The Treasury

Official information regarding the Crown’s support for Air New Zealand as a result of the COVID-19 pandemic

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[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

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

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Office of the Minister of Finance
Office of the Associate Minister of Finance

Chair
Cabinet Economic Development Committee

AIR NEW ZEALAND CAPITAL RAISE

Purpose

1. Air New Zealand (Air NZ) intends to undertake a capital raise, including new equity and debt, in early calendar 2022. The size of this capital raise, and as a result the amount of any Crown contribution, is subject to change as Air NZ's financial position may change.
2. This paper asks Cabinet to:
   2.1. confirm the Government's objectives for its ownership stake in Air NZ,amend the terms on which the Crown is providing support to Air NZ, ahead of the capital raise, to provide a bridge to the capital raise, including the establishment of the ability for the Crown to subscribe for up to $1,000 million in non-voting redeemable shares in Air NZ,
   2.2. provide approval for the Crown to participate in the capital raise so as to maintain a 51% ordinary shareholding in Air NZ and thereby achieve the Government's objectives, and
   2.3. delegate authority to the Minister of Finance and the Associate Minister of Finance (Hon David Parker) to finalise the terms of the Crown's involvement in an Air NZ capital raise, subject to a financial range as outlined in this paper.

Executive Summary

3. Air NZ is an important strategic asset for New Zealand. As our national carrier it has connections domestically and to overseas markets to, among other matters, promote and build people-to-people links, tourism, regional growth, trade and export growth.
4. The Crown's long-term position as the majority shareholder in Air NZ is a source of stability for the company through difficult periods while also achieving public policy outcomes. The Crown does not have a majority shareholding in Air NZ for purely commercial returns.
5. We propose that Cabinet confirm that the Government's objectives for maintaining a majority shareholding in Air NZ are ensuring:
   5.1. a national airline continuing in operation to support economic development, including access to international markets for our exporters and international tourism linkages, once international borders re-open,
   5.2. a comprehensive domestic route network that allows people and goods to move across New Zealand in a timely fashion at a reasonable cost,
   5.3. the airline's commitment to environmental sustainability including engaging with the development of new aviation fuels for New Zealand,
   5.4. the airline's role as a leader for best practice workplace relations given that it is one of New Zealand's largest employers,
   5.5. Air NZ continues acting as a responsible corporate citizen, and
   5.6. Air NZ achieves these objectives while operating as a commercially sustainable and capital efficient business.

6. These objectives can be achieved by the Crown owning exactly 51.0% of Air NZ (slightly less than the existing shareholding). There is no benefit for the Crown to have more capital than this amount invested in the company in the form of equity facing uncertain financial returns.

7. Air NZ's ability to operate, its financial position and its ability to achieve the Government's objectives have been severely impacted by measures imposed to manage the COVID-19 pandemic. The current restrictions to domestic and trans-Tasman travel are estimated to impact Air NZ's financial performance by $45 million to $60 million per month.

8. While the Crown has provided $505 million of debt support through a Crown Standby loan Facility (CSF-1) to ensure Air NZ remains solvent, this is not sustainable or desirable.

9. A number of measures must be taken for Air NZ to be financially sustainable in the longer-term. A capital raise is the best option, as it allows all shareholders to recapitalise Air NZ on an enduring basis.

10. Air NZ intends to undertake a capital raise in the first quarter of 2022. Air NZ's financial position is likely to continue to deteriorate in advance of the capital raise, with total borrowing from the Crown forecast to increase to $970 million by March 2022.

11. Previous efforts to complete a capital raise have been deferred as there was material uncertainty with factors such as the timing of border reopenings, which Cabinet considers separately. There is no guarantee the proposed upcoming capital raise will not be similarly affected. The biggest variable in Air NZ's financial modelling is the date at which international travel will be unrestricted. The implications of this affects Air NZ's forecasting and overall solvency position.

12. It is in the Crown's interest for Air NZ to be well-placed to undertake a capital raise. We therefore propose that the Crown amend the terms of the support it provides to Air NZ in advance of a capital raise.

13. The limit of the existing CSF-1 would decrease from $1,500 million to $1,000 million, and its term would be extended to January 2026.

14. Separate to this, the Crown would agree to subscribe for up to $1,000 million in non-voting redeemable shares in Air NZ from the time that CSF-1 is 85% ($850 million) drawn. These shares would carry a mandatory quarterly dividend to the Crown – Air NZ could defer the payment of these dividends, but any unpaid dividends would accumulate and require payment before any ordinary dividend could be paid. The dividend rate of the redeemable shares will increase in steps in 2024 and 2027, which incentivises Air NZ to redeem the shares (and repay the Crown) as soon as possible.

15. As a result of the amendments, the total amount of liquidity available from the Crown to Air NZ would increase from $1,500 million to $2,000 million. It is Air NZ's intention to use the redeemable shares as required in advance of the capital raise, and then, using the proceeds of the capital raise, to fully repay funds borrowed under CSF-1 and the redeemable shares. These facilities would then be canceled.

