serious consideration in the current context – that the Air NZ and Ansett businesses are now deeply enmeshed. You will recall, for example, the grounding of Ansett's 767s earlier this year. Long term solutions to the problems behind that grounding lie in the application of safety systems which Air NZ has available, and which Ansett does not. There can be no early, simple or inexpensive removal of Air NZ's vital engineering support for Ansett. The investment required for Ansett to operate on its own, and the time and leadership essential to address CASA's concerns, mean that no practical separation can occur. SIA does not have the ability to simply replace Air NZ in this matter.

Similar but slightly less crucial separation problems arise in other areas of the integrated Group.

I ask that the Australian Government urgently considers the significance of this advice. The Group will continue to work actively with the processes of the New Zealand and Australian Governments. However, an early re-capitalisation of the Group with assistance from SIA remains the preferred position adopted unanimously by the Group's Directors.

Yours sincerely,



**Dr J A Farmer, QC  
Acting Chairman**

Copy: The Hon John Anderson MP, Deputy Prime Minister of Australia and Minister of Transport & Regional Services