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AIRWAYS NEW ZEALAND
STATEMENT OF CORPORATE INTENT

2015-16 – 2017-18

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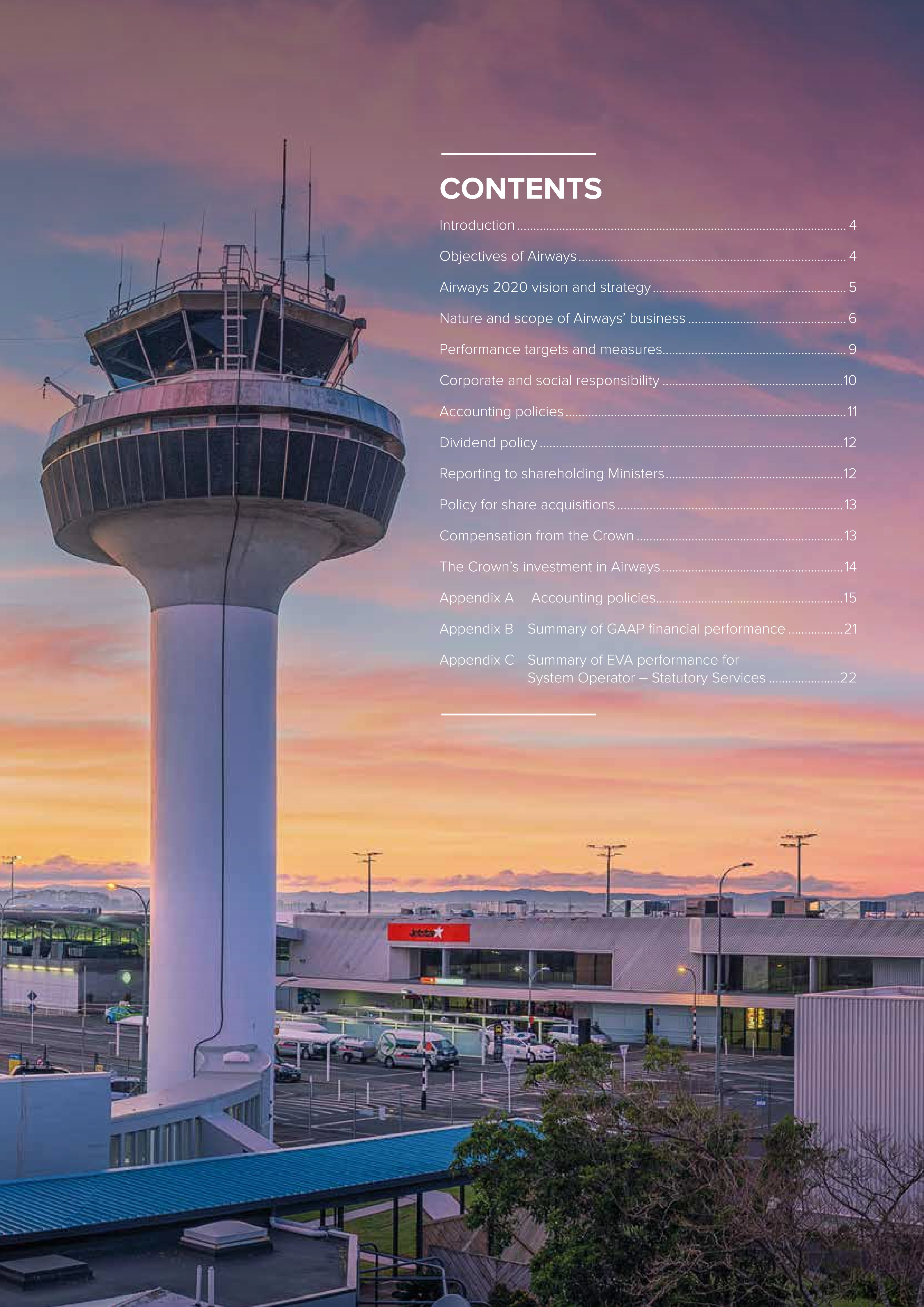

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Airways provides air traffic control and air navigation services across New Zealand's 30 million square kilometres of airspace, managing more than one million air traffic movements per year. Renowned globally for leading innovation and development in the aviation sector, Airways also delivers air navigation and air traffic management consultancy and training services in over 65 countries. The organisation is at the forefront of developing procedures and technology to reduce aviation's environmental footprint.

Airways is owned by the New Zealand Government and operates as a fully commercial business.

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Introduction

Airways Corporation of New Zealand Limited (ACNZ) is a State-Owned Enterprise (SOE) established under the State-Owned Enterprise Act 1986 (the Act) and is a public company registered under the Companies Act 1993. The shareholders are the Minister for State-Owned Enterprises and the Minister of Finance, each of whom holds 20.55 million fully paid shares of $1.

ACNZ fully owns three subsidiaries – Airways International Limited, Airways Training Limited and Aviation English Services. This Statement of Corporate Intent (SCI) refers to the Airways Group (Airways), including ACNZ and its subsidiaries. It is prepared in accordance with the Act and sets out Airways' business goals and objectives for the period 1 July 2015 to 30 June 2018.

Airways' achievements against the objectives outlined in last year's SCI are referred to in the 2014-15 annual report.

Objectives of Airways

The principal objective of every SOE as defined by the Act is to be a successful business and to:

- be as profitable and efficient as comparable businesses
- be a good employer
- exhibit a sense of social responsibility.

Airways is focussed on delivering safe air navigation services in the New Zealand airspace, and transforming ideas by commercialising intellectual property into a portfolio of highly profitable businesses providing world class products and services. Airways' aim is to:

- ensure customers are safe by enabling all aircraft and passengers operating in New Zealand's controlled airspace to reach their destination safely and efficiently
- enhance shareholder value by achieving a return that meets or exceeds Airways' cost of capital.

Mission, vision and values of Airways

MISSION: To ensure the safe and efficient management of New Zealand's aviation system with leading edge technology and experienced professional staff

VISION: To be safe (always), successful (ongoing) and sustainable (for the future)

VALUES: We value safety, each other, excellence and success.

Airways 2020 vision and strategy

Long term context and strategy

Airways provides air traffic management (ATM) services to the aviation market. The global industry's traditional business model is based on ground-based radar, centralised control, proprietary systems, specialist skills and sovereign provision. Service of this traditional business model is coming under pressure from a number of directions. These include the evolution of satellite-based navigation, decentralised control enabled by advanced flight deck systems, open systems enabling "nose to tail" internet connectivity on aircraft, automation and a drive for industry consolidation (from airlines). With forecast annual growth of 2% compared with 7-8% for Asia Pacific as a whole, the New Zealand aviation industry needs to find innovative solutions to fund this technological transition.

Airways is one of the world's safest, most efficient and most innovative ATM service providers. This internal capability and experience helps to turn external threats into growth opportunities. Accordingly, in 2012, Airways implemented a new, transformational strategy to exploit the industry changes. The core of the strategy was to transform Airways from a traditional, one-dimensional business model into a portfolio of different business models designed to thrive in the evolving industry. The strategic goal was to double revenue, triple value and create 200 new jobs by 2020 (Airways' "2:3:200" goal).

The two key business units and models established by the strategy were:

- **System Operator:** Tasked with reshaping Airways' traditional air traffic control business into a highly competitive aviation system optimisation business with the thought leadership position in the Pacific region.
- **Airways Global Services (AGS):** Tasked with commercialising Airways intellectual property to create valuable, new niche businesses which hold a first or second position within their target global markets.

	System Operator	Airways Global Services	Shared Services/Governance
Strategies	• Proactive in safety • High performance • Creating connectedness • Innovative service delivery • People make it happen	• Venturing approach • Partnering approach • Create 1-2 market leading businesses through strategic product development	• Deliver excellent support services and expert advice • Create a positive, proactive and preventative work culture • Protect and enhance Airways' reputation

During the initial three years of strategic implementation, Airways established its new business model, optimised that model and achieved a respectable degree of progress towards its 2:3:200 goal. The key challenge for 2015-16 is to address a handful of factors so that Airways can shift gear from optimisation into true transformation, growth and value creation mode.

Nature and scope of Airways' business

System Operator

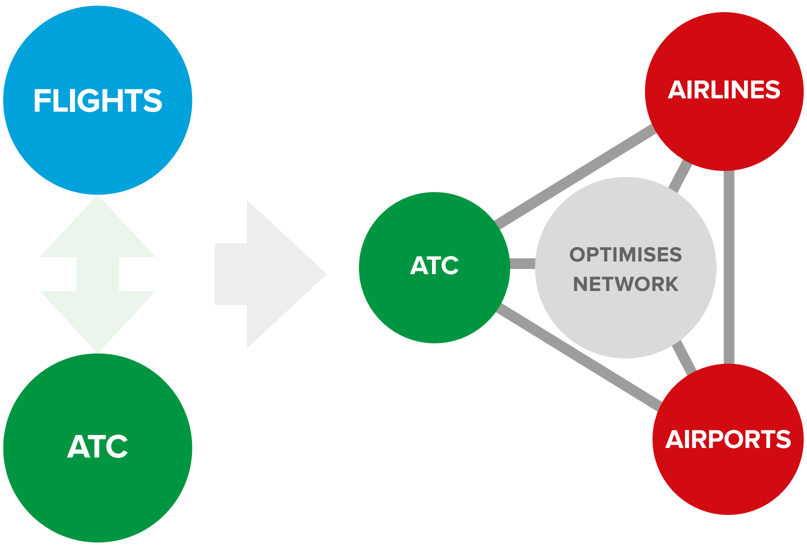
The System Operator goal is to optimise the entire ATM network to provide the safest and best economic outcome for all industry participants. It is the System Operator's responsibility to sustain a safe and effective air traffic service throughout New Zealand and the Pacific region.

The System Operator concept expands Airways' role from a traditional safe separation function to optimising traffic flows across the aviation network. Airways has a network-wide perspective that makes taking a thought leadership and 'central facilitator' role practical and effective.

Five strategies have been developed for System Operator:

- **Proactive in safety:** Clear accountability across System Operator with a workforce who are actively engaged in reducing risk and utilising predictive measures of safety performance.
- **High performance:** Through robust policy, processes, procedures and aligned behaviours, people across System Operator deliver on time, to budget and deliver shareholder value.
- **Creating connectedness:** Create strong customer focus and relationships with aviation stakeholders to deliver value.
- **Innovative service delivery:** Utilising Airways' unique position, introduce new operating procedures and technologies to drive towards global leadership in air traffic management.
- **People make it happen:** Create a climate where people believe they are treated fairly, where capability is nurtured and grows continuously. Airways has an agile and flexible workforce, delivering high productivity where lifestyle choices are respected and wellbeing is promoted.

System Operator strategic network



- System wide perspective
- Network resources coordination service provider
- Information services
- Self service enables customers to optimise capacity, efficiency and profit
- Vital enabler
- Thought leader

From: Navigation and separation service provider

To: Network performance services provider

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New Zealand's Flight Information Region

Airways provides services to domestic and international air traffic within New Zealand's Flight Information Region (FIR) which totals 30 million square kilometres – one of the largest areas of sovereign airspace in the world.

Within this FIR, Airways System Operator controls approximately 1.1 million aircraft movements per year.

Core services

The System Operator's core business is defined by the key components of its services as follows:

Air traffic control services: This is primarily the separation of aircraft in flight, to standards determined by the appropriate regulatory authority (the Civil Aviation Authority in New Zealand).

Air traffic management services: This is the management of aircraft in flight to maximise access to the most efficient flight paths as determined by the customer, limited only by the constraints of safe delivery of an ATM service. ATM also includes optimising the flow of aircraft across the aviation network – enabling increased capacity in the network, improved fuel savings, and improved on time performance.

Navigation services: These are the navigation infrastructure and supporting services used by aircraft to navigate.

Other services

Other services offered by Airways include management and operation of air navigation services, aviation equipment installation and maintenance in the Pacific, and flight inspection services.

Airways' customers

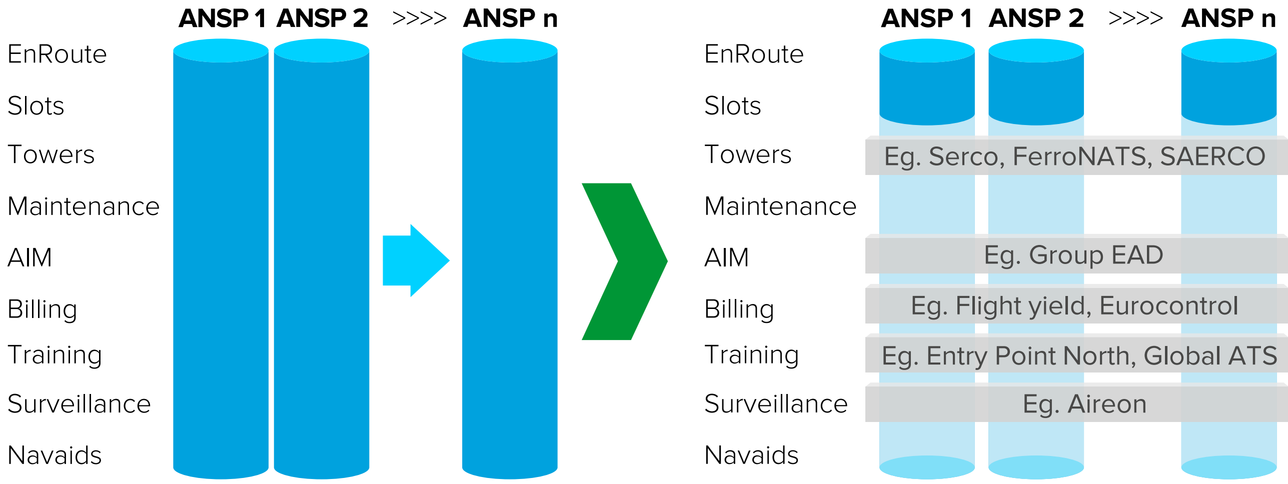
System Operator is committed to working with Airways aviation customers and stakeholders in enabling a safe and efficient aviation network. Major customer groups are:

- airlines and commercial aircraft operators
- general aviation
- the Royal New Zealand Air Force
- airports
- Pacific air navigation service providers.

Airways Global Services

Airways Global Services (AGS) is the commercially focussed arm of Airways, operating internationally and usually in partnership with other aviation industry leaders to provide services predominantly to air navigation service providers (ANSPs). AGS has identified business opportunities that Airways can capitalise on profitably in the air traffic management sector, and is engaged in commercialising a number of these, managing a portfolio of business opportunities through various phases of maturity. AGS aims to capitalise on the trend for ANSPs to migrate from a traditional insourced approach to an increasingly outsourced approach, thereby creating the opportunity for global service businesses. From the overall ~$30 billion ANSP market, AGS will continue to identify areas of outsourcing potential and invest in businesses which have the potential to have a significant share (i.e. 20%+) of a specific element of the overall ANSP service provision. The two main strategic philosophies remain unchanged:

- **Strategy 1, Venturing:** A "Venturing" approach to the formation and development of business opportunities, including a willingness to envisage, establish, and invest in new businesses and, through a disciplined gating process, to focus resources and investment on the highest potential outcomes.
- **Strategy 2, Partnering:** A "Partnership" approach which recognises Airways' small scale, geographical challenges and limited access to risk capital by establishing mutually beneficial arrangements with other organisations to achieve business outcomes better, faster and at lower risk. In addition to the two strategic pillars, maintaining leadership and relevance in the outsourcing debate requires reinvestment in a disciplined new product development capability that will ensure market needs and customer requirements are fully understood.



There is a transformation of ANSP service provision away from fully-integrated, do-it-yourself "silos", towards a more flexible and nimble model where global commercial providers are engaged to provide elements of air navigation service provision.

AGS' mid to long term success will be delivered predominantly via a suite of software-based products which will be professionally specified and developed based on clearly defined and customer validated business needs. With software now increasingly difficult to patent, Airways needs to adopt continuous innovation based on deep knowledge of customer needs, and leverage the economic value it adds to other ATM products by negotiating licensing or distribution partnerships. Furthermore, AGS' long term success will depend on the ability to deliver and extract value from the more profitable parts of the aviation sector, for example airports and airlines, rather than solely being a supplier to ANSPs who are often poorly funded and slow, conservative decision makers.

AGS products and services

AGS'portfolio of air navigation services solutions includes:

- Revenue management solution Flightyield.
- Airways Training business, including the Total Control air traffic control simulator, and Aviation English Services.
- GroupEAD: a joint venture with Group EAD Europe to provides next-generation aeronautical information and aeronautical data quality solutions across the Asia Pacific region. GroupEAD also offers an advanced and integrated procedure design service providing innovative solutions and leading the way in Performance Based Navigation implementation.
- SureSelect online selection and recruitment tool to assist recruitment of air traffic controllers.
- Collaborative Flow Manager tools to provide sophisticated air traffic queue management solutions.

Shared Services and Governance

Shared Services provides fit-for-purpose enablement services to the System Operator and AGS businesses. The Governance functions include independent Safety, Audit and Risk, and Communications teams which report directly to the CEO, providing business improvement, assurance, ensuring safety and driving a high level of compliance and independence across the business.

Safety is Airways' top priority. As such, reassurance is provided to key stakeholders through direct line of sight from the CEO to the continued safety record and critical safety processes. Safety management, business continuity and security capabilities are managed by the Safety Office. Operational risk functions are managed throughout the business.

A more integrated approach is being taken across Governance for information provided to its customers. In order to succeed Governance will: (i) foster the culture of continuous improvement; (ii) be leaders of change; (iii) be a watchdog for the business; (iv) understand the needs of the internal customer segment/group; (v) maintain a co-ordinated and innovative approach to meeting internal customer group's needs; and (vi) streamline its processes and operations.

Performance targets and measures

Targets for 2015-16

The key targets and financial results for 2015-16 are as follows:

	2014-15 Forecast	2015-16 Target	2016-17 Target	2017-18 Target
Business performance				
Operational safety – near collision incident	0	**0**	0	0
Staff safety – serious harm injuries	0	**0**	0	0
Service availability	99.96%	**99.95%**	99.95%	99.95%
Customer satisfaction	84%	**FY15+2%**	FY16+2%	FY17+2%
Financial performance				
Group NOPAT	$14.9m	**$16.5m**	$21.3m	$24.1m
Capex – Value creating investments[1]	$30.0m	**$35.0m**	$52.3m	$54.0
SO Statutory Services Return on Capital	10.2%	**7.7%**	8.3%	8.3%
Non-Statutory Services NOPAT (AGS & SO–Other)	$1.8m	**$5.8m**	$8.6m	$9.3m
Leadership				
Staff satisfaction	72%	**75%**	FY16+3%	FY17+3%
Succession (suitable candidates for senior roles)	≥3	**≥3**	≥3	≥3
Visibility – internal event platforms (per week)	2	**≥2**	≥2	≥2

[1] Includes allowance for investment in Automatic Dependent Surveillance - Broadcast (ADS-B)/Multilateration (MLAT) surveillance ($27m over 3 years) and a new ATM platform ($50m over 3 years) from FY17.

Key strategic initiatives for 2015-16

The key initiatives to progress Airways' transformation strategy in 2015-16 are summarised below.

System Operator	Airways Global Services	Shared Services and Governance
▶ Enhance safety management programme ▶ Operations and ATM platform strategies defined ▶ Airways Lite model for regional airports implemented ▶ Develop and implement remotely piloted aircraft systems (RPAS) strategy ▶ Pricing implementation plan agreed with customers ▶ Deliver $35m service enhancement capital programme ▶ Pacific revenues secured on sustainable basis	▶ Drive performance of training campuses ▶ Realise value in GroupEAD Asia Pacific and Flightyield as viable businesses ▶ Incubate high potential business opportunities ▶ Make the right "buy, hold, sell" decisions	▶ Drive forward value creation strategy ▶ Enhance Occupational Safety & Health performance ▶ Deliver leadership capability ▶ Enhance business continuity and national crisis response capability ▶ Enhance safety incident investigation and risk outcomes

Corporate and social responsibility

Airways' corporate and social responsibility objectives are to provide a safe, cost effective and environmentally friendly air navigation service within New Zealand's airspace.

The key areas on which Airways will focus on in 2015-16 are:

Safety

Safety underpins all activity at Airways. Airways works with its customers to guide aircraft and their passengers to their destination safely and efficiently. The health and safety of Airways staff is a key focus. Airways takes significant lead roles on the CANSO Safety Sub-Committee (global industry body) and the Business Leaders Health and Safety forum. Airways offers an annual aviation safety scholarship in memory of air traffic controller Jilly Murphy who passed away in the Canterbury earthquake of 22 February 2011.

Carbon emissions

Airways plays a leading role with airline customers in reducing New Zealand's aviation greenhouse gas emissions. To this end Airways has a number of important programmes which will assist the airlines to fly the most direct routes with a minimum of delay, hence reducing fuel consumption and emissions. Airways estimates it will provide $56 million of fuel savings between 2014 and 2017, and with it, large CO_2 emission reductions. This represents a lower benefit in dollar terms compared to last year as the dollar value of the CO_2 emissions is based on a lower fuel price of NZ$0.62 per litre (last year $1.03 per litre).

Aviation industry support

Airways plays a critical role in the New Zealand economy. It supports aviation's key role in the New Zealand economy, with tourism spending contributing 17.3% to New Zealand's total exports of goods and services[1] and export air freight 12.8% of total exports of goods. Whilst Airways is a "behind-the-scenes" player, Airways needs to deliver service reliability and continuity of service in a safe manner to support New Zealand Inc. and the Airways brand. Airways offers an annual scholarship for a young person to attend flying school in Matamata, called the Glenn C Ashton Memorial Scholarship, in memory of an air traffic controller who passed away in 2000. As part of Airways' support of the general aviation community, the company sponsors a number of regional and national events.

Growth

Airways has a track record of innovation and is recognised globally as an industry leader (for example in 2013 Airways received the International Janes' ATC Award for achievements in Operational Efficiency). Airways plans to grow through commercialising its intellectual property, creating high quality jobs for New Zealanders and enhancing shareholder value.

[1] Source: Statistics New Zealand

Accounting policies

Airways prepares conventional Financial Statements in accordance with Generally Accepted Accounting Practice (GAAP). The GAAP Financial Statements in the SCI and business plan comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards, as appropriate for profit oriented entities. The Financial Statements comply with International Financial Reporting Standards.

A complete list of GAAP accounting policies is attached in Appendix A.

Airways also use Economic Value Added (EVA) principles to guide pricing decisions.

Summary of financial performance

All figures are NZ$m unless otherwise stated	2014-15 Forecast	2015-16 Target	2016-17 Target	2017-18 Target
Revenue				
System Operator – Statutory Services	168.9	**170.3**	180.7	187.0
System Operator – Other Services	10.6	**12.3**	13.2	14.1
Airways Global Services	12.3	**20.2**	24.7	30.8
Total Revenue	191.8	**202.8**	218.6	231.9
NOPAT				
System Operator – Statutory Services	13.1	**10.7**	12.7	14.8
System Operator – Other Services	2.3	**2.8**	3.0	3.2
Airways Global Services	(0.5)	**3.0**	5.6	6.1
Total NOPAT	14.9	**16.5**	21.3	24.1
Key Indicators				
Capital expenditure	30.0	**35.0**	52.3	54.0
Headcount (FTEs)	780	**786**	786	786
EVA – System Operator – Statutory[1]	2.8	**(0.3)**	0.0	0.0
Dividends	4.0	**5.0**	6.0	6.0

[1]The Economic Value Added (EVA) target is EVA = 0, on average over time.

Appendix B sets out a summary of Airways GAAP Financial Performance and Appendix C the EVA performance for the periods 2013-14 to 2017-18.

Airways forecast 2014-15 results and recent performance

Airways is on target to deliver a positive full year result of Group NOPAT of $14.9 million. This compares favourably to last year's operating NOPAT of $11.8 million.

System Operator – Statutory Services full year NOPAT is forecast to be $13.1 million versus budget of $10.6 million. Revenue has benefited from the general price increase and a continued strengthening in air traffic volumes.

Non-Statutory Services full year NOPAT is expected to be $1.8 million versus budget of $4.4 million, due to delays in key Airways Global Services revenue projects.

Airways is forecasting to invest $30 million in service improvement (capital) projects – $3.8 million lower than last year and $7 million lower than the target level. The variance against target is due to further consultation around the Wellington air traffic control tower and an alternative solution for the contingency centre. Airways is still on target to deliver the service improvement benefits as planned for the 2013-16 pricing period. Significant benefit delivery this period will include replacement of the core communication network with Internet Protocol (IP) capability.

Dividend policy

The Directors will recommend such dividend payments as are consistent with Airways' earnings, capital structure, capital expenditure and future investment requirements and will seek to return a dividend of between 75% and 100% of available cash from the System Operator – Statutory Services business to the Shareholder over the medium term[1], subject to targeting a gearing ratio below 40% for the System Operator over the medium term[1]. The five-year rolling time horizon reflects Airways need for long term strategic planning in respect of the lifecycle replacement of key capital assets. Where there are significant capital projects forecast outside of this horizon, the Board will consider whether further free cash flow should be retained in the business and dividends reviewed accordingly.

The level of dividend will be reviewed annually as part of the business planning process and at each declaration date. Dividends are usually paid in October, February and a final dividend not later than 30 June of each year.

A reduced dividend through to 2016, to cover additional capital expenditure while enhancing total shareholder returns, is provided for in this plan.

Reporting to shareholding Ministers

In compliance with the Act and in accordance with the requirements of the shareholding Ministers, the following reports will be presented to shareholders.

Annual report

Within three months after the end of each financial year an annual report including:

- audited financial statements for the year
- notes to the financial statements including accounting policies
- a report from the Chairman which will include:
  - a review of operations
  - changes in the nature and scope of Airways' activities
  - a summary of achievements measured against performance targets
  - comments on the outlook for the next 12 months
  - statement of dividend payable.

Interim report

Within two months of the end of each half-year an interim report including:

- an abridged, unaudited statement of Airways' financial position
- a qualitative report from the Directors on Airways' performance compared with the objectives set out in the SCI, any significant changes in intent and scope during the half-year and the outlook for the next half-year.

Quarterly report

Within one month of the end of each quarter a quarterly report comprising a commentary and summary of financial statistics indicating performance against targets for the preceding quarter.

Investment project review

Provide a report covering all post-project investment reviews conducted in the previous calendar year, by 28 February each year. This applies to all projects greater than $5 million for Airways, as the shareholders book value of equity for Airways is below $100 million.

[1]Medium term refers to a five-year rolling horizon.

Policy for share acquisitions

Any share, equity or asset acquisitions (or sales) will reflect Airways' business strategy requirements for achieving its vision. Airways will consult shareholding Ministers on equity investment or capital expenditure above:

- $10 million on an individual item of capital expenditure or investment in New Zealand
- $5 million investment in an individual overseas project, or other significant investments, even if they do not meet the above thresholds.

Compensation from the Crown

Section 7 of the Act allows for the Crown to enter into an agreement with Airways whereby the Crown would pay Airways for undertaking a non-commercial activity.

Airways does not currently undertake any such activities but reserves the right to seek payment where Airways is restrained from acting in a normal business-like manner.

The Crown's investment in Airways

The Directors estimate of the current commercial value of the Crown's investment in the Airways group is $177.7m (2013/14 $141.8m). Key points about the manner in which that value was assessed are:

- The valuation was calculated as at 30 June 2015.
- The FCF (Free Cash Flow) to Enterprise methodology was used to calculate the Net Present Value (NPV) of the entire Airways Group, including all subsidiaries, on an after-tax basis.
- The NPV was based on the expected future cash flows set out in the Airways Group's three-year business plan, with forward projections then also made about years 4 to 10. A terminal value of $129.8m (present value) was included. A growth rate of 0.5% per annum was assumed in the terminal value calculation of the AGS businesses and 0.0% on the System Operator – Statutory Services and System Operator – Other Services businesses.
- The discount rate was based around the projected average cost of capital (long term averages of 8.41% for the System Operator – Statutory Services, 9.54% for the System Operator – Other Services and 12.32% for the AGS businesses).
- The valuation was prepared by the Airways finance team, and reviewed by Ireland, Wallace & Associates Limited, prior to approval by the Board.
- Sensitivities to the underlying assumptions could affect the valuation of System Operator – Statutory Services, System Operator – Other Services and AGS businesses.
- The valuation compares with a commercial value as at 30 June 2014 of $141.8m. The key reasons for the increase in commercial value are:
    - System Operator – Statutory Services (up $29.7m): Net new investment of $11.5m, improved cash flow and changes in the capital expenditure profile.
    - System Operator – Other (up $3.5m): Higher expected earnings and lower risk free rates.
    - AGS (up $1.6m): Higher expected earnings and lower risk free rates.
    - Increase in Group Debt (down $1.1m): Higher borrowing has been more than offset by a reduction in implied debt from capitalised property leases.

Valuation sensitivity and range

	Range	Low	High
Base Valuation		**$177.7m**	**$177.7m**
Change in growth factor used in terminal value calculation	0% - 1%	-	16.1m
Change in Free Cash Flow or NOPAT	+ / - $0.5m p.a.	(3.4m)	3.4m
Estimated Range		**$174.3m**	**$197.2m**

Appendix A – Accounting policies

SECTION A: HOW THE NUMBERS ARE CALCULATED

A1) Basis of preparation

The financial statements are for the consolidated Group ("Airways"), consisting of Airways Corporation of New Zealand Limited and its subsidiaries: Airways International limited, Airways Training Limited and Aviation English Services (refer to note C1 for further details). They are prepared in accordance with:

- Generally Accepted Accounting Practice (GAAP) in New Zealand (as a result they comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards, as appropriate for profit-oriented entities. They also comply with International Financial Reporting Standards (IFRS)); and
- The requirements of the Financial Reporting Act 2013, Companies Act 1993 and the State-Owned Enterprises Act 1986.

The financial statements are prepared on the historical cost basis as modified by the revaluation of derivative financial instruments and are presented in New Zealand dollars, which is Airways' presentation currency and the functional currency of all entities within the Group. All values are rounded to the nearest thousand dollars ($'000) unless otherwise stated.

All components in the primary statements are stated net of GST, with the exception of receivables and payables which include any GST invoiced.

Airways has not adopted any new standards, interpretations or amendments to existing standards in the current financial year.

The following standards and amendments to existing standards with an impact on Airways have been published and are mandatory for future accounting periods however Airways has not early adopted them:

(i) NZ IFRS 15 (2014), 'Revenue from Contracts with customers', issued in July 2014 (effective for periods beginning on or after 1 January 2017, with early adoption allowed). Management expect this standard to have some impact on the timing of revenue recognition for contracts where multiple service components are provided to customers, however this impact has not yet been quantified. Airways intend to adopt this standard in the 2018/19 financial year.

A2) Key accounting policies

Key accounting policies adopted in the preparation of the consolidated financial statements can be found in the specific note to which the policy applies. These policies are consistently applied to all the years presented, unless otherwise stated.

A3) Profit or loss and other comprehensive income information

This note provides further information about items in the profit or loss or other comprehensive income statement, that are either individually significant or involve estimates or judgements in determining their value.

A3.1) Revenue

Airways' principal business is the provision of air traffic management services however it is also involved in a number of related revenue generating activities. Airways' revenue streams, and the associated recognition policies, are set out in the table below:

Revenue Type	Accounting Policy
Air traffic management	Recognised as flights or other aircraft movements occur
Consulting	Revenue from discrete consultancy services is recognised based on the percentage of expected project time and material costs completed, using the expected project margin Revenue from ongoing, recurring consultancy services is recognised as the service is provided
Publications	Subscription revenue from the publication of aeronautical information is recognised evenly over the period of the subscription (typically one year)
Training	Recognised as courses are delivered

A3.2) Employee entitlements

Superannuation

Airways operates various defined contribution schemes which are funded through fixed contributions into trustee administered funds. Airways has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The contributions are recognised as an employee benefit expense when they are due.

Leave benefits

Liabilities for annual leave, long service leave and retiring leave are accrued and recognised in the balance sheet. These liabilities equal the present value of the estimated future outflows as a result of employee services provided at balance date. Long service leave that has vested with employees is recognised as a current liability within employee entitlements. Actuarial estimates of future demographic trends and employee remuneration are used to calculate the long service leave and retiring leave liabilities that have not yet vested with staff.

A4) Income tax and related balances

Income tax expense

The tax expense for the year comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is recognised in other comprehensive income or directly in equity, respectively.

Deferred tax is recognised in respect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. The amount of deferred tax is based on the expected manner of realisation of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the reporting year end.

Deferred tax

Deferred tax assets and liabilities are offset on the face of the balance sheet.

A5) Financial assets and liabilities

Airways' financial assets and liabilities are classified as either derivatives used for hedging, liabilities at amortised cost or loans and receivables, depending on the purpose for which the transactions were entered into. Management determines the classification at initial recognition and re-evaluates this designation at every reporting date.

Financial liabilities (other than derivatives used for hedging) are recognised initially at fair value, net of any costs incurred, and subsequently measured at amortised cost using the effective interest method. The carrying value of trade and other payables and cash and cash equivalents approximates their fair value.

Loans and receivables are recognised initially at fair value, plus any transaction costs, and subsequently measured at amortised cost using the effective interest method, less provision for any impairment. The carrying value of trade and other receivables approximate their fair value.

Airways uses forward exchange contracts to hedge expenditure and revenue denominated in foreign currency and interest rate swaps to hedge interest repayments on its term debt. The effective portion of changes in the fair value of hedging instruments is recognised in equity until the underlying transaction being hedged occurs. At this point, the value of the hedging instrument is recognised in profit or loss (as interest costs, or foreign currency denominated revenue or expenses as appropriate) or on the balance sheet (within the recognised value of any hedged asset or stock purchase). If the hedged transaction is no longer expected to take place, then the cumulative, unrealised balance recognised in equity is recognised immediately in profit or loss.

The derivatives used for hedging are considered level 2 financial instruments and are recognised on the balance sheet at their fair values, which are determined using observable inputs as follows:

(i) Forward Exchange Contracts values are determined using observable forward exchange market rates at the balance date.

(ii) Interest Rate Swaps are valued using the "Projected" methodology. For floating rates this method projects all future floating cash flows and discounts these back to the revaluation date. For fixed rates, the individual cash flows are discounted from the cash flow date to the revaluation date. The discount rate used to calculate the NPV of the deal is the zero coupon curve, based on a blended swaps curve obtained from Thomson Reuters.

A6) Trade and other receivables

Collectability of trade receivables is reviewed on an ongoing basis and uncollectible debts are written off. A provision for doubtful receivables is recognised when there is objective evidence that Airways may not be able to collect some or all amounts due according to the original terms. The amount of the provision will reflect the specific circumstances of individual debtors, including the expected ability and intent to pay, however as a guide and based on previous experience:

(i) debt which is greater than 90 days but less than one year overdue is discounted by the current cost of capital;

(ii) debt which is greater than one year but less than two years old is discounted by 50% of the carrying value; and

(iii) debt which is greater than two years old is discounted by 100% of the carrying value.

The amount of the provision is recognised in the statement of profit or loss and other comprehensive income.

A7) Trade and other payables

Trade and other payables are unsecured, non-interest bearing and typically paid within 30 days.

A8) Property, plant & equipment and intangibles

Recognition and measurement

All classes of property, plant & equipment and intangibles are initially recorded at cost. Cost is determined by including all charges directly associated with bringing the assets to their location in working condition. Capital work in progress includes expenditure on partially completed assets that management expect will form part of the asset cost at completion.

Where assets are generated internally, costs are only capitalised once a formal investment case has been prepared and approved in line with Airways' delegated financial authority policy. The investment case must demonstrate that:

- the economic and other benefits of the asset are clearly articulated and consistent with Airways' strategy;
- the cost associated with the project is within Airways' budget;
- there are sufficient staffing and technical resources available to complete the project (either internally or externally); and
- the asset to be created is technically feasible.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to Airways and the cost of the item can be measured reliably. The carrying amount of any replaced parts is written off.

Depreciation and amortisation

The cost of all fixed and intangible assets (excluding freehold land and work in progress), less their estimated residual value, is written off on a straight line basis over the asset's estimated useful economic life. Asset useful lives and residual values are assessed annually and adjusted if required. The range of useful economic lives used for calculating depreciation and amortisation are shown in the table below:

Land	not depreciated
Buildings structure:	
Freehold	10-40 years
Leasehold	8-40 years
Plant and equipment	3-30 years
Computer equipment	3-20 years
Furniture and fittings	3-25 years
Motor vehicles	3-10 years
Intangibles	2-10 years
Capital work in progress	not depreciated

Impairment

All assets are reviewed for potential indicators of impairment at every balance date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For work in progress, these indicators include any changes to the scope or expected outcome of individual projects.

In addition, impairment tests are carried out at every balance date for intangible assets within work in progress regardless of whether indicators of impairment exist. This test involves re-assessing the feasibility of the project, the expected cost to completion and the expected economic benefit to be realised. Where the expected economic benefit provided by the asset is lower than the expected cost to completion, the difference is booked as an impairment to the current carrying value in work in progress.

A9) Share capital and reserves

Airways has capital of $41.1 million (2014: $41.1 million) issued ordinary shares which confer on the holders the right to vote at any general meeting of shareholders. This consists of 41,100,000 authorised ordinary shares.

The Cash Flow Hedge Reserve records the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge.

SECTION B: RISK

B1) Financial risk management

Airways is exposed to a number of financial risks, which are managed through setting appropriate objectives and implementing prudent policies and controls. These objectives, policies and controls are managed through Airways' Treasury Policy and summarised below.

Liquidity risk

In the short term, Airways is exposed to liquidity risk through timing differences between: cash receipts from sales or facility drawdowns; and cash requirements for current capital expenditure and business operating costs. In the long term, Airways is exposed to liquidity risk through the potential unavailability of debt funding to finance future capital expenditure, business developments and loan repayments.

Airways' primary objective in managing liquidity risk is to ensure there is sufficient liquidity and funding capacity to cover known, and a reasonable level of unforeseen, funding requirements. The policies that have been established to meet this objective include:

(i) Maintaining sufficient, short term funding capacity to accommodate the worst case short-term event (currently defined as a delay of one month's revenue due to an inability to invoice customers e.g. as a result of a system or other process failure);

(ii) Ensuring debt facilities have the provision to accommodate 10% surplus funding over and above the projected maximum level of debt for the next three years, based on the most up to date forecasts;

(iii) Ensuring all facility renewals are secured at least three months prior to maturity, with the decision to re-negotiate or tender banking arrangements being made 12 months before maturity; and

(iv) Remaining 100% compliant with banking covenants at all times.

To ensure these policies are adhered to, Airways operate the following controls:

- Maintaining and monitoring cash-flow forecasts on a monthly basis, to provide views on monthly, quarterly and annual cash-flow requirements;
- Maintaining debt funding in at least three tranches to ensure funds can be drawn down on a monthly basis; and
- Monitoring compliance with banking covenants on a monthly basis and reporting semi-annually to banking providers.

Interest rate risk

Airways is exposed to interest rate risk through:

(i) differences between cost of debt assumptions used when setting air traffic management (ATM) service pricing for three-yearly periods , and actual interest rates available when debt is drawn down; and

(ii) fluctuations in interest rates on unhedged, floating debt.

Airways' primary objective in managing interest rate risk is to secure interest rates below pricing assumptions and the long term average cost of debt. This is achieved through the use interest rate swaps to secure fixed debt funding costs for forecast positions, subject to the following limits:

ATM service pricing period	Minimum Hedging levels	Maximum Hedging levels	Maximum swap rates
Current pricing period	25% Forecast Debt	90% Forecast Debt	Current pricing cost of debt assumption
Next pricing period	None	30% Forecast Debt	Current 10 year government bond rate, plus the current pricing debt margin

To ensure these policies are adhered to, Airways operate the following controls:

- Maintaining and monitoring forecast debt levels to identify required hedging activity; and
- CFO approval is required for all hedging decisions.

Foreign exchange risk

Airways is exposed to foreign exchange (FX) risk through:

(i) revenue streams denominated in foreign currencies;

(ii) operational costs requiring payment in foreign currencies; and

(iii) capital expenditure requiring payment in foreign currencies.

Airways' primary objective in managing foreign exchange risk is to protect foreign exchange rates implicit in project or expenditure approvals and foreign revenue streams. This is achieved by using forward exchange contracts to hedge: a) all transactions greater than NZD $50,000 and with a transaction date greater than one month; and b) all transactions greater than NZD $500,000 regardless of transaction date. In addition, management monitor all residual exposures to ensure they do not become material.

To ensure these policies are adhered to, Airways operate the following controls:

- No purchase order or invoice request for FX exposures above control limit levels can be approved without a hedge in place; and
- Residual exposures are monitored and reported internally on a monthly basis.

Credit risk

Airways is exposed to credit risk through:

(i) cash and cash equivalents on deposit with banks;

(ii) interest rate swaps and foreign exchange contracts with counterparties; and

(iii) customers with outstanding receivables.

Airways' primary objective in managing credit risk is to minimise financial loss resulting from counterparties failing to meet obligations. The policies that have been established to meet this objective include:

- Requiring a credit rating of A1 (short term) or A+ (long term) as rated by Standard and Poor's, or equivalent credit rating from another internationally recognised rating agency, for all banking and derivative counterparties; and
- Setting a maximum exposure of $10m to any individual counterparty.

Adherence to these policies is continuously monitored and reported on monthly.

B2) Capital management

Airways' primary objectives when managing capital are to safeguard its ability to continue as a going concern and to maintain a target gearing ratio over the medium term (5 years). In order to maintain or adjust the capital structure, Airways may: adjust the amount of dividends paid to Shareholders; return capital to Shareholders; increase or reduce debt; sell assets; or reduce capital expenditure.

SECTION C: GROUP STRUCTURE

C1) Group entities and ownership

Airways Corporation of New Zealand Limited is a limited liability company incorporated and domiciled in New Zealand. The address of its registered office is Level 5, 100 Willis Street, Wellington, New Zealand. It is also is a State-Owned Enterprise established under the State-Owned Enterprise Act 1986 with shares held in equal numbers by the Minister for State-Owned Enterprises and the Minister of Finance, on behalf of the Crown.

