As New Zealand’s national carrier, we’re committed to moving this country and our airline forward.
There is much in the first half result that we can all be proud of. All our key metrics – including yield, passenger numbers, revenue, profitability and share price – are up. That’s great reward for all the change and new investment.

In the six months to 31 December 2006 we increased our net profit by 61 percent to $74 million. This improvement was achieved despite another tough operating environment, with average jet fuel prices up 13 percent over last year and 55 percent over the same period two years ago.

As a result of the improvement in profitability, the Board has declared a half-a-cent increase in interim dividend to three cents per share.

**CASH PROJECTIONS PROMPT A SPECIAL DIVIDEND**

Our focus on maintaining a strong balance sheet has seen gearing (including net capitalised aircraft operating leases) move to the lower end of our target gearing range of 45-55 percent. Cash holdings at over $1 billion are healthy.

With the current cycle of fleet investment coming to an end and no wide body aircraft arriving until 2010, we will be in a position to generate free cash for the next two-to-three years. With that in mind, a review of our current medium-term financial and cash projections has prompted the Board to declare a special dividend of $105 million or 10 cents per share.

The dividend reinvestment plan will not apply to the special dividend. Both the special and interim dividends will have full imputation credits attached, with supplementary dividends for overseas shareholders.

We’re certainly pleased with the progress we’re making. Our product is now world-class. Our network strength and profitability are improving. The revenue opportunities and cost reductions represented in the reconfigured business are better than they have ever been. Overall though, returns, while they are better, are still well below their potential. The Board’s view is that we are not yet achieving the levels of performance we consider appropriate to properly reward shareholders for the capital employed and the associated investment risk.

**OUR PLANS TO ACHIEVE EVEN BETTER RETURNS**

Over the next two-to-three years, conscientious and creative thinking needs to go into ensuring we make even more of our speed and manoeuvrability. That means fast, effective decision making and implementation.

Moving quickly and proactively is one of our fundamental strengths, and where we’ve used that to our advantage, it has certainly paid off. A good example is our success in the online environment. This year we expect to record over $1 billion in online sales. It’s hard to imagine that only five years ago our online sales were just $19 million. To continue building this capability, we have developed our own online innovation team.

We’ve also added a new dimension to the Board with the appointment of Jim Fox, Managing Director and founder of Vision Systems Limited, an ASX listed technology company with a market capitalisation of around $900 million. Jim’s proven ability to commercialise technology and his international experience will bring a different and important perspective to the development of our future strategy.

**WORKING WITH OTHERS IN THE INDUSTRY**

New Zealand’s future performance as a tourism destination will play a critical role in our future. There’s little doubt in our minds that we need to step up and offer leadership within the tourism sector as the country gears up for tougher competition for tourists in the years ahead. The chief ingredients – vision and capital investment – are contributions we’ll make alongside others in order to preserve this country’s competitiveness.

Growing our domestic business is equally as important. Over the past four years our domestic success has come from listening to our customers and responding accordingly – lower airfares, more flights and new destinations have resulted. We will continue to identify opportunities to make air travel more affordable and more accessible to all New Zealanders, ensuring Air New Zealand is at the heart of every New Zealand journey.

We’ve come a long way, and I want to thank all Air New Zealanders for all the work that’s got us to here. But the journey back to realistic financial returns is by no means over.

John Palmer
CHAIRMAN
The country and the airline share much more than a name. Both as a tourism destination and the national carrier, we are small challengers up against much larger, well resourced competitors. By world standards, we represent less than one percent of global tourism and a fraction of the worldwide aviation sector. As niche players, we simply don’t have the resources to outmuscle our competitors or create a significant global presence that gives us worldwide top of mind awareness. Instead, we need to box clever. Competing with other countries and their airlines on their terms will see New Zealand as a destination and Air New Zealand lose. We need to find creative, New Zealand ways to use our size, history, culture and personality to our advantage.
Niche players have a key strength that they must capitalise on to succeed. They are able to be much more nimble, flexible and personalised than their bigger competitors. Scale-driven entities have no choice but to churn out production-driven experiences, and both tourism and the airline industry tend towards a scaled approach. We need to take that preoccupation with size and turn it on its head. We need to use our size, in our way, to outperform.
USING OUR SIZE, OUR WAY

