

Air New Zealand Current Situation and Options

Developments

There have been two major developments in the Air New Zealand situation.

Firstly, the independent directors have reached the conclusion that the Heads of Agreement funding package will not ensure the viability of the company because:

- ▶ It may be an insufficient quantum of money and/or inappropriate securities; and
- ▶ They believe the company needs immediate equity support to justify continued trading.

Secondly, the Chairman of Air New Zealand and the company's advisors have negotiated a Heads of Agreement with the Voluntary Administrator (VA) for Ansett. Under this agreement the Administrator will waive all claims against Air New Zealand (including the Letter of Comfort, reckless trading claims against directors and claims by the Australian Government and other statutory authorities) in return for A\$150 million in cash (NZ\$185 million) and a waiver by Air New Zealand to any claims (as an unsecured creditor) in the Ansett wind up. SIA will also use best endeavours to assist the Voluntary Administrator in relation to the management of an airline to be salvaged from the Ansett assets and operations. The deal with the VA requires immediate cash. Settlement is proposed to take place a day after the settlement is approved by the Federal Court (likely to be later this week/early next week).

The position of the independent directors reflects:

- ▶ Concerns about the commitment and ability of the major shareholders to support Air New Zealand in the recapitalisation and reorganisation process.
- ▶ The perceived impact of recent events related to the US terrorist attacks on the operations and finances of Air New Zealand.

The proposed settlement with the Ansett Voluntary Administrator has a number of attractive features including:

- ▶ Settling the claims against Air New Zealand for a fixed sum much lower than the total potential liability.

- ▶ Eliminating the prospect of further large liabilities arising from action by the Australian Government or creditors in the Courts which “lifts the corporate veil” and opens the door to direct claims on Air New Zealand.
- ▶ Enabling the Voluntary Administrator to salvage some of the operations and routes of Ansett and quickly restore a third airline in the Australian domestic market.
- ▶ Helping to reduce the anti-New Zealand sentiment that has developed in Australia and thereby mitigating its impact on Air New Zealand’s Trans-Tasman operations and the broader Trans-Tasman business, trade and political relationships.

Choices for the Government

Air New Zealand requires an injection of capital over the next week or so to finance the settlement with the Voluntary Administrator. The independent directors have informed the major shareholders that unless they are willing to immediately fund the settlement with the Ansett Voluntary Administrator and put up a further \$115 million (being the balance of the \$300 million or \$150 million each proposed under the Heads of Agreement) the independent directors will be unwilling to continue trading and will resign and/or recommend Statutory Management.

The major shareholders have confirmed that they are unable to put up these amounts until they have completed due diligence and received their approvals.

This situation presents stark choices in relation to Air New Zealand's future:

- ▶ The Government can finance the settlement with the Voluntary Administrator and provide the independent directors with comfort to continue trading while a new recapitalisation plan is developed and due diligence is undertaken.
- ▶ If the Government is unable to assist, the company will commence its path towards Statutory Management or liquidation with the likelihood that this course of action will be irreversible.

Statutory Management

Statutory Management has the potential to enable Air New Zealand's activities to be reorganised into a viable national “flag carrier” and has the additional (compared to a recapitalisation) advantage of giving the Government priority in respect of any funding it provides to the Statutory Manager for this purpose. However, it also has a number of uncertainties and risks including:

- ▶ The path into Statutory Management is unlikely to be straightforward or uncontested by the major shareholders or Air New Zealand's bankers and this could further harm Air New Zealand's operations.
- ▶ Although the Government would be funding the activities of the Statutory Manager it would have no direct control over the choice of Manager or his commercial decisions.
- ▶ Statutory Management would be regarded negatively by the banks (which lose any of their control rights and influence under this process).
- ▶ Global capital markets are unlikely to regard Statutory Management as analogous to the US court approved Chapter 11 process and this could effect the assessment of New Zealand's Sovereign risk.
- ▶ Compared to a recapitalisation option, the process and constraints imposed by Statutory Management is likely to involve some loss of value and disruption to Air New Zealand's activities.

Recapitalisation of Air New Zealand

While the capital requirements of Air New Zealand have yet to be clearly established based on preliminary financial information provided by the company, it is now clear that this will require a substantial injection of equity by the Crown over and above the amount required to finance the settlement with the Ansett Voluntary Administrator. This situation arises because of the inability/unwillingness of the major shareholders to contribute more equity and the deterioration in the outlook implied by recent international events.