These Group consolidated financial statements are for Airways Corporation of New Zealand Limited (ACNZ) and its subsidiaries: Airways International Limited (AIL); Airways Training Limited (ATL); and Aviation English Services (AES). "Airways" refers to the Group, and the term "Parent" refers to ACNZ as a separate legal entity.

Subsidiaries are all entities over which Airways has control. Airways controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to Airways and are deconsolidated from the date that control ceases.

Accounting policies of subsidiaries are consistent with the policies adopted by the Parent, and all subsidiaries share a 30 June balance date. The Parent recognises its investment in subsidiaries at cost, less impairment.

Key details for each subsidiary in the Group are provided in the table below:

	COUNTRY OF INCORPORATION	GROUP SHAREHOLDING	PARENT	PRINCIPAL ACTIVITIES
Airways International Limited (AIL)	New Zealand	100% (2014: 100%)	Airways Corporation of New Zealand (ACNZ)	Aeronautical information management, revenue management, recruitment and training, and air navigation services and maintenance of systems
Airways Training Limited (ATL)	New Zealand	100% (2014: 100%)	Airways Corporation of New Zealand (ACNZ)	Holding company
Aviation English Services (AES)	New Zealand	100% (2014: 100%)	Airways Training Limited (ATL)	Aviation english training

C2) Joint arrangements and other investments

Investments in joint arrangements are classified as either joint operations or joint ventures, depending on the contractual rights and obligations of each investor. Joint ventures are accounted for using the equity method, whereas investments in joint operations are reflected through the recognition of Airways' portion of assets, liabilities, revenues and expenses incurred.

Appendix B – Summary of GAAP Financial Performance

Year ended 30 June All figures are NZ$m	2013-14 Actual	2014-15 Forecast	2015-16 Target	2016-17 Target	2017-18 Target
Profitability					
Total revenue	181,282	191,768	202,763	218,608	231,942
EBITDA	37,623	43,710	47,059	57,430	61,193
EBIT	19,401	23,252	25,839	33,397	37,881
NOPAT	11,835	14,938	16,539	21,327	24,151
Shareholders returns					
Total shareholder return[1]	7.4%	28.1%	2.8%	3.4%	3.4%
Dividend yield	2.2%	2.5%	2.8%	3.4%	3.4%
Dividend payout	41.0%	30.4%	32.3%	30.0%	26.1%
Return on equity	16.4%	18.1%	17.6%	19.9%	19.6%
ROE, adj IFRS movements and assets revaluations	16.2%	18.0%	17.6%	19.9%	19.6%
Profitability /efficiency					
Return on capital employed	18.3%	19.4%	19.2%	21.3%	20.3%
Return on assets	12.5%	13.8%	14.2%	16.3%	16.2%
Operating margin	20.8%	22.8%	23.2%	26.3%	26.4%
Net profit margin	6.5%	7.8%	8.2%	9.8%	10.4%
Asset turnover	1.1	1.1	1.1	1.0	0.9
Leverage/solvency					
Equity multiplier	2.1	2.0	1.9	1.9	1.9
Gearing ratio (net)	31.1%	29.0%	28.7%	32.4%	34.3%
Interest cover	17.1	18.2	16.2	15.1	14.2
Solvency (current ratio)	0.7	0.9	0.9	0.9	0.9
Growth/investment					
Revenue growth	10.0%	5.8%	5.8%	7.8%	6.1%
EDITDAF growth[2]	19.0%	16.2%	7.7%	22.0%	6.6%
NPAT growth[2]	32.0%	26.2%	10.7%	29.0%	13.2%
Capital employed growth	15.0%	11.6%	12.6%	20.2%	17.7%
Capital renewal	1.9	1.5	1.7	2.2	2.3

[1] Company valuations are not forecast from 2015-16.

[2] Pre MANA transformation and QTE termination costs the actual NOPAT would have been $9.137m for June 2013. Adjusting for these revenue/ costs changes the Revenue growth for 2013-14 from (1%) to 10%, EBITDAF growth from (24%) to 19% and NPAT growth from (46%) to 32%.

Definitions for the financial performance measures above can be found at the following link:
http://www.treasury.govt.nz/commercial/resources/pdfs/fpm-soes.pdf

Appendix C – Summary of EVA performance for System Operator – Statutory Services

Under EVA, “Shareholders Funds” is defined as share capital and other economic equity (including earnings that have not been returned to the Shareholders). “Total Assets” is defined as total capital employed, including long-term assets, net operating capital and non-operating capital (work in progress).

The EVA summary below relates only to the System Operator – Statutory Services business and not the entire Airways Group.

Year ended 30 June All figures are NZ$m	2014-15 Forecast	2015-16 Target	2016-17 Target	2017-18 Target
Debt and equity employed				
Debt	59.0	71.6	91.9	111.0
Equity	101.1	104.7	111.2	120.5
Total capital employed	160.1	176.3	203.1	231.5
Capital charge	13.0	13.5	16.0	18.3
Economic Value Added[1]	2.8	(0.3)	0.0	0.0
Return on capital (RoC)	10.2%	7.7%	8.3%	8.3%
Summary of parameters for cost of capital				
Risk free rate	3.6%	3.5%	4.0%	4.0%
Debt premium	1.86%	1.86%	1.86%	1.86%
Market risk premium	7.0%	7.0%	7.0%	7.0%
Company tax rate	28%	28%	28%	28%
Business risk factor (Asset beta)	0.60	0.60	0.60	0.60
Cost of capital	8.5%	8.0%	8.4%	8.4%

[1] The Economic Value Added (EVA) target is EVA=0, on average over time.
The cost of capital model and some parameters are intended to emulate the Commerce Commission approach.


AIRWAYS
making your world possible

Contact us

AIRWAYS NEW ZEALAND
Level 5,
Majestic Centre
100 Willis Street
PO Box 294
Wellington 6140
New Zealand

PHONE
04 471 1888

EMAIL
info@airways.co.nz

www.airways.co.nz