Being very clear about what we offer and who we want to attract is at the heart of our strategy. That focus is already driving our network development, the way we position our product and our pricing, the destinations we choose to fly to and the markets we choose to serve. We’re unequivocal about the fact that we have best in class product in order to attract higher value tourists to this market. What’s more, it’s working.

Overall, yields for the six months ended 31 December 2006 were up 10.7 percent over the last comparative period. Better yet, on long-haul Business Premier, which is where much of our in-flight investment has been centred, yields have increased by over 30 percent.

Our market share has also improved, particularly on our UK route, which has lifted from 30 percent to 40 percent following the introduction of our Hong Kong – London service. Our customer satisfaction levels continue to improve too.

BEYOND THE LAND – MAXIMISING OUR PEOPLE FACTOR

Historically, this country has traded on the strength of its natural beauty. But interestingly, two of our greatest successes in recent years have looked beyond that. People flocked here to experience the country behind the Lord of the Rings. They wanted to see how and why New Zealand formed the backdrop for such an epic tale. But what they noticed were the people they met, and what New Zealanders manage to achieve. Equally, the America’s Cup may have lured them as an event, but many visitors left here with a sense of intrigue that we could do so well against others who were far better resourced.

There’s little doubt our warmth, can-do attitude and remoteness add up to a mix that visitors are beguiled by. My vision for our tourism industry is that we can build our confidence to the point where our distinctive characteristics are a competitive advantage that adds to the overall naturalness of what we have to offer. We should have a goal to attract people here to experience the exuberance and warmth of our national personality not just our natural scenery.

We’ve said for some time that the journey to New Zealand must begin when people engage with our airline. So it makes sense that bringing the country to life through people is something that Air New Zealand should take the lead on. Having improved our product, focused our routes and streamlined our operations, our key focus for growth centres on the personality of this organisation and how we become a reference point for New Zealand. Online, on board, onshore, we need to be sharing stories and emotions that bring who we are as a nation to life.

Our biggest challenge as an airline going forward is to galvanise our people to project our personality and to engage in interactions that make us proud. As Air New Zealanders, we are uniquely placed to do that, but it will take guts and a huge leap of faith. Because the sense of New Zealanders being themselves isn’t something you can script for. We need to be prepared to let go of the control, to allow initiative and personality to make their presence felt, to accept variability in interactions. Such an idea, which would be considered anathema and anarchy to most airlines and customer service models, is critical for us if we are to successfully embrace our New Zealandness.

Let me share a story with you that shows why I believe it’s more than possible. When we were opening our new route to Shanghai, we made the decision to recruit people from China as flight attendants. The question arose: given our focus on being the most New Zealand of airlines, wasn’t that an inconsistent approach?

But the insight we gained is that you don’t have to be a New Zealander to be an effective ambassador for our country and to represent our personality and culture to others. After all, one of the key roles of our flight attendants is to provide the bridge between the culture of our passengers and the New Zealand they have chosen to visit, particularly when, in the case of the Chinese market, the vast majority of visitors come from a very different background and don’t speak English. That’s why our selection process called for individuals with the ability to passionately embrace the New Zealand character. And that’s also why, after we had chosen the people we wanted, we brought them to New Zealand and gave them a taste of our life here. At their graduation, this group stood up and, off their own bat,
sang a song in Maori with such passion, motivation and enthusiasm for our culture that I only wished all staff could have been there to witness it. Having people like this representing us on our international flights will do us all proud – as an airline and as a country.

THE LONG GAME IS SHORT

There’s no dodging the fact that ultra-long-haul travel is progressively being replaced by shorter haul options, as our target markets struggle with the pressures of time and with the need to justify flying so far in the light of global concerns over climate change. A key challenge for tourism globally – and New Zealand is no exception – is to develop journeys and experiences that are environmentally sensitive and, ultimately, carbon neutral end-to-end. This is a huge challenge for the tourism industry but one that, as you can read elsewhere in this report, we are committed to addressing.

We need to act on the fact that our remoteness and isolation, whilst being our biggest assets and opportunities, are also potentially, in this changing environment, our greatest barriers. Our greatest opportunities lie in destinations that can be accessed by direct flight from New Zealand. For that reason, we need to focus much more actively on re-targeting our resources to the Pacific Rim – as can be seen by our new direct Shanghai services from November 2007 – and developing product and value propositions, as an airline and nation, that are as attractive as possible to these countries and their people.

One of the things we don’t have, and urgently need, if tourism is to reach anything like its potential, is a very clear and well integrated value proposition nationally. Given our constrained infrastructure, we cannot afford to play a pure numbers game as a destination. We need to think a lot harder and much more clearly about how we target people with the most value for our nation, and what we do to entice them to visit. We do need growth, but it must be quality growth.

TOGETHER, WE’LL STAND

Over the past decade, significant focus on our tourism industry has seen our country’s profile and tourism performance climb dramatically. The industry now accounts for a massive nine percent of GDP. But we lack unity and a common vision, and if we are to succeed internationally we need to work together to pick up our game in the face of increasing competition. Our growth has slowed dramatically, with inbound tourism growing at a mere 1-2 percent per annum over the past two years, lagging that of key competing destinations – our performance, plain and simple has been poor.

The answer lies in a cohesive national strategy, aligned national interests, clear target markets, integrated marketing and stringent quality control to ensure the integrity of the visitor experience. As a nation we must project a unique and compelling reason for people to want to experience our New Zealand, and it must be genuine. I believe the emerging environmental consciousness presents a great opportunity for New Zealand, but only if we are prepared to take a bold global leadership position. Without that unity and sense of common purpose, our lack of size and our geographical location could make us very vulnerable indeed.

Focused, spirited New Zealanders working together to lift our game are a force to be reckoned with. I have no doubt that we can do this. I know too, that when we do, we’ll ensure New Zealand’s place on the map as a must-visit destination.

Rob Fyfe
CHIEF EXECUTIVE OFFICER

Air New Zealand has launched a new brand campaign on television, billboards and in cinemas.

The “Amazing Journeys. Every Day” campaign, which replaces the “Being There Is Everything” series that ran from late 2002 until the end of 2005, has been created to do New Zealand proud and make Air New Zealand staff even prouder.

The three commercials – “Mother”, “Grandfather” and “Chef” – each start and end in different New Zealand locations. As with previous campaigns, they were inspired by the stories sent to us by our own people of their personal “amazing journeys” – times when flying somewhere had allowed them to experience something amazing.

New Zealand’s stunning landscape is showcased through breathtaking aerial shots. “Chef” starts out on the jetty of The Smokehouse Café in Mapua, just outside Nelson, and finishes in the courtyard of Otago University in Dunedin. “Grandfather” opens in Christchurch, then flies out over the city to the Canterbury Plains, over the Southern Alps and down to a home by the sea outside Hokitika. “Mother” begins in Wellington, flies up over bush and farmland and arrives at a retirement home in Kohimaramara, Auckland.

Over 700 hours of post-production and special effects work went into creating the seemingly one shot flying sequences that are a hallmark of these commercials. Some of the sequences have been sped up more than 20 times.

The goal is to bring back some of the magic of flight by creating a campaign that dramatises the emotions Air New Zealand evokes and to rekindle the connection New Zealanders have with their land and culture.

The three stories of New Zealanders connecting with people who are incredibly important to them have been made to celebrate who we are as a nation and to remember the strong bond many New Zealanders feel at the sight of the koru.