As we have outlined in an earlier note to you, there are substantial commercial risks for the Crown in an equity position in Air New Zealand.

If the Government is to choose to support the recapitalisation of Air New Zealand we believe it should agree with the shareholders to set aside the current Heads of Agreement and reach agreement on a new package which:

- ▶ Ensures Air New Zealand will be adequately capitalised going forward.
- ▶ Resolves the ownership and governance issues that have negatively affected (and continue to affect) the company's focus and performance.
- ▶ Minimises the Crown's due diligence risk on any further capital that may need to be contributed beyond the cash required to settle with the Ansett Voluntary Administrator.
- ▶ Provides the opportunity for the Crown to significantly reduce its cash (equity) input by "farming in" a partner which is prepared to take greater risk and responsibility for the leadership of Air New Zealand. (This partner could

be Singapore Airlines if it chooses to make the necessary financial and other commitments).

We have developed the attached recapitalisation proposal which we believe better meets these objectives and, in our view, substantially reduces the Crown risk on any capital contributed beyond the initial \$185 million.

DRAFT TERM SHEET FOR SIA/BIL (Subject to contract)

Background

Current situation is:

Independent directors concerned about solvency. Unlikely to continue without immediate equity support. Resignation of independent directors likely to create a situation that the company cannot continue to trade. In particular, banks are likely to withdraw support.

BIL/SIA unwilling to provide the support. Both insistent that any support be conditional upon due diligence.

Deal with Ansett VA requires immediate funding. Failure to commit funding in the next 48 hours may cause that deal to collapse. Failure of Ansett VA deal raises Air New Zealand's ongoing capital requirements.

Crown Offer

The Crown offers to make available the following funding to Air New Zealand:

- ▶ Immediate funding of NZ\$185 million (tranche A);
- ▶ Long-term funding of up to NZ\$750 million (tranche B).
- ▶ Tranche A to be made available in the week ending September 28, 2001.
- ▶ Tranche B available subject to satisfactory due diligence by the Crown. Due diligence to be completed no later than November 10, 2001.

Security as follows:

- ▶ Instrument: Convertible preferred stock.
- ▶ Coupon: 5% pa payable semi-annually.
- ▶ Voting rights as per ordinary equity.
- ▶ Conversion terms: mandatorily convertible into ordinary shares at NZ\$0.20 per share or market price (whichever the lower) and adjustable for changes in underlying capital structure.
- ▶ Timing of conversion: at the Crown's option but no later than December 31, 2004.
- ▶ Ranking: ahead of ordinary equity, below senior unsecured lending.

Other Conditions

Unsecured lenders agree to a standstill prior to the end of the due diligence period and a funding package acceptable to the Crown for the period November 10, 2001 to November 10, 2003.

Crown to be satisfied that secured creditors will not exercise rights against assets/Air NZ.

Termination of the Heads of Agreement

Air New Zealand Board, SIA and BIL agree to support the Crown proposal. This support to include (but not be limited to):

- ▶ Supporting merging of company's ordinary equity into one share class.
- ▶ Recommending package to minority shareholders.
- ▶ Voting in favour of Crown proposal at necessary shareholder meetings.
- ▶ BIL and SIA agree to standstill until such time as Crown's proposal is implemented (ie no right to sell shares or give proxies to any other party prior to completion or expiry of Crown package ie 31/12/2001).
- ▶ SIA and BIL agree that they will each procure the resignation of all but one of their director nominees and support immediate appointment of [3] Crown nominees to the Air New Zealand Board.
- ▶ Subject to shareholder approvals and regulatory consents.
- ▶ Subject to the Crown being satisfied that;
 - Air New Zealand can be fund liabilities in respect of the tax indemnity and put option to the extent they exceed the funding available under tranche A;
 - The deal with the Ansett VA precludes all claims against:
 - Air NZ, and associates of all kinds, other than SIA/BIL
 - Air NZ's directors, officers, etc
 - Crown and all its instruments, agencies, advisors, etc :
 By a - VA, liquidator, receiver, etc of Ansett whenever in office
 - any other person subject to Australian jurisdiction (irrespective of wherever the claim may be lodged)
 - however and on whatever basis those claims arise, before and after 12 September 2001