16. It will be necessary for the Crown to contribute equity capital in the capital raise to achieve a 51% ordinary shareholding post capital raise. The precise size and composition of the capital raise will be finalised in 2022 but current forecasts are for a total capital raise of around [25] and [37] comprised of:

    16.1. Around [25] and [37] of new equity – with a Crown contribution of approximately [25] and [37]

    16.2. Around $600 million of medium-term private debt, and

    16.3. $400 million from a new Crown Standby loan Facility (CSF-2) – provided as a backstop measure to ensure liquidity in a downside scenario. Based on current modelling, the expectation is that there will be no need to draw down funds from this facility.

17. In a downside scenario, the size of the capital raise could increase as Air NZ's operations remain restricted for an extended period. We therefore seek approval to increase the size of both the Crown's equity contribution, and CSF-2 by [25] and [37] if required.

18. We are also seeking Cabinet's agreement to delegate authority to ourselves to finalise the terms of the Crown's involvement in the Air NZ capital raise, subject to these financial limits. We will report back to Cabinet once we have taken decisions under delegated authority.

19. The terms of the proposed amendments in the Crown's support of Air NZ, and the proposed size and composition of the capital raise, have been determined on a commercial basis. Air NZ is incentivised, through the dividend-rate step-up, to not issue more redeemable shares than is necessary and to redeem the redeemable shares as soon as possible.

20. We are satisfied that the proposed amendments to the Crown's support are necessary, and that the specifics of the proposed capital raise are appropriate. Providing further support as a bridge to a capital raise, and contributing to the capital raise within the proposed range, is the most efficient commercial path for the Crown to achieve its objectives for owning a majority of Air NZ.

21. [34] and [38]

Background – strategic challenges and the need for a capital raise

22. COVID-19 has had severe impacts on aviation businesses worldwide. In March 2020 the Government provided Air NZ with a $900 million (later increased to $1,500 million) Crown Standby Facility (CSF-1) to secure the continuation of aviation services and support the company's financial position in the face of significant uncertainty.

23. As at 3 November 2021 Air NZ had drawn down $505 million of CSF-1. The balance of $995 million in CSF-1 comprises the majority of Air NZ's available liquidity as it currently has negative operating cash flow due to restrictions on its ability to fly passengers to and from New Zealand, and domestically within New Zealand, as a result of measures put in place to protect New Zealand from community transmission of COVID-19. In September 2021 the number of total passengers carried by Air NZ was 60% less than in September 2020, which in turn was 60% lower than the number of passengers carried, pre-COVID, in September 2019.

24. The Crown's financial support for Air NZ since the onset of COVID-19 was always intended to be a temporary measure that provided the time for Air NZ to reposition its operations and facilitate the implementation of an optimal long-term capital structure. This was always expected to require a capital raise, following which the Crown's financial support (in the form of debt) would be repaid.

25. Air NZ faces several challenges, most notably:

    25.1. Air NZ's ability to operate, domestically and internationally, is subject to the Government's decisions regarding the timing of border openings. The same decisions have consequential effects for the level of demand from Air NZ's customers. By far the most significant variable in Air NZ's financial modelling is the date at which international travel will become unrestricted.

    25.2. There is the potential for strong competition from other airlines which take the opportunity to restructure their operations to emerge from the pandemic as low-cost operators, or from new low-cost airlines that are set up post-COVID-19, due to the likely surplus of aircraft available at low prices.

    25.3. Air NZ must manage the implications of its own long-haul fleet configuration being aligned to a different, pre-COVID-19, environment. There are contractual complications and cost impacts from unwinding these fleet arrangements.

26. Substantial analysis and scenario modelling has now been completed on how the pandemic may develop and the subsequent impacts on Air NZ's business operations, fleet, operating cost structure, and capital requirements. Treasury officials and the Crown's commercial advisors, Goldman Sachs and Calibre Partners, have participated in this analysis.

27. This work confirms that a capital raise is required as it is the only enduring option for Air NZ to improve its balance sheet.

28. The work demonstrates that Air NZ has made reasonable attempts to lower its costs and minimise its capital requirements before seeking additional debt and equity capital. [25] and [37]

There is also a strong market expectation that Air NZ needs to raise equity, and failure to do so could result in a loss of confidence by minority shareholders or a downgrade of Air NZ's credit rating, which may have financial consequences for the company.

29. We agree with the assessment that a capital raise is necessary. The preparatory work will also allow for a fully informed investor base and a stronger investment story for prospective investors.

The Government's objectives for its investment in Air New Zealand

30. The Crown's role as majority shareholder has been a source of stability for Air NZ during difficult operating periods and is a key reason that Air NZ is better placed than many airlines around the world. The majority shareholding is a direct result of Air NZ's near failure in 2001 and 2002, in the wake of a failed investment in an Australian airline and the impact of the 11 September 2001 terrorist attacks.

31. It is proposed that Cabinet confirm that the Government's objectives for maintaining a majority shareholding in Air NZ are ensuring:

    31.1. a national airline continuing in operation to support economic development, including access to international markets for our exporters and international tourism linkages, once international borders re-open,

    31.2. a comprehensive domestic route network that allows people and goods to move across New Zealand in a timely fashion at a reasonable cost,

    31.3. the airline's commitment to environmental sustainability including engaging with the development of new aviation fuels for New Zealand,

    31.4. the airline's role as a leader for best practice workplace relations given that it is one of New Zealand's largest employers,

    31.5. Air NZ continues acting as a responsible corporate citizen, and

    31.6. Air NZ achieves these objectives while operating as a commercially sustainable and capital efficient business.

32. These objectives have been previously communicated to Air NZ through a letter of expectations provided to the company on 8 April 2021. As with all letters of expectation, the letter to Air NZ has been made public, so that the public, and potential and current investors in Air NZ, are aware of the Crown's objectives for its majority shareholding.

33. The Minister of Finance (as the shareholding Minister) has regular interactions with the Chair of Air NZ's board and the Chief Executive Officer so that the Minister of Finance can indicate the Government's expectations as a majority shareholder. Air NZ has confirmed that the Crown's ownership objectives are aligned with its strategic business plan.

34. Consideration has been given as to whether a different Crown shareholding level would offer any additional advantages. The Government's policy is not to sell any Crown-owned assets, therefore selling shares to reduce the Crown's shareholding below 51% would not be consistent with this policy. Owning a higher shareholding percentage than 51% (i.e. holding a

51.1% to 99.9% shareholding) does not provide any useful additional control to the Crown, as the business would still be run by the company's board and management, and additional Crown capital would be tied up for no additional policy benefits and uncertain financial returns. The Crown does not own businesses solely because it wants financial returns.

35. Owning 100% of Air NZ would also not be preferable. It is not necessary to achieve the Government's objectives and would require the Crown purchasing all of the shares owned by other shareholders. This is likely to be complicated, expensive and time-consuming, and does nothing to assist Air NZ – all it does is transfer money from the Crown to the other shareholders. It would also require the Crown to contribute all of the equity that Air NZ requires, both now and in the future.

36. On balance, we seek Cabinet's agreement that the Government's policy should be to own exactly 51% of Air NZ for the foreseeable future. This provides the ability to achieve the Government's objectives for Air NZ and aviation services, given the critical role they play in the economy and wellbeing of New Zealanders, for the minimum allocation of Crown capital. A Crown ownership of 51% can be achieved by subscribing for the appropriate number of new ordinary shares, when Air NZ offers new shares to all of its shareholders as part of its capital raise in 2022.

Amending the terms of Crown support for Air NZ as a bridge to the capital raise

37. While a capital raise is the best option to recapitalise Air NZ on an enduring basis, there is no guarantee that a capital raise will be able to be completed in the first quarter of calendar 2022 as intended by Air NZ. The successful completion of a capital raise will be subject to several factors, including the ability of capital and debt markets to meet the size and composition of the capital raise once these details have been finalised.

38. We are also advised that the capital raise should not ideally occur during a period when the Government intends to announce significant policy decisions that would have a material impact on Air NZ's forecast financial position, for example, decisions on border openings. It would also be undesirable for the capital raise to be completed shortly before such decisions are announced. This means the capital raise would ideally not occur until such decisions have been taken and made public. Material uncertainty, including around the timing of announcements of border openings, has previously deferred Air NZ's attempts to complete a capital raise.

39. We are also mindful of Air NZ's current operating environment, with limited ability to operate due to COVID-19 restrictions and a resulting impact on its financial performance estimated at $45 million to $60 million per month.

40. As at 3 November 2021 Air NZ had drawn down $505 million of CSF-1. This is forecast to increase to around $970 million by the end of March 2022 as Air NZ continues to have negative operating cash flow, it is required to meet approximately $300 million in PAYE to Inland Revenue (that has been previously deferred), and as Air NZ takes delivery of new aircraft and makes final payments on them to the manufacturer (the arrival of which was deferred in 2020 to decrease capital expenditure).

41. As a result, the available liquidity in CSF-1 is forecast to decrease to approximately $530 million by the end of March 2022, with this liquidity forecast to decrease by $370 million in the first three months of 2022 alone.

42. [25], [26] and [37]

43. As majority shareholder, it is in the Crown's interest for Air NZ to be well-placed to undertake a capital raise, not only to achieve the Government's objectives but also given that a counter-factual is significantly increased levels of Crown support with no contribution by minority shareholders.

44. We therefore seek Cabinet's agreement to amend the Crown loan arrangements currently in place to enable the Crown to support Air NZ with a bridge to a capital raise, and to ensure that this support is future-proofed should a capital raise be deferred beyond the first quarter of calendar 2022.

45. The key elements of the proposed amendments are:

    45.1. The Crown would make available up to $1,000 million by way of an agreement to subscribe for non-voting redeemable shares, separate to CSF-1 – noting that Air NZ is only forecast to issue a small portion ($150 million to $200 million) of these shares ahead of the planned capital raise in the first quarter of calendar 2022,

    45.2. The total loan facility limit under CSF-1 would reduce from $1,500 million to $1,000 million and the term of CSF-1 would be extended from September 2023 to January 2026,

    45.3. As a result, the overall liquidity available from the Crown to Air NZ would increase from $1,500 million to $2,000 million, being the sum of the CSF-1 facility limit plus the available non-voting redeemable shares,

    45.4. Air NZ could issue these non-voting redeemable shares once 85% (or $850 million) of CSF-1 had been drawn,

    45.5. Air NZ's access to the redeemable shares will expire once Air NZ has completed one or more ordinary equity raises totalling at least $1,000 million,

    45.6. The non-voting redeemable shares will carry a mandatory quarterly dividend – Air NZ can choose not to pay this in any quarter, however, any suspended dividends on the redeemable shares accumulate and are required to be paid in full at a future date, and Air NZ cannot pay dividends on its ordinary shares while the redeemable share dividends are suspended,

    45.7. The dividend on the redeemable shares will be set at a base rate plus a margin, with the margin initially the same as the interest rate on CSF-1, 3.5%, but stepping up to 5.5% on 1 January 2024 and 7.5% on 1 January 2027, if the shares have not been redeemed by then,

    45.8. The scheduled redemption date for all of the redeemable shares issued is set at 25 years, however, this can be extended by five years (on multiple occasions) if Air NZ has not raised a total of at least $1,000 million in ordinary equity, or if Air NZ's directors resolve that the company will not satisfy a solvency test immediately following redemption of the redeemable shares, and

    45.9. Air NZ could choose to redeem the redeemable shares, in whole or in part, at any time if its directors resolve that the company will satisfy a solvency test immediately following redemption of the redeemable shares, and no insolvency event has occurred. Air NZ is incentivised to redeem the shares due to the step-ups in the dividends payable on them.

46. The redeemable shares will be treated as equity in Air NZ's financial statements.

47. Air NZ's intention is to draw on the redeemable shares, once CSF-1 has been drawn to $850 million, in order to fund its operations ahead of the capital raise; and then repay all of the redeemable shares from the proceeds of the capital raise. Access to the redeemable shares would then be cancelled. In this way, the redeemable shares provide a bridge to the capital raise by the Crown temporarily providing equity (in accounting terms) to strengthen Air NZ's balance sheet ahead of the planned capital raise.

48. The redeemable shares need to be for $1,000 million, to provide Air NZ with access to sufficient liquidity, and certainty around access to that liquidity – even though the company currently forecasts to call for subscription for a far smaller dollar value of the redeemable shares ($150 million to $200 million as noted above). The size of the redeemable shares also provides support for Air NZ should its planned equity raise need to be deferred again.

49. There is the possibility that Air NZ will need to retain some of the redeemable shares beyond the completion of its capital raise, in order to optimize the size of its equity raise and still achieve the appropriate balance sheet strength. As a result, the Crown may hold some redeemable shares for a period of time. As noted in paragraph 45.9 above, Air NZ is incentivised to redeem these shares as soon as it is able to do so.

50. Air NZ has requested from the New Zealand Stock Exchange (NZX), and NZX has granted, two waivers from Listing Rule 5.1.1(b) and Listing Rule 5.2.1, as the Crown subscribing for non-voting redeemable shares in Air NZ would be considered a major transaction, and a Material Transaction with a Related Party, respectively. Normally for both of these, the approval of Air NZ's shareholders would be necessary; NZX has, in the circumstances, granted a waiver from these requirements.

51. The waiver regarding the major transaction requirement has been granted on the condition that if CSF-1 or the redeemable shares are still in place in 12 months, approval by Air NZ's shareholders would be required. The NZX has stated that the Crown would be able to vote in favour of this resolution.

52. CSF-1 and the redeemable shares are intended to be repaid when Air NZ carries out a capital raise. However, if the capital raise is delayed, or if Air NZ wishes to keen some of the redeemable shares following the capital raise, it would need to seek a shareholder vote to do so. Air NZ has requested that the Crown enter into a voting undertaking to vote in favour of such a resolution. The Minister of Finance proposes to give this undertaking.

53. While the key elements of the redeemable shares proposal have been negotiated, the final Terms Sheet may be subject to slight amendment. We therefore seek delegated authority to be able to make minor changes and to approve the final Terms Sheet, consistent with the key elements outlined in paragraph 45 above.

International precedent

54. Due to the impact of COVID-19, the Hong Kong Administration has provided support to Cathay Pacific, and the Swedish and Danish Governments have provided support to Scandinavian Airline SAS Group. The precise terms of the instruments used to support these airlines in both these cases were slightly different, and the terminology used to describe them was also different, but in substance the support provided was very similar to the terms outlined above for the proposed redeemable shares for Air NZ.

Structure of the capital raise and delegated authority

55. Based on information available as at 18 November 2021, a total capital raise of approximately [25] and [37] is proposed. The precise composition of the capital raise will be determined in the first quarter of 2022, however, at this time the total is comprised of:

    55.1. **around** [25] and [37] **of new equity**, through the issue of ordinary shares – with approximately [25] and [37] to be provided by the Crown in order to maintain a 51% majority shareholding,

    55.2. **around $600 million of medium-term private debt** – Air NZ proposes to issue Medium Term Notes in the Australian market, and

    55.3. **a $400 million new Crown Standby loan Facility** – a new Crown Standby loan Facility (CSF-2), will be provided as a backstop measure, intended to provide liquidity cover for any downside scenarios from the base case. The facility will have a maturity of January 2026. Based on current modelling, the expectation is that there will be no need to draw down funds from this facility.

56. The Crown would therefore provide new equity and CSF-2 debt facility. The medium-term private debt would not be provided by the Crown.

New equity

57. For an around [25] and [37] equity raise by Air NZ, the amount of Crown equity required for the Crown to maintain a 51% shareholding depends on the exact number of new ordinary

shares to be issued and the price that Air NZ will issue the new shares for, both of which will not be decided until closer to the time, but is likely to be around [25] and [37] Accordingly, an appropriation of [25] and [37] is sought. Delegated authority to increase this amount to [25] and [37] is also sought should it be considered necessary as the size and composition of the capital raise is finalised in 2022.

58. The Government has indicated to Air NZ that it considers fair treatment of retail investors to be a requirement of the capital raise. It is common in equity raisings for share placements to be made to institutional investors on a preferential basis, with retail investors provided less than pro-rata access. This can have the effect of diluting retail investors' holdings in the company. Companies often prefer this structure as it is quicker and provides more certainty that the desired funds will be raised. In the case of Air NZ, the dilutionary impacts on retail investors could be significant as institutional investors sold out of the company at the start of the pandemic and the non-Crown ownership of the company is now overwhelmingly retail investors.

59. Air NZ agrees that fair treatment of retail investors is important. To ensure fairness, it is intended that the proposed equity raising will be conducted through a traditional rights issue. Each shareholder will receive an identical right to subscribe for new ordinary shares in proportion to their current shareholding. Shareholders who do not wish to exercise their right to subscribe for new ordinary shares can sell those rights on the market. Under this approach all shareholders are treated equally and there is no loss of value for retail investors, participating or non-participating, irrespective of the price that the new ordinary shares are offered at or the number of new shares issued.

60. The Crown will be asked to pre-commit to taking its allocation of ordinary shares in the equity raise, before any other investors, and before the underwriters. The Crown pre-commitment to the equity raise will last for a period of around six weeks from the launch of the offer until settlement. Other investors have the ability to wait until the last day of the offer period before committing to participate. The underwriters will also be pre committing, but only after the Crown has already committed to take up the portion of the offer necessary to result in a 51% shareholding, and they will retain some ability to withdraw from their underwrite in limited circumstances.

61. The Crown's commercial advisors have advised that in these circumstances it would be normal practice for a commercial cornerstone shareholder to charge a pre-commitment fee. In our view, the Crown should also charge Air NZ a pre-commitment fee.

62. Based on advice received on the precedents for similar commercial transactions, we propose to charge Air NZ a fee of 0.5% of the Crown equity contribution as a pre-commitment fee. This would result in the Crown receiving a fee of around $3 million. This fee will be disclosed as part of the offer materials for Air NZ's equity raise.

New debt

63. The inclusion of debt in the proposed capital raising, rather than an all equity raise, recognises that Air NZ faces temporary challenges and heightened uncertainty, and therefore needs the temporary boost in capital that debt provides, rather than only the permanent increase that equity provides. As the pandemic wanes and international travel recovers, Air NZ's financial position is expected to improve, and it will be sustainable with a lower level of capital. The debt will be raised by Air NZ from private lenders, as is normal practice for Air NZ and for other commercial companies where the Crown has a shareholding.

64. CSF-2 is also advantageous for the Crown as it minimises the amount of capital that the Crown has locked into Air NZ on an enduring basis. Even though the Crown faces debt exposure through the existing CSF-1 and proposed new CSF-2, this capital should be repaid, unlike equity, which is difficult to extract. Crown support for CSF-2 is necessary to enable a more efficient equity raise.

New stand-by facility

65. CSF-2, the new Crown Standby loan Facility of $400 million, will include enhanced reporting requirements for Air NZ. The company must prepare an annual business plan and submit it to the Crown, and report monthly against the business plan.

66. If it draws on CSF-2, Air NZ must consult with the Crown about its financial position and the steps it will take to repay the Crown loan, and provide to the Crown any information that is requested by the Crown. It must also not pay any dividends while any amount remains outstanding against CSF-2.

67. If Air NZ's financial position is materially better than forecast, it can cancel a portion of CSF-2. However, to ensure the Crown reporting requirements remain in place, Air NZ cannot cancel the facility to a level below $100 million. CSF-2 will have an expiry date of 31 January 2026.

68. CSF-2 replaces the existing loan facility, rather than being an amendment of it, because the terms of CSF-2 are materially different – for example, unlike CSF-1, it is a revolving credit facility (if repaid by Air NZ the amount of the facility can be redrawn) and is unsecured. This reflects the different circumstances applying now compared to when CSF-1 was negotiated, as well as the fact that CSF-2 is intended to operate as a true standby facility that is not expected to be drawn on, unless Air NZ's financial position is materially worse than it currently expects.

69. Delegated authority to increase the size of CSF-2 by [25], [37] and [38] is sought should it be considered necessary as the size and composition of the capital raise is finalised in 2022.

70. Overall, we are satisfied that the estimated size and the structure of the proposed capital raise is appropriate and recommend that Cabinet agree that the Crown should participate in the equity raise and provide the redeemable shares and the debt facilities as outlined above. Appropriations to this effect are included in the recommendations.

Delegated authority

71. The timetable for Air NZ to prepare and undertake a capital raise in the first quarter of calendar 2022 is compressed. As noted above, the Crown will need to provide a pre-commitment to take up its share of the equity raise, and decisions around the size, pricing and composition of the capital raise will likely need to be made in a short time period.

72. We therefore recommend that Cabinet delegate authority to the Minister of Finance and Associate Minister of Finance (Hon David Parker) to take all necessary measures to finalise the details of the Crown's involvement in the capital raise. These decisions would be required to be within the appropriations outlined in the recommendations of this paper.

73. We will report back to Cabinet once we have taken decisions under this delegated authority.

Risks

74. Equity investment involves inherent financial risks. The company may perform poorly and the value of the Crown's equity investment may decline. Aviation is, historically, a particularly risky sector to invest in and this has been further exacerbated by the pandemic. However, we believe the strategic benefits from having a majority shareholding in our national airline, in order to achieve the Crown's objectives for Air NZ, justify the commercial risks the Crown is taking on its investment in Air NZ.

75. These risks are mitigated by the fact that the Crown is already financially exposed to Air NZ through its existing shareholding of 51% and CSF-1. The proposed equity raising is intended to fully repay the outstanding balance of CSF-1, and the facility would then be cancelled.

76. If a capital raise cannot be executed that is sufficiently large to fully reimburse the Crown, the Crown may retain a number of redeemable shares for a period of time. As noted in paragraph 45.9 above, Air NZ is incentivised to redeem these shares.

Financial Implications

77. An appropriation of $1,000 million is sought to fund the Crown's subscription for non-voting redeemable shares in Air NZ as required, once 85% of CSF-1 has been drawn. It is forecast that approximately $120 million of redeemable shares will be issued by the end of March 2022 in advance of the intended capital raise. The intention is for these shares to be redeemed following the completion of the capital raise.

78. It is proposed, as part of the establishment of the appropriation for redeemable shares, that the appropriation for CSF-1 be decreased by $500 million, to $1,000 million.

79. An appropriation of [25] and [37] is sought to fund the Crown's participation in the equity raise. This figure would be sufficient to ensure the Crown subscribes for enough ordinary shares to achieve its 51.0% ownership target, given an approximately [25] and [37] equity raise, and across a wide range of possible issue prices for the new ordinary shares. The actual issue price will not be determined until closer to the date of the equity raise. Delegated authority to increase this appropriation by up to [25] and [37] is also requested. This would allow for a total equity raising of up to approximately [25] and [37] again across a wide range of possible issue prices for the new ordinary shares.

80. The total potential cost under the appropriations for the equity portion of the capital raise is therefore [25] and [37] , but it is unlikely that the full [25] and [37] would be required.

81. In addition, an appropriation of $400 million is sought for CSF-2. Delegated authority is sought to increase this appropriation by [25] and [37] if required. Current projections imply that there will be no need to make drawdowns against CSF-2, assuming that the equity and private debt can be raised in the first quarter of calendar 2022.

82. The Minister of Finance has statutory power under section 65L of the Public Finance Act 1989 to lend money to Air NZ if he determines it to be necessary or expedient in the public interest to do so. It is the current intention of the Minister of Finance to make a decision as to whether to amend CSF-1 as outlined in paragraph 45.2 and whether to make available to Air NZ a $400 million CSF-2.

83. Funds from the capital raise are intended to be used to repay the outstanding balance of CSF-1 and the redeemable shares (forecast to be $850 million and $120 million respectively at the end of March 2022).

84. Using current forecasts of what Crown support Air NZ will require before the capital raise and the forecast size of the capital raise, net core Crown debt is forecast to <u>decrease by a net amount of</u> [25] and [37] comprised of:

    84.1. an increase of approximately [25] and [37] reflecting the subscription for new ordinary shares in the equity raise,

    84.2. a decrease to reflect the repayment of the outstanding balance of CSF-1 which is forecast to be $850 million as at the end of March 2022,

    84.3. a decrease to reflect the repayment of the outstanding balance of the redeemable shares which is forecast to be $120 million as at the end of March 2022 (and if the redeemable shares are not issued the outstanding balance of CSF-1 is forecast to be $970 million as opposed to $850 million),

    84.4. an increase through CSF-2 only if it was drawn down by the company, which is not expected, with that impact reversing over the term of CSF-2.

85. Capital expenditure for the Crown's subscription for new ordinary shares in Air NZ will be a charge against the Multi-year Capital Allowance. In the interim it will be met by Imprest Supply and will be included in the Supplementary Estimates.

86. CSF-2 will be established on a commercial basis and will be repaid within ten years, so will have no impact on Budget allowances.

87. The redeemable shares are also expected to be repaid within ten years, so will have no impact on Budget allowances.

88. We are satisfied that these financial implications are appropriate as providing further support as a bridge to a capital raise, and contributing to the capital raise within the proposed range, is the most efficient commercial path for the Crown to achieve its objectives for owning a majority of Air NZ.

Legislative Implications

89. There are no legislative implications.

Human Rights, Gender implications, Disability Perspective

90. None.

Publicity

91. Air NZ will announce the terms of the redeemable shares, if Cabinet agrees to this part of the proposal. The Minister of Finance would also make a statement at this time.

92. No publicity is proposed regarding the capital raise itself, until it is announced by Air NZ at the appropriate time, given the commercial sensitivity. The Crown's participation in the capital raise will be announced by Ministers at the appropriate time as part of this process.

93. We intend to proactively release this paper following the completion of a capital raise, subject to information that remains commercially sensitive being redacted.

Consultation

94. The Department of the Prime Minister and Cabinet has been informed.

Recommendations

We recommend that the Committee:

1. **agree** that the objectives of the Government maintaining a majority shareholding in Air New Zealand (Air NZ) are to ensure:
   1.1. a national airline continuing in operation to support economic development, including access to international markets for our exporters and international tourism linkages, once international borders re-open,
   1.2. a comprehensive domestic route network that allows people and goods to move across New Zealand in a timely fashion at a reasonable cost,
   1.3. the airline's commitment to environmental sustainability including engaging with the development of new aviation fuels for New Zealand,
   1.4. the airline's role as a leader for best practice workplace relations given that it is one of New Zealand's largest employers,
   1.5. Air NZ continues acting as a responsible corporate citizen, and
   1.6. Air NZ achieves these objectives while operating as a commercially sustainable and capital efficient business;
2. **agree** that it is the Government's policy to maintain an ordinary shareholding in Air NZ of exactly 51% for the foreseeable future in order to achieve the Government's objectives as stated in recommendation 1;
3. **note** that the operations and financial position of Air NZ have been severely impacted by restrictions imposed in order to manage the COVID-19 pandemic;
4. **note** that Air NZ intends to undertake a capital raise, including new equity and debt, in early calendar 2022;

5. **note** that significant preparatory work has been and continues to be undertaken ahead of the capital raise and that officials and the Crown's commercial advisors have been participating in this work;

Additional Crown support for Air New Zealand in advance of a capital raise

6. **note** that additional Crown support for Air NZ in advance of the capital raise is required;

7. **note** that the Crown is considering amending the terms of the existing Crown Standby loan Facility (CSF-1) as follows:

   7.1. decrease the total loan facility to $1,000 million (from $1,500 million), and

   7.2. extend the term to 31 January 2026;

8. **agree** for the Crown to subscribe to up to $1,000 million in non-voting redeemable shares in Air NZ, with the key terms of the redeemable shares being:

   8.1. Air NZ could request that the Crown subscribe for these non-voting redeemable shares once 85% (or $850 million) of CSF-1 had been drawn,

   8.2. Air NZ's access to the redeemable shares will expire once Air NZ has completed one or more ordinary equity raises totalling at least $1,000 million,

   8.3. The non-voting redeemable shares will carry a mandatory quarterly dividend – Air NZ can choose not to pay this in any quarter, however, any suspended dividends on the redeemable shares accumulate and are required to be paid at a future date, and Air NZ cannot pay dividends on its ordinary shares while the redeemable share dividends are suspended,

   8.4. The dividend on the redeemable shares will be set at a base rate plus a margin, with the margin initially the same as the interest rate on CSF-1, being 3.5%, but stepping up to 5.5% on 1 January 2024 and 7.5% on 1 January 2027, if the shares have not been redeemed by then,

   8.5. The scheduled redemption date for all of the redeemable shares issued is set at 25 years, however, this can be extended by five years (on multiple occasions) if Air NZ has not raised a total of at least $1,000 million in ordinary equity, or if Air NZ's directors resolve that the company will not satisfy a solvency test immediately following redemption of the redeemable shares, and

   8.6. Air NZ could choose to redeem the redeemable shares, in whole or in part, at any time if its directors resolve that the company will satisfy a solvency test immediately following redemption of the redeemable shares, and no insolvency event has occurred. Air NZ is incentivised to redeem the shares due to the step ups in the dividends payable on them.

9. **delegate** authority to the Minister of Finance and Associate Minister of Finance (Hon David Parker) to finalise the terms and final drafting matters on which the Crown agrees to subscribe for up to $1,000 million of redeemable shares, consistent with the key terms agreed in recommendation 8;

10. **note** that if CSF-1 or the redeemable shares are still in place in 12 months' time, then under the terms of the waiver granted by NZX, Air NZ would require the approval of its shareholders

11. **note** that the Minister of Finance intends to give a voting undertaking that, if a shareholder vote is required, the Crown would vote in favour

Capital raise

12. **note** that the structure of Air NZ's proposed capital raise is:

    12.1. around [25] and [37] of new equity,

    12.2. around $600 million of medium-term private debt, and

    12.3. a new $400 million Crown Standby Facility (CSF-2) available until 31 January 2026;

13. **note** that, as part of the capital raise, the Crown would provide new equity and the CSF-2 debt facility to Air NZ, and the medium-term private debt would not be provided by the Crown;

14. **note** that the intention is for Air NZ's capital raise to be used, in part, to repay the amounts outstanding under CSF-1, which will then be cancelled, and to redeem any redeemable shares that have been issued to the Crown;

15. **note** that the new CSF-2 includes enhanced reporting requirements for Air NZ, and a requirement that the company cannot pay dividends if it draws on CSF-2;

16. **agree** that the Crown will participate in the proposed capital raise to maintain the Crown's majority ordinary shareholding and to achieve the Government's objectives as stated in recommendation 1;

17. **delegate** authority to determine whether the commercial aspects of the deal are satisfactory, and, therefore, to take the final decision for the Crown to participate in the equity raise, to the Minister of Finance and Associate Minister of Finance (Hon David Parker), in line with the appropriations outlined in recommendations 23 and 27;

18. **note** that the Crown, as part of the proposed capital raise, will be requested by Air NZ to pre-commit to taking its allocation of ordinary shares in the equity raise, before any other investors, and that the Crown will charge Air NZ a fee of 0.5% of the Crown equity contribution as a pre-commitment fee, which would result in the Crown receiving a fee of around $3 million;