We hope you enjoy the journeys as they take to the air.
MAKING CHANGES FROM THE GROUND UP
Air New Zealand’s environmental programme has been developing over some time and we will cover where we have landed in more depth in the next report. In the meantime, here are some of our thoughts on the role air travel plays in climate change and how we are working to reduce our impact.

There’s no doubt that for a nation such as ours, tourism, the national reputation and the role we play as national carrier are interlinked. Air New Zealand is highly aware of the image of New Zealand and takes pride in doing our bit to maintain and enhance our international image. We also recognise that transportation of products and people, through air links and ports, will always be critical for a small and remote nation that relies on tourism and export receipts for its economic prosperity. These factors are key drivers behind our environmental policy development.

However, it’s also important to recognise that whilst environmental awareness may be growing globally, the contribution made by air travel to climate change is actually relatively small indeed. Air transport worldwide is responsible for around 1.6 percent of global CO2 emissions. It’s also a very efficient mode of transport environmentally, compared with other options. For example, today’s modern aircraft consume, on average, 3.5 litres of fuel per 100 passenger kilometres – less than a small car. The next generation of aircraft will target fuel efficiency rates below 0.000003 litres per 100 kilometres.

**OUR CARBON FOOTPRINT**

Air New Zealand emitted around 3.6 million tonnes of CO2 in 2006 – 92 percent of that came from jet fuel, the rest predominately from electricity for offices, engineering bases etc.

Domestically, the airline emitted around 400,000 tonnes of CO2, split relatively evenly between the regional airlines and our domestic jets.

Our trans-Tasman operations emitted 500,000 tonnes; Pacific Islands 175,000 tonnes and long-haul 2.2 million tonnes.

On our international routes, we operate some of the world’s most efficient aircraft, with the mix of fleet types and varying flight distances, but we have been proactive in benchmarking our emissions profile through our involvement in the Environmental Working Group of the Association of Asia Pacific Airlines (AAPA).

A recent report compared the performance of a number of large airlines in the Asia-Pacific region based on three years’ CO2 emissions data. This is the first time environmental performance has been benchmarked in this way. The results show conclusively that Air New Zealand rates very well alongside other Asia-Pacific airlines, and that our practices are in line with world class practice.

As shown on the graph, we are at the lower end of our Asia-Pacific peer group in terms of CO2 emissions. The Kyoto agreement allows for countries to be incentivised or penalised according to their environmental improvement record. We support such an approach because we believe it adds immediacy to the problem and adds momentum to the need to continue addressing these issues. We believe that those airlines that successfully improve their benchmark performance should be rewarded for doing so. Equally, we support any initiative designed to penalise airlines who don’t maintain their current and future performance expectations in CO2 emissions.

For the same reason, we do not support broad based taxation approaches that fail to recognise the differing contribution and efforts of individual companies within an industry, and thereby fail to incentivise any change in behaviour.

**REDUCING OUR IMPACT**

Our 777s, introduced over the past two years, are much more efficient than our older fleet, whilst the new Dreamliner 787 aircraft, on order from Boeing and expected here in the next three years, is 30 percent more fuel efficient than other long-haul aircraft.

We’ve also been adjusting routes and schedules to take out lower load flights such as Nagoya, Taipei, Singapore and Christchurch-Los Angeles that have higher emissions per passenger.

Air New Zealand’s operations have also recently been audited by the International Air Transport Association (IATA). This highly experienced group of professionals have decades of experience between them in helping airlines conserve fuel and reduce emissions.

As a result, we are introducing simple measures like not carrying excess water on short-haul flights, which saves aircraft weight, and therefore fuel usage. Another measure is reducing the amount of time we run the Auxiliary Power Unit (the small jet engine in the tail of airliners), which also cuts down on fuel use. We’re even looking closely at the weight of paper, charts and documentation our pilots carry on board each aircraft. There are numerous other initiatives we are looking into – everything from how our aircraft taxi on the runway to how we perform our ground operations.

We have also worked with Landcare Research to develop specific software to monitor our CO2 emissions footprint. This has enabled us to show that since 2001, for example, our long-haul fleet has reduced fuel burn, and therefore CO2 emissions per passenger kilometre, by 10 percent on a cumulative basis.

Global warming and climate change are international issues which cannot be ignored. We are taking them seriously and the work we are doing on a number of fronts will include New Zealand-driven solutions alongside the industry’s international efforts.

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Sara Smeath – Winner of Inspiring New Zealanders in Fashion Scholarship
Every year it seems, New Zealanders find more and more ways to make their mark on the world. They do us proud – and Air New Zealand has chosen to recognise up-and-coming faces of the nation with a scholarship programme that now spans three fields.

**Inspiring New Zealanders**

Inspiring New Zealanders is a scholarship programme developed by Air New Zealand because we recognised that fostering young New Zealand talent was one way we could give something back to the community. The scholarship programme itself involves top-achieving “inspiring” New Zealanders providing inspiration and guidance to the next generation of talented New Zealanders.

We’re involved because we recognise the importance of finding more and more ways for New Zealanders to make an impression globally.

**Olympics Scholarships**

The first scholarships in the Air New Zealand Inspiring New Zealanders Olympic Sport programme were awarded in September 2005 to young athletes who were mentored by Hamish Carter, Bevan Docherty, Sarah Ulmer and Claudia Riegler. Each successful applicant received two workshops during the year with one-on-one mentoring sessions, ongoing contact and support from their mentor throughout the year, and travel with Air New Zealand to compete in an international sporting event.

Recipients of the inaugural scholarships included under 23 World Champion Triathlete, Andrea Hewitt; cyclist and winner of gold and silver medals at the Junior World Track Championships, Sam Bewley; long jumper, and silver medals at the Junior World Track Championships, Andrea Hewitt; cyclist and winner of gold and silver medals at the Junior World Track Championships, Sam Bewley.

In 2006, Barbara Kendall joined the programme as a mentor. Ten scholarships were awarded at the beginning of November 2006.

**Fashion Scholarship**

In July 2006, we launched the Inspiring New Zealanders in Fashion Scholarship, with well known New Zealand designer Karen Walker as mentor. Four interim finalists were selected to each spend a week in Auckland working with Karen. From that group, Sara Smeath was chosen and has now completed a structured 12 week work experience programme designed for her by Karen.

Twenty-two-year-old Sara from Kawakawa in the Bay of Islands was completing her Bachelor of Design at Massey University at the time she was selected. As part of the selection process, she entered an outfit inspired by onions and their layers – a panelled knit top, fitted onion dress and onion sack coat.

Sara’s winning package included:
- Gaining experience in a wide range of areas with mentoring, feedback and advice from Karen on her performance.
- Accompanying Karen to New York and assisting in the production of her show at New York Fashion Week.
- Support from Karen and her team.
- A weekly living allowance during her 12 weeks of work experience.
- One international trip on Air New Zealand during the course of the scholarship.
- Presentation and media training.
- Accommodation assistance.

The 12-month scholarship includes:
- Spending time with John and the other panelists learning from their techniques and experiences.
- Spending a vintage in France at a winery of their chosen speciality.
- Ongoing contact with John throughout the 12 months.

New Zealand’s wine industry is the third field to receive the Inspiring New Zealanders programme and is a natural extension of our support of the industry. Air New Zealand dedicates significant time and effort to the food and wine served on its international routes in an effort to showcase the very best of New Zealand to the world. Its in-flight selection comes from all over the country, ensuring a representation of styles for customers. We are the single largest server of New Zealand wine and have sponsored the annual Air New Zealand Wine Awards for the past 20 years. We’re passionate about the New Zealand wine industry. This passion has been well rewarded with Air New Zealand’s premium board wine selection being recognised as one of the best in the world, scooping three prestigious awards in UK Business Traveller Magazine’s annual Cellars in the Sky competition. This was the most awarded to any one airline in this year’s competition.

