

The Treasury

Air New Zealand (Air NZ) Aircraft Replacement Transaction Information Release

November 2019

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Cabinet Document Details

Title: **Cabinet Paper DEV-19-SUB-0072: Air New Zealand (Air NZ) Aircraft Replacement Transaction**

Date: **10 April 2019**

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Information Withheld

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- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

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Office of the Minister of Finance

Chair, Cabinet Economic Development Committee

AIR NEW ZEALAND (Air NZ) AIRCRAFT REPLACEMENT TRANSACTION

Proposal

1. Air NZ is considering purchasing and leasing a number of new aircraft and engines to replace its Boeing 777-200ERs, which are around 13 years old. The current plan is to exit eight Boeing 777-200ER aircraft in 2022 to 2025. This paper is to inform Cabinet of my intention, as shareholding Minister for Air NZ, to support the widebody replacement transaction (the transaction).

Background

2. Replacement of aircraft is a business as usual activity for Air NZ. However, Air NZ's proposed widebody replacement would be a "major transaction" under the NZX listing rules, but not under the New Zealand Companies Act, where the threshold for a "major transaction" is higher.
3. This means the transaction, being a series of aircraft and engine purchases, requires approval by the majority of Air NZ's shareholders. This ultimately means shareholder approval can be provided by the Crown alone, given the Crown owns 51.9% of Air NZ. Understandably Air NZ is seeking Crown support before progressing its negotiations further.
4. Air NZ has advised that it intends to fund the transaction from its own balance sheet and the transaction is not expected to have any direct impact on dividends. The improved economics of the new fleet should provide greater financial resilience for Air NZ, compared with the 777-200ER fleet, and therefore provide greater support for future dividends. The transaction cash flows will be spread over several years.

Inside information provided by Air NZ

5. The Treasury has signed a confidentiality agreement with Air NZ, which allows the company and the Crown to discuss the details of this matter. The Treasury met with Air NZ on 13 March 2019 to discuss the transaction. The information provided by Air NZ, and contained in this paper, will remain "inside information" until it is disclosed to other investors. Given this, any information regarding the proposed transaction should be disclosed to as few people as possible.
6. The Treasury has advised me that Air NZ gave a comprehensive and compelling presentation on the rationale for buying new airplanes. This presentation used the same information that will eventually be made public – i.e. Treasury did not receive

any information that needs to remain confidential indefinitely. The information provided by Air NZ will be disclosed to other investors in June 2019.

7. In order to narrow the scope of possible replacement aircraft Air NZ modelled its requirements based on forecast passenger demand growth, the potential for new destinations and the specific aircraft capability.
8. To allow flexibility Air NZ's wide body replacement will not necessary be a like for like replacement of the eight Boeing 777-200ER aircraft. Instead there may be more or less than eight aircraft, with some flexibility as to the delivery dates of the aircraft.
9. Air NZ has narrowed its options down to six types of aircraft. The aircraft include offerings from both Boeing and Airbus, being suppliers of jet aircraft to Air NZ's current fleet. Four of the types aircraft are currently in service with the remaining two aircraft expected to enter service in 2020 and 2022.
10. One of our key considerations for Air NZ was why replace now versus refitting the existing Boeing 777-200ER aircraft. Air NZ advised that:
 - by the time new replacement aircraft could be delivered (2022 to 2025) the Boeing 777-200ER aircraft will be approximately eighteen years old and will require their third major structural integrity check – an expensive process. At this point it is not uncommon for unexpected problems to eventuate which could increase the cost, as well as result in substantial delays and creating operational uncertainty
 - aircraft require major structural integrity checks every six years and given the cost of this, once the check is carried out, it makes sense to fly the aircraft for another six years until the next check. This means operating the aircraft for a few years longer, rather than six years, is not a sensible option
- [25], [26], [38]
- given the fuel efficiencies offered by the new aircraft the analysis conducted by Air NZ was strongly in favour of replacing the Boeing 777-200ER aircraft. Depending on the particular plane chosen, and how you measure it (per seat or per flight) there would be a reduction in fuel costs of 20-25%.
11. Therefore buying new planes now (for delivery in a few years) makes sense from a financial and operational perspective, as it is superior to keeping the existing planes for longer.
12. Air NZ has not decided yet exactly which planes to buy, so I am not considering or being asked to approve a specific transaction. Treasury has also not been told the specific financial details of the transaction.

13. However, I consider that the incentives of the board and management are well aligned with its shareholders, that is the transaction supports Air NZ's core operations.

Consultation

14. This paper does not require consultation with other departments.

Financial Implications

15. Air NZ has advised that it intends to fund the transaction from its own balance sheet and the transaction is not expected to have any direct impact on dividends. Therefore there are no fiscal implications for the Crown.

Legislative Implications

16. This transaction does not have any regulatory or legislative impacts.

Human Rights

17. Not relevant.

Gender Implications

18. Not relevant.

Disability Perspective

19. Not relevant.

Publicity

20. In May 2019 Air NZ will release a notice of meeting for a special meeting of shareholders, to be held in June 2019. At that point the proposed transaction will be made public. The Crown's support for the transaction will be announced by Air NZ. No publicity by the Government is planned or necessary. My office will respond to any questions received after Air NZ makes its announcement.
21. Until Air NZ's announcement, details of this paper should not be made public as the paper contains "inside information" with respect to a New Zealand listed company.

Proactive Release

22. Due to the commercial sensitivity of this paper and that it contains "inside information" with respect to a New Zealand list company this paper should not be released, until the inside information is publicly made available to other shareholders by Air NZ.

Recommendations

The Minister of Finance recommends that the Committee:

1. **note** that, as shareholding Minister for Air New Zealand, I will be providing my support to Air New Zealand for the major transaction that involves the replacement of Air New Zealand's existing 8 Boeing 777-200ER aircraft with new aircraft, and
2. **note** I will write to Air NZ advising of my decision.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance