KEEPING OUR EYE ON THE BALL

WE'RE STARTING TO SEE IMPROVED RETURNS ON THE INVESTMENTS AND THE DECISIONS WE'VE MADE. BUT WE STILL HAVE SOME WAY TO GO WITH OUR GAME PLAN.

EARNINGS WELL UP

It's been a busy and productive half year, as we continued to lift performance and boost the value we deliver to shareholders from right across the business. Operating revenue rose 12 percent, or $237 million, to $2,135 million – a healthy gain that translates through to other key performance indicators.

At $109 million, profit before unusuals and tax is up 35 percent, while profit after tax was $74 million, up 61 percent.

Operating cash flow, before taking into account the cash impact of rolling over forward exchange contracts that hedge exposures in other financial periods, was up $9 million to $209 million. After taking into account the cash impact of the rollover of the forward exchange contracts, operating cash flow decreased $131 million compared to the previous period.

GROWING OUR REVENUES BY OPTIMISING OUR ASSETS

In the first half of this financial year, we've added two new long-haul routes, Auckland – Shanghai and Hong Kong – London, plus made changes to Auckland – Los Angeles – London and exited Singapore, making this the biggest overhaul of our long-haul network for some time. Further to this, we recently announced our intention to fly direct services into Vancouver, from November 2007. The significant network changes have improved the quality of our yields and enabled us to better deploy our assets on higher value routes, with even greater growth potential.

With our long-haul investment programme complete, there is now a robust platform in place to help us achieve our revenue targets, particularly in the premium cabins where much of our in-flight investment has been focused.

Customer satisfaction on these routes has lifted nine points to 77 percent and with that long-haul passenger revenue has increased 13 percent to $695 million, paralleled by increases in long-haul yields which have gained 12.7 percent.

Market share on key routes, particularly our Asian and UK long-haul routes, have improved as more and more passengers have made the decision to experience our product.

Closer to home, our market share and revenues in the short-haul market have also improved. In fact, short-haul passenger revenue has increased 11 percent to $1,019 million with yields also up 8.9 percent.

It's encouraging to see increases in other parts of the business because they reveal opportunities for us to foster over coming years. A continuing focus on growing our ancillary revenue, through initiatives such as buy on board sales, charter services, holiday packages and travel insurance has seen these revenue lines grow. Today, they only account for a very small percentage of overall revenue, but ancillary revenue is an area where we are achieving good margins and can expect to earn more with increased focus going forward.

Cargo revenue has also increased, up 20 percent due largely to the increased capacity offered by our new 777 aircraft and higher yields. New international services have generated strong cargo demand, with our services to Shanghai and Hong Kong – London both performing well. We're also pleased with the performance of our domestic cargo operation, brought back in-house in April 2006.

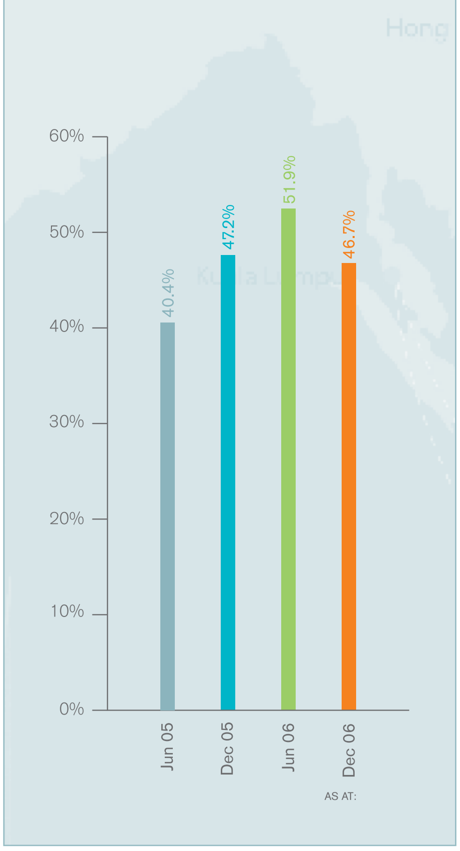
SIMPLIFYING

Sustained competitiveness demands we continue simplifying the business and reducing costs. We've achieved additional cost savings of $63 million during the first half of the year, and we are on track to achieve targeted cost savings of $130 million for the full year. This is the final year of our four-year cost saving programme, which originally targeted savings of $245 million per annum once fully implemented. By the end of this programme we will have posted $326 million per annum in savings – $81 million higher than our original target.