19. **note** that the Minister of Finance, as the Minister responsible for the administration of the Public Finance Act 1989, is the Minister with the statutory power under section 65L of that Act to lend money to Air NZ if he determines it to be necessary or expedient in the public interest to do so;

20. **note** that it is the current intention of the Minister of Finance to make a decision under section 65L of the Public Finance Act 1989 as to whether to amend CSF-1 as outlined in recommendation 7 and whether to make available a new $400 million Crown Standby Facility (CSF-2);

Appropriations

21. **agree to** establish the following new annual appropriations:

Vote	Appropriation Minister	Title	Type	Scope
Finance	Minister of Finance	Subscription for Non-Voting Redeemable Shares in Air New Zealand	Non-Departmental Capital Expenditure	This appropriation is limited to the subscription for non-voting redeemable shares in Air New Zealand.
Finance	Minister of Finance	Subscription for Ordinary Shares in Air New Zealand	Non-Departmental Capital Expenditure	This appropriation is limited to the subscription for new ordinary shares in Air New Zealand.

22. **agree** to establish the following new multi-year appropriation, to run from 1 March 2022 to 30 June 2026:

Vote	Appropriation Minister	Title	Type	Scope
Finance	Minister of Finance	Crown Standby Loan Facility for Air New Zealand	Non-Departmental Capital Expenditure	This appropriation is limited to loans to Air New Zealand.

23. **approve** the following change to appropriations to reflect the Crown's participation in Air New Zealand's planned capital raise, each with a corresponding impact on net core Crown debt:

	$m – increase/(decrease)				
Vote Finance Minister of Finance	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Non-Departmental Capital Expenditure: Subscription for Non-Voting Redeemable Shares in Air New Zealand	1,000.000				
Non-Departmental Capital Expenditure: Subscription for Ordinary Shares in Air New Zealand	[25] and [37]	-	-	-	-
Total Capital	[25] and [37]				

24. **approve** the following change to appropriations to reflect the reduction in the size of CSF-1 to $1,000 million with a corresponding impact on net core Crown debt:

	$m – increase/(decrease)	
Vote Finance Minister of Finance	**2021/22 to 2024/25**	**2025/26 & Outyears**
Multi-Year Appropriation Non-Departmental Capital Expenditure: COVID-19: Loans to Air New Zealand	(500.000)	-

25. **approve** the extension of the term of the existing multi-year appropriation in Vote Finance for CSF-1, titled "COVID-19: Loans to Air New Zealand", to 30 June 2024;

26. **approve** the following change to appropriations to reflect the terms of CSF-2 with a corresponding impact on net core Crown debt:

	$m – increase/(decrease)

Vote Finance Minister of Finance	2021/22 to 2025/26	2026/27 & Outyears
Non-Departmental Capital Expenditure: Crown standby loan facility for Air New Zealand	400.000	-

27. **delegate** authority to the Minister of Finance and Associate Minister of Finance (Hon David Parker) to increase the amount of the relevant appropriations for:

    27.1. the Crown to subscribe for ordinary shares in Air New Zealand by a maximum of [25] and [37] if the size of Air NZ's equity raise increases, in order to maintain the Crown's 51% ordinary shareholding in the company, and

    27.2. the new Crown standby loan facility for Air NZ, CSF-2, by a maximum of [25] and [37] if necessary;

28. **note** that, as CSF-2 is a revolving credit facility, if Air NZ draws on the loan and then subsequently repays it, under the proposed terms of the facility agreement, the amount available under the facility increases by the amount of any repayments;

29. **delegate** authority to the Minister of Finance and Associate Minister of Finance (Hon David Parker) to increase the amount of the appropriation for CSF-2, to reflect any drawdowns and repayments of the loan by Air NZ;

30. **note** that there will be an increase in net core Crown debt from the funding to subscribe for ordinary shares in Air NZ to achieve the Crown's targeted 51% ordinary shareholding in Air NZ post the equity raise;

31. **note** that there will be an initial increase in net core Crown debt as a result of the Crown subscribing for redeemable shares in Air NZ;

32. **note** that there would only be an initial impact on net core Crown debt from the new CSF-2 to Air NZ if this loan was drawn by the company, and if drawn, this impact would reverse over the term of the loan;

33. **note** that there will be a decrease in net core Crown debt when the existing CSF-1, is repaid by Air NZ once the company receives the proceeds from the capital raise, and also when any redeemable shares issued, are repaid, which Air NZ is expected to do after the capital raise;

34. **agree** that the capital expenditure in recommendation 23 for the Crown's subscription for new ordinary shares in Air NZ be a charge against the Multi-year Capital Allowance;

35. **note** that as the CSF-2 and the subscription for redeemable shares will be established on a commercial basis and if drawn, are expected to be repaid within ten years, there is no impact on Budget allowances;

36. **agree** that the proposed change to appropriations above be included in the 2021/22 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply; and

37. **note** that as CSF-2 is not expected to be drawn on, there is no indicative spending profile for this appropriation.

Authorised for lodgement

Hon Grant Robertson Minister of Finance	Hon David Parker Associate Minister of Finance