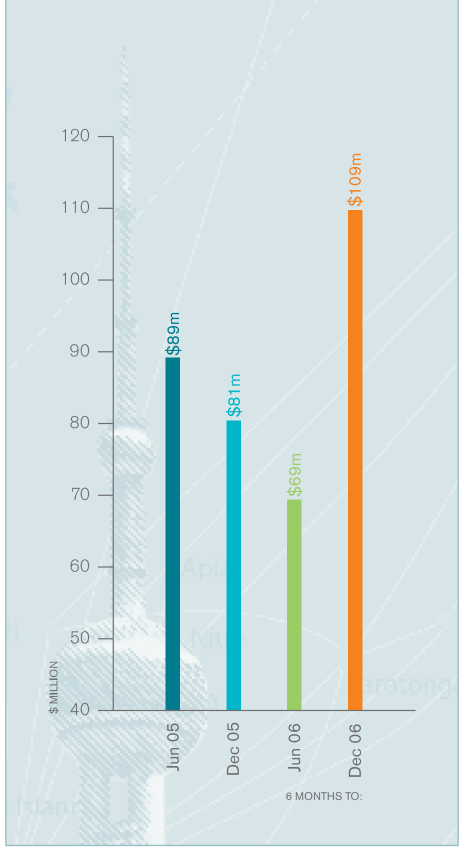
The migration from bricks and mortar to online bookings is impacting positively on cost of sales. What's particularly pleasing is the take-up in the US markets, where long-haul online sales now make up 25 percent of total US sales.

Corporate overheads have been reviewed, leading to a 20 percent reduction in corporate staff numbers. This has meant we are working smarter and faster than ever before. The reduction of staff in corporate areas has helped maintain a flat labour cost base across the total airline, despite capacity growth of 3.6 percent and wage price increases of around three percent.

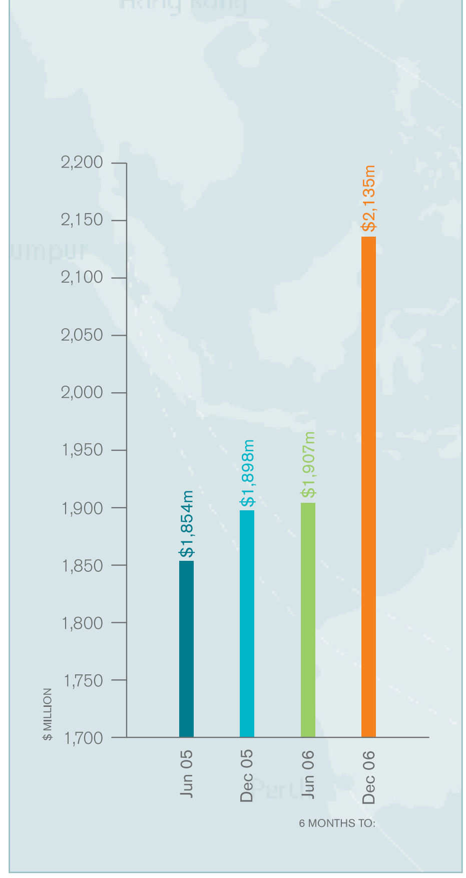
GEARING[1]



PROFIT BEFORE UNUSUALS AND TAX



OPERATING REVENUE



We are currently in discussions with our airport services staff on ways we can improve effectiveness in this part of the business. We believe that the services and experiences airlines offer customers in the airport will emerge as the new frontier of competition over coming years. The scope for new technologies, new customer experiences, innovations and flexibility to create more competitive and fulfilling travel experiences are significant, and the opportunity to streamline a customer's journey through the airport will be a source of competitive advantage for those airlines that get it right.

Those airlines that are not able to move in a nimble and bold fashion in the airport environment will jeopardise customer loyalty and become uncompetitive. Air New Zealand must be a leader in the airport revolution if we are to continue the recovery of the airline that we have all worked so hard for. That's why we have identified a proposal that would save the company $120 million over the next decade.

Clearly this is a very uncertain period for our airport services staff and to date they have dealt with this in a very professional manner. While management's preference is to keep these services in-house, this can only be achieved if alternative proposals developed by staff representatives deliver comparable cost, flexibility and service quality benefits and have the mandate of their members.

STRONGER FINANCIAL POSITION

In an industry as volatile as ours, a strong financial position is important in order to be in a position to actively respond to unforeseen shocks and rapid industry changes.

Gearing as at 31 December 2006 is 46.7 percent, which is at the bottom end of our target gearing range of 45 to 55 percent (including net capitalised aircraft operating leases treated as debt). Gearing reflects convertible notes treated as equity, following their conversion on 14 February 2007.

At the same time, cash holdings remain above $1 billion despite repaying $140 million of debt early as we sought to reduce debt levels.

With capital spend expected to fall to around $200 million per annum over the next two years, we now have the headroom to deliver a special fully imputed dividend of 10 cents per share or $105 million. This is in addition to an increase in our interim dividend to 3.0 cents per share from 2.5 cents last year.

ON TRACK, BUT HIGHER RETURNS REQUIRED

Overall, we're pleased with the improvement in earnings, but we're still a long way from achieving satisfactory returns. New assets in our long-haul business mean that earnings need to increase further if we are to effectively meet the higher returns demanded by investment of this scale.

Jet fuel prices remain a concern, with an average jet fuel price in the first half of this financial year of US$82 per barrel, compared with US$72 last year. Our jet fuel hedge book is available to view on our shareholder website (www.airnzinvestor.com) but to summarise, we have hedged 83 percent of the four million barrels estimated for consumption in the second half of this year.

We have continued to invest in our future by adding to our 787-9 order. This now comprises eight firm aircraft orders and eight options to purchase, which means we have secured production slots for up to 16 aircraft. We also have purchase rights for an additional eight aircraft. We plan to start introducing the 787-9 from December 2010 and currently have no other firm wide-body commitments from now until then.

There's much to be encouraged by in this latest result, but operating conditions are still challenging. Building on the momentum we have achieved means continuing to address issues proactively and constantly looking for robust and innovative ways to lift our game.

Rob McDonald
CHIEF FINANCIAL OFFICER

[1] Gearing figures include net capitalised aircraft operating leases treated as debt and convertible notes treated as equity.

CHANGE IN PROFITABILITY

THE KEY CHANGES IN PROFITABILITY ARE BROKEN DOWN BELOW:		
	$81m	**PROFIT BEFORE UNUSUALS AND TAX FOR THE PERIOD ENDED 31 DECEMBER 2005**
Passenger and cargo yield improvement	+$89m	→ Passenger yield for the Group increased 10.7% from 11.8 cents per RPK[1] to 13.1 cents per RPK. → Long-haul yields increased 12.7%. → Short-haul yields increased 8.9%.
Passenger and cargo traffic improvement	+$61m	→ Group capacity increased 3.6% with traffic up 0.9%. → Long-haul capacity was up 5.1% with traffic up 0.2%. → Short-haul capacity increased 1.7% with traffic up 1.9%.
Fuel cost increase relating to higher jet fuel prices	-$90m	→ Jet fuel prices averaged US$82 per barrel for the six months ended 31 December 2006 compared with US$72 per barrel in the last comparative period. → Jet fuel hedge gains totalled $2 million which was $44 million lower than gains made in the comparable period. → The weaker average NZD:USD rate also had a significant negative impact on the cost of fuel. The impact of this is captured under "net impact of foreign exchange movements" below.
Fuel cost increase relating to increase in capacity	-$11m	→ Around 4.2 million barrels of jet fuel were consumed during the period. The higher consumption relates to capacity growth and increased activity around the network.
Increased depreciation charges	-$16m	→ The increase in depreciation charges relates to the acquisition of new aircraft and refurbishment of existing 747 fleet.
Increase in net interest	-$15m	→ The combination of increased debt and average borrowing rates resulted in an increase in net interest charges.
Labour cost increase due to wage adjustments and growth in capacity	-$27m	→ Wage rate increases averaged 3%. → Long-haul flight crew numbers increased due to long-haul capacity growth of 5.1%. → Staff numbers fell by 689 people to 10,312 due to significant restructuring in the engineering division and corporate services areas. These savings more than offset the wage rate increase which is included in the cost savings line below.
Cost savings	+$63m	→ Cost savings included significant labour productivity gains following the reorganisation of engineering and corporate areas. Cost of sales have continued to improve as a result of channel shift to online and sales commission reductions.
Net impact of foreign exchange movements	-$30m	→ Movements in exchange rates resulted in a negative $30 million net impact on Air New Zealand's profitability. → A 7.7 percent reduction in average NZD:USD rates had a negative impact on cost items such as fuel, aircraft parts and aircraft leases, which are USD denominated.
Other movements	+$4m	→ Various movements in the revenue and cost lines.
	$109m	**PROFIT BEFORE UNUSUALS AND TAX FOR THE PERIOD ENDED 31 DECEMBER 2006**

[1] Revenue Passenger Kilometres: The number of revenue passengers carried multiplied by the distance flown.

STATEMENT OF FINANCIAL PERFORMANCE

Passenger revenue
Increase related to higher yield and passenger numbers.

Labour
Includes $31 million of savings relating to engineering and corporate reorganisations.

Fuel
Average jet fuel price increased 13 percent over last year. Fuel hedge gains also reduced by $44 million.

Net interest
Higher debt levels and average borrowing rates led to increased net interest charges.

	6 MONTHS TO 31 DEC 2006 $M	6 MONTHS TO 31 DEC 2005 $M	12 MONTHS TO 30 JUN 2006 $M
Operating Revenue			
Passenger revenue	**1,714**	1,534	3,088
Cargo and mail	**217**	181	359
Contract services	**131**	123	237
Other revenue*	**73**	60	121
	2,135	1,898	3,805
Operating Expenditure			
Labour	**(435)**	(437)	(863)
Fuel	**(584)**	(440)	(949)
Maintenance and overhaul	**(117)**	(115)	(218)
Aircraft operations	**(191)**	(177)	(352)
Passenger services	**(116)**	(114)	(222)
Sales and marketing	**(156)**	(165)	(311)
Other expenses	**(122)**	(115)	(201)
	(1,721)	(1,563)	(3,116)
Earnings Before Interest, Taxation, Depreciation, Amortisation and Rental Expenses	**414**	335	689
Depreciation and amortisation	**(143)**	(127)	(261)
Rental and lease expenses	**(155)**	(135)	(280)
Earnings Before Interest and Taxation	**116**	73	148
Net interest**	**(7)**	8	2
Operating Surplus Before Taxation and Unusual Items	**109**	81	150
Unusual items***	**(5)**	(9)	(44)
Operating Surplus Before Taxation	**104**	72	106
Taxation expense	**(30)**	(26)	(10)
Net Surplus Attributable to Shareholders of Parent Company	**74**	46	96
Per Share Information:			
Basic earnings per share (cents)	**7.4**	4.6	9.6
Diluted earnings per share (cents)	**7.2**	4.5	9.4
Net tangible assets per share (cents)	**163**	156	159

* Other revenue includes equity earnings from associates of nil (31 December 2005: $2 million; 30 June 2006: $1 million).

** Net interest includes interest revenue of $42 million (31 December 2005: $36 million; 30 June 2006: $74 million) and interest expense of $49 million (31 December 2005: $28 million; 30 June 2006: $72 million).

*** The current period unusual items reflect business reorganisation costs of $5 million. Unusual items for 31 December 2005 and 30 June 2006 relate to business reorganisation costs (31 December 2005: nil; 30 June 2006: $14 million) and ANZES reorganisation programme costs (31 December 2005: $9 million; 30 June 2006: $30 million).

STATEMENT OF MOVEMENTS IN EQUITY

	6 MONTHS TO 31 DEC 2006 $M	6 MONTHS TO 31 DEC 2005 $M	12 MONTHS TO 30 JUN 2006 $M
Net surplus attributable to shareholders	**74**	46	96
Translation (loss)/gain in foreign currency translation reserve	**(3)**	1	4
Total Recognised Revenues and Expenses	**71**	47	100
Shares issued	**4**	2	3
Dividend on Ordinary Shares	**(25)**	(25)	(50)
Movements in Equity for the Period	**50**	24	53
Equity at the Beginning of the Period	**1,594**	1,541	1,541
Equity at the End of the Period	**1,644**	1,565	1,594

These financial statements have not been audited. They have been the subject of review by the auditors pursuant to the Institute of Chartered Accountants of New Zealand Review Engagement Standards RS-1. The accompanying notes form part of these financial statements.

AIR NEW ZEALAND LIMITED AND ITS CONTROLLED ENTITIES

STATEMENT OF FINANCIAL POSITION

	NOTES	31 DEC 2006 $M	31 DEC 2005 $M	30 JUN 2006 $M
Current Assets				
Bank and short term deposits		**1,045**	1,054	1,150
Trade and other receivables		**463**	417	429
General stores		**118**	116	121
Income taxation		**28**	–	–
Other assets		**31**	23	21
Total Current Assets		**1,685**	1,610	1,721
Non-Current Assets				
Trade and other receivables		**16**	12	16
Property, plant and equipment		**2,760**	2,416	2,669
Investments	3	**50**	50	54
Other assets		**250**	364	325
Total Non-Current Assets		**3,076**	2,842	3,064
Total Assets		**4,761**	4,452	4,785
Current Liabilities				
Bank overdraft and short term borrowings		**–**	1	–
Trade and other payables		**442**	516	516
Transportation sales in advance		**537**	423	504
Borrowings		**68**	88	315
Finance lease liabilities		**39**	16	30
Provisions		**101**	98	102
Income taxation		**–**	72	14
Other liabilities		**105**	99	100
Total Current Liabilities		**1,292**	1,313	1,581
Non-Current Liabilities				
Trade and other payables		**30**	30	26
Convertible notes	8	**98**	98	98
Borrowings		**516**	703	537
Finance lease liabilities		**647**	270	478
Provisions		**83**	105	94
Other liabilities		**28**	13	13
Deferred taxation		**423**	355	364
Total Non-Current Liabilities		**1,825**	1,574	1,610
Total Liabilities		**3,117**	2,887	3,191
Net Assets		**1,644**	1,565	1,594
Equity				
Issued capital		**2,112**	2,107	2,108
Asset revaluation reserve		**9**	9	9
Revenue reserves		**(477)**	(551)	(523)
Total Equity		**1,644**	1,565	1,594

Property, plant and equipment

Increased due to addition of two 777s and eight Q300 aircraft since December 2005.

Transportation sales in advance

Increased due to higher average fares.

Convertible notes

Converted to ordinary shares on 14 February 2007.

John Palmer, CHAIRMAN

Roger France, DIRECTOR

For and on behalf of the Board, 27 February 2007

These financial statements have not been audited. They have been the subject of review by the auditors pursuant to the Institute of Chartered Accountants of New Zealand Review Engagement Standards RS-1. The accompanying notes form part of these financial statements.

STATEMENT OF CASH FLOWS

	6 MONTHS TO 31 DEC 2006 $M	6 MONTHS TO 31 DEC 2005 $M	12 MONTHS TO 30 JUN 2006 $M
Cash Flows from Operating Activities			
Receipts from customers	**2,151**	1,881	3,856
Interest received	**41**	33	69
Payments to suppliers and employees	**(1,919)**	(1,651)	(3,443)
Income taxation paid	**(14)**	(32)	(61)
Interest paid	**(50)**	(31)	(79)
	209	200	342
Rollover of foreign exchange contracts*	**(107)**	33	131
Net Cash Flow from Operating Activities	**102**	233	473
Cash Flows from Investing Activities			
Disposal of property, plant and equipment	**59**	6	10
Finance lease receipts	**–**	1	1
Acquisition of property, plant and equipment	**(292)**	(488)	(764)
Secured deposit	**(5)**	(5)	(15)
Acquisition of investments	**(3)**	(4)	(4)
Net Cash Flow from Investing Activities	**(241)**	(490)	(772)
Cash Flows from Financing Activities			
Shares issued	**1**	1	1
Borrowing and finance lease liability drawdowns	**255**	335	589
Borrowing and finance lease liability payments	**(200)**	(72)	(163)
Dividend on Ordinary Shares	**(22)**	(24)	(48)
Net Cash Flow from Financing Activities	**34**	240	379
Net Movement in Cash Holding	**(105)**	(17)	80
Cash balance at beginning of period	**1,150**	1,070	1,070
Cash Balance at End of Period	**1,045**	1,053	1,150
Reconciliation of Net Surplus Attributable to Shareholders to Operating Cash Flows:			
Net surplus attributable to shareholders	**74**	46	96
Plus/(less) non-cash items:			
Depreciation and amortisation	**143**	127	261
(Gain)/loss on disposal of property, plant and equipment	**(3)**	1	2
Share of surplus of associates	**–**	(2)	(1)
Foreign exchange (gains)/losses	**(58)**	7	57
Other non-cash items	**16**	2	7
	172	181	422
Net working capital movements:			
Assets	**(24)**	(5)	(24)
Transportation sales in advance	**33**	(32)	49
Deferred foreign exchange (gains)/losses	**(49)**	26	74
Liabilities	**(30)**	63	(48)
	(70)	52	51
Net Cash Flow from Operating Activities	**102**	233	473

* Relates to gains/losses on rollover of foreign exchange contracts that hedge exposures in other financial periods.

Net operating cash

The year-on-year reduction in operating cash of $131 million principally relates to the cash impact of rolling over forward exchange contracts that hedge exposures in other financial periods.

Borrowing payments

Includes early debt repayment of $140 million.

These financial statements have not been audited. They have been the subject of review by the auditors pursuant to the Institute of Chartered Accountants of New Zealand Review Engagement Standards RS-1. The accompanying notes form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. FINANCIAL STATEMENTS

The interim financial statements should be read in conjunction with the annual report for the year ended 30 June 2006.

The accounting policies used in the preparation of the interim financial statements are consistent with those used as at 30 June 2006 and 31 December 2005.

These financial statements have not been audited. The interim financial statements have been prepared in accordance with FRS-24: Interim Financial Statements and have been the subject of review by the auditors, pursuant to the Institute of Chartered Accountants of New Zealand Review Engagement Standards RS-1.

Where necessary, comparative information has been reclassified to achieve consistency in disclosure with the current period.

Other Disclosures

Total operating revenue (including interest revenue) is $2,177 million (31 December 2005: $1,934 million; 30 June 2006: $3,879 million).

All borrowings are secured over aircraft or aircraft related assets.

Non-cash movements in investing activities include foreign currency losses on translation of $87 million (31 December 2005: gains of $12 million; 30 June 2006: gains of $80 million). Non-cash movements in financing balances include foreign currency gains on translation of $145 million (31 December 2005: losses of $19 million; 30 June 2006: losses of $140 million).

2. SEGMENTAL INFORMATION

Industry Segment

Air New Zealand operates predominantly in one industry segment, its primary business being the transportation of passengers and cargo on scheduled airline services.

Geographical Segment

The Group's airline operations are scheduled services within, to or from New Zealand. An analysis of flight revenue by route area is provided below. The principal assets of the Group are located in New Zealand.

	6 MONTHS TO 31 DEC 2006 $M	6 MONTHS TO 31 DEC 2005 $M	12 MONTHS TO 30 JUN 2006 $M
Analysis of revenue by route area			
Domestic	**554**	490	975
Australia and Pacific Islands	**522**	473	932
Asia and Europe	**281**	245	491
North America and Europe	**574**	507	1,049
Total flight revenue	**1,931**	1,715	3,447
Contract services and other revenue	**204**	183	358
Total operating revenue	**2,135**	1,898	3,805

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

3. ASSOCIATE INVESTMENTS

Significant associate investments comprise:

NAME	% OWNED	PRINCIPAL ACTIVITY	COUNTRY OF INCORPORATION
Christchurch Engine Centre (CEC) *	49	Engineering services	New Zealand
Travel Software Solutions Pty Limited **	50	Airline reservation systems	Australia

* The CEC is operated in partnership with Pratt and Whitney.

** The Group's 50 percent ownership of Travel Software Solutions Pty Limited represents 25 percent held directly by the Company and 25 percent held by Ansett. Following Ansett being placed into voluntary administration on 12 September 2001, only the 25 percent interest held directly by the Company has been equity accounted into the Group result.

4. OPERATING LEASE COMMITMENTS

	31 DEC 2006 $M	31 DEC 2005 $M	30 JUN 2006 $M
Aircraft leases payable			
Not later than 1 year	**213**	247	284
Between 1 and 2 years	**191**	199	220
Between 2 and 5 years	**399**	533	547
Over 5 years	**22**	84	48
	825	1,063	1,099
Property leases payable			
Not later than 1 year	**34**	31	37
Between 1 and 2 years	**24**	23	22
Between 2 and 5 years	**51**	43	43
Over 5 years	**83**	60	63
	192	157	165

5. CAPITAL COMMITMENTS

	31 DEC 2006 $M	31 DEC 2005 $M	30 JUN 2006 $M
Aircraft	**1,853**	1,287	1,302
Non-aircraft	**26**	29	43
	1,879	1,316	1,345

On 19 December 2006, the Company confirmed the purchase of an additional four B787-9 aircraft, bringing its total firm commitments to eight, by converting two existing options and two existing purchase rights. The Company also acquired six additional options for B787-9, bringing its B787-9 options to a total of eight. The B787-9 that are subject to firm commitments will be introduced over the period from December 2010 to September 2013. The table includes the firm commitments in relation to these aircraft.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

6. CONTINGENT LIABILITIES

All significant legal disputes involving probable loss have been provided for in the financial statements. Air New Zealand has been named in two class actions in Australia, one claiming travel agents commission on fuel surcharges and another alleging anti competitive conduct in the air cargo business. Based upon the information known by the Company at the date of signing the financial statements, the possible liability that Air New Zealand may face cannot be reliably measured and accordingly, no provision has been made in these financial statements. No other significant contingent claims are outstanding at balance date.

Outstanding letters of credit and performance bonds total $19 million (31 December 2005: $19 million; 30 June 2006: $19 million). Under certain operating lease arrangements the Group has an obligation to return aircraft to specified operational conditions prior to redelivery.

The Group has a partnership agreement with the Christchurch Engine Centre (CEC) in which it holds a 49 percent interest. By the nature of the agreement, joint and several liability exists between the two parties. Total liabilities of the CEC are $41 million (31 December 2005: $48 million; 30 June 2006: $65 million).

7. DIVIDENDS

On 27 February 2007, the Board of directors declared an interim dividend of 3.0 cents per Ordinary Share, and a special dividend of 10 cents per Ordinary Share payable on 26 March 2007 to registered shareholders at 13 March 2007. The total dividends payable will be $136 million. Imputation credits will be attached and supplementary dividends paid to non-resident shareholders. These dividends have not been recognised in the December 2006 interim financial statements.

A final dividend of 2.5 cents per Ordinary Share was paid on 21 September 2006. Imputation credits were attached. Supplementary dividends were also paid to non-resident shareholders. Under the dividend reinvestment plan, dividends payable of $3 million were settled by the issue of 2,634,365 Ordinary Shares, at $1.1201 per Ordinary Share. A coupon of $1 million, equivalent to the dividend declared, was also paid on the Convertible Notes and has been recognised as a component of interest expense.

A dividend reinvestment plan has been established which offers eligible shareholders the opportunity to increase their investment in the Company by applying dividends received on some or all of their existing Ordinary Shares to the acquisition of additional Ordinary Shares. All shareholders with registered addresses in New Zealand and Australia are entitled to participate in the Plan. The subscription price of Ordinary Shares issued under the Plan will be at a discount of 2.5 percent of the volume weighted average sale price of the Ordinary Shares on the NZSX and ASX over the first five trading days on which the Shares trade ex-entitlement on the NZSX. For participation in the Plan to be effective in relation to the interim dividend which is proposed to be paid on 26 March 2007, a properly completed participation form must already be held, or will need to be received, by Computershare prior to 5.00 pm (NZ time) on 13 March 2007. The dividend reinvestment plan will not apply to the special dividend declared.

8. SUBSEQUENT EVENT

On 14 February 2007, all of the convertible notes issued to a subsidiary of Qantas in 2002 were converted into 44,152,695 new ordinary shares (at issue price $2.225) in Air New Zealand), equivalent to approximately 4.2% of reported capital. Following the conversion the total number of Ordinary Shares on issue was 1,050,671,938 shares. The impact of the conversion was to increase issued capital by $98 million and reduce total non-current liabilities by an equivalent amount.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

9. IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (NZ IFRS)

Air New Zealand Limited intends to adopt NZ IFRS for the year commencing 1 July 2007. The project to convert to NZ IFRS commenced in October 2003 and is now in the transition phase. The project is proceeding to plan. Conversion to NZ IFRS will conclude with the delivery of the first set of NZ IFRS compliant interim financial statements for the six months ending 31 December 2007 and the first set of NZ IFRS compliant annual financial statements for the year ending 30 June 2008.

This disclosure highlights the most significant changes in accounting policies expected to arise upon conversion to NZ IFRS. Impacts on these financial statements for the six months to 31 December 2006 are yet to be reliably estimated.

It should be noted that further developments in NZ IFRS may result in changes to the accounting policy decisions made by directors to date and, consequently, the likely impacts outlined in the discussion below. The directors may, at any time until the completion of the Group's first NZ IFRS compliant financial statements, revisit, and where considered necessary, revise the accounting policies applied in preparing the estimates below. The estimated adjustments on the opening balance sheet may be materially different from the actual adjustments on transition.

The table below provides a summary of the potential impacts resulting from transition to NZ IFRS. The summary should not be taken as an exhaustive list of all the differences between existing NZ GAAP and NZ IFRS. Only a complete set of financial statements and notes together with comparative balances can provide a true and fair presentation of Air New Zealand's financial position, results of operations and cash flows in accordance with NZ IFRS.

	ASSETS $M	LIABILITIES $M	EQUITY $M
NZ GAAP as at 30 June 2006	4,785	3,191	1,594
Jet aircraft residual value hedge	(102)	–	(102)
Financial instruments	165	(37)	202
Maintenance	(24)	130	(154)
Defined benefit plans	(3)	10	(13)
Taxation	–	(77)	77
Restated under NZ IFRS	**4,821**	**3,217**	**1,604**

All adjustments are shown before taxation.

Jet Aircraft Residual Value Hedge

Air New Zealand currently designates the USD denominated residual values of the jet aircraft fleet, engines, simulators and progress payments as a hedge of related USD denominated borrowings and finance lease liabilities. NZ IFRS does not permit such a hedge. Therefore this accounting treatment will be reversed on transition to NZ IFRS. On transition date, the impact of reversing the current treatment is estimated to be a reduction in equity (before tax) of $102 million.

Financial Instruments

NZ IFRS requires the recognition of all derivatives at fair value through the Statement of Financial Performance, unless they are successfully designated as part of a cash flow hedge. Under existing NZ GAAP, derivatives remain off balance sheet until the underlying hedged item is realised. The recognition of derivatives at fair value on transition will increase net equity (before tax) by $202 million.

NZ IFRS requires strict criteria to be met in order to qualify for hedge accounting. Whilst Air New Zealand's general hedging strategies are permissible under NZ IFRS, certain changes have been made to enable these hedges to be designated as cash flow hedges. Risk management practices will continue to be determined on an economic basis, rather than being designed to achieve a particular accounting outcome. Consequently, it is expected that this will result in some transactions failing the hedge effectiveness criteria from time to time and hedging gains or losses being recorded in current period earnings. In particular given the high volatility of fuel markets, the effectiveness test may not always be met and changes in the fair value of fuel hedging instruments would then need to be recognised in the Statement of Financial Performance and consequently, some earnings volatility may arise.

9. IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (NZ IFRS) (continued)

Accounting for Maintenance

Air New Zealand currently expenses all maintenance as incurred. The application of NZ IFRS in respect of accounting for aircraft and related maintenance costs results in the following changes:

– Engines will be accounted for as a separate component of aircraft and depreciated separately. The estimated useful life of engines will be revised on transition to NZ IFRS;
– The cost of major airframe inspections and engine overhauls will be capitalised and recognised in the carrying amount of the asset. The capitalised amount will then be depreciated over the period to the next expected inspection or overhaul. On transition to NZ IFRS, the appropriate carrying value of previously expensed maintenance will be reinstated on the Statement of Financial Position; and
– Where the Group has a commitment to maintain aircraft held under operating lease arrangements, provision is made during the lease term for the lease return obligations specified within those lease agreements. The provision is based on estimated future costs of major inspections and engine overhauls by making appropriate charges to the Statement of Financial Performance calculated by reference to the number of hours or cycles operated during the year.

The overall net impact on equity of these adjustments on transition is a decrease of $154 million, before tax.

Future earnings will see a transfer from the maintenance and overhaul expense category to depreciation. The provisioning for lease return costs will be recognised as maintenance and overhaul expense.

Defined Benefit Plans

NZ IFRS requires actuarial valuations to use a different valuation methodology and a different discount rate to that currently employed. Actuarial gains and losses will only be recognised to the extent that they exceed 10 percent of the greater of the scheme assets or liabilities. This excess will be spread over the remaining average service lives of the employees. This is the “corridor” approach permitted by NZ IFRS.

On transition, the above will increase the Group’s defined benefit obligation and reduce equity (before tax) by $13 million. It is not anticipated that there will be any material impact on future earnings as a result of adopting NZ IFRS.

Taxation

NZ IFRS requires deferred taxation to be determined using a balance sheet method as opposed to the income statement method currently employed under existing NZ GAAP. Under the balance sheet approach, income tax on the profit or loss for the year comprises both current and deferred taxation. In brief, temporary differences are differences between the carrying value of assets and liabilities for financial reporting purposes as compared to their carrying value for tax purposes. Temporary differences may give rise to deferred tax assets or deferred tax liabilities. Applying NZ IFRS at transition date results in an overall decrease in the deferred tax liability and increase in net equity of $77 million.

Deloitte.

REVIEW REPORT OF THE AUDITOR-GENERAL

REVIEW REPORT OF THE AUDITOR-GENERAL
TO THE READERS OF THE FINANCIAL STATEMENTS OF AIR NEW ZEALAND LIMITED GROUP

We have reviewed the interim financial statements on pages 20 to 27. The interim financial statements provide information about the past financial performance of Air New Zealand Limited and its controlled entities (the Group) and its financial position as at 31 December 2006. This information is stated in accordance with the accounting policies set out in the Group annual financial statements as at 30 June 2006.

Board of Directors' Responsibilities

The Board of Directors is responsible for the preparation, in accordance with New Zealand law and generally accepted accounting practice, of interim financial statements which give a true and fair view of the financial position of the Group as at 31 December 2006 and of the results of operations and cash flows for the six months ended on that date.

Independent Accountant's Responsibilities

The Auditor-General is the auditor of the Group pursuant to section 5(1)(f) of the Public Audit Act 2001. Pursuant to section 32 of the Public Audit Act 2001, the Auditor-General has appointed Andrew Burgess of Deloitte to undertake the annual audit of the Group.

We are responsible for reviewing the interim financial statements presented by the Board of Directors in order to report to you whether, in our opinion and on the basis of the procedures performed by us, anything has come to our attention that would indicate that the interim financial statements do not present fairly the matters to which they relate.

Basis of Opinion

A review is limited primarily to enquiries of company personnel and analytical review procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

We have reviewed the interim financial statements of the Group for the six months ended 31 December 2006 in accordance with the Review Engagement Standards issued by the Institute of Chartered Accountants of New Zealand.

We have performed other engagements in the areas of taxation, audit and other assurance services. None of these engagements impact, in any way, on our independence. In addition to these engagements, principals and employees of our firm deal with the Group on arm's length terms within the ordinary course of trading activities of the Group. Other than these engagements and arm's length transactions, and in our capacity as auditor acting on behalf of the Auditor-General, we have no relationship with or interests in the Group.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial statements on pages 20 to 27 do not fairly present the financial position of the Group as at 31 December 2006 and the results of operations and cash flows for the six months ended on that date in accordance with generally accepted accounting practice in New Zealand.

Our review was completed on 27 February 2007 and our review opinion is expressed as at that date.

A G Burgess

A Burgess
DELOITTE

On behalf of the Auditor-General, Auckland, New Zealand

Matters Relating to the Electronic Presentation of the Interim Financial Statements

This review report relates to the interim financial statements of Air New Zealand Limited and Group (the Group) for the six months ended 31 December 2006 included on Air New Zealand Limited's web-site. The Company's Board of directors is responsible for the maintenance and integrity of the Air New Zealand Limited web site. We have not been engaged to report on the integrity of the Air New Zealand Limited web site. We accept no responsibility for any changes that may have occurred to the interim financial statements since they were initially presented on the web site. The review report refers only to the financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to/from these financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the interim financial statements and related review report dated 27 February 2007 to confirm the information included in the unaudited financial statements presented on this web site. Legislation in New Zealand governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.