The Air New Zealand Inspiring New Zealanders Scholarship in Wine will start in April 2007.

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ONLINE BOOKS
$1 BILLION
Air New Zealand’s in-house software, to enable online booking for short and long-haul travel, is projected to generate over $1 billion in online bookings this financial year and is key in our bid to ensure our customers can access and book their travel in the way that best suits their needs.

Developed by a team from across the business, the working prototype of a new booking engine was ready in just 12 weeks, defying the predictions of outside vendors who said it simply couldn’t be achieved. In fact, the software was developed more quickly and cheaply than other products currently on the market, and has provided the platform to enable us to launch world-first innovations like grab-a-seat (really low online fares that change daily), which has been a great success since its launch in July 2006.

It’s one more example of the airline using innovation, capability and vision to redefine competitive possibilities within the sector. Being able to change airfares, packages and offers quickly and get them to market in a fraction of the normal time has given Air New Zealand a competitive edge. And with more and more travellers becoming aware of the site and what they can do with it, www.airnewzealand.co.nz now gets more hits than any other New Zealand tourism site – by some distance.

One of the reasons the booking engine has been so successful is because of its usability. Buying a long-haul ticket online is now as user friendly as buying a short-haul ticket. Booking is quicker and easier, and pricing is displayed for people as they move through the booking process, instead of right at the end.

Tying our distribution channels together more closely is a strategy that we expect will gather pace in the years ahead, mainly because it enables us to better align the experiences our customers have with us online, via phone and in store. Blending personality and technology enables people to engage with us every step of their journey.
Air New Zealand Holidays was launched in November 2006, offering travellers an exciting and convenient new way to buy their holiday packages. By combining an innovative online presence, a dedicated Contact Centre Holidays Team and our Air New Zealand Holidays stores nationwide, we have created greater synergy for our customers under the Air New Zealand Holidays brand. Our customers can now access the channel most suitable to their specific holiday needs.

Changes to legislation around annual leave mean that more than 43 percent of New Zealand workers will qualify for an additional week’s holiday from April 2007. Many of those we’ve spoken to have said they intend using their extra weeks leave to take a break. Thanks to Air New Zealand Holidays, they’ll be able to discover, research and book almost every aspect of their well-earned leave, just by visiting us.

With a comprehensive breadth of leisure travel products across all channels (click, call and visit) our customers can now do their planning and booking for all types of holiday experiences at their own convenience. We want to create as many opportunities as we can to encourage leisure travellers of all ages to “just imagine...” their dream holiday anywhere in the world. Deciding to take a holiday is the first step, but choosing the right experience and activity to ensure you get the most out of it are just as important. This initiative is part of our quest to build the best understanding possible of how to leverage capabilities for fuller profitability in this leisure travel sector – moving into non-traditional areas of the travel industry in creative and fast moving ways to meet the demands of customers.

The timing of this integrated Holidays brand launch couldn’t be better.
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.

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.
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.

---

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:

<table>
<thead>
<tr>
<th>Change in Profitability</th>
<th>Amount</th>
<th>Profit Before Unusuals and Tax for the Period Ended 31 December 2006</th>
</tr>
</thead>
</table>
| Passenger and cargo yield improvement                       | +$89m   | - Passenger yield for the Group increased 10.7% from 11.8 cents per RPK 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

### Operating Revenue

<table>
<thead>
<tr>
<th></th>
<th>6 MONTHS TO 31 DEC 2006</th>
<th>6 MONTHS TO 31 DEC 2005</th>
<th>12 MONTHS TO 30 JUN 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passenger revenue</td>
<td>1,714</td>
<td>1,534</td>
<td>3,088</td>
</tr>
<tr>
<td>Cargo and mail</td>
<td>217</td>
<td>181</td>
<td>359</td>
</tr>
<tr>
<td>Contract services</td>
<td>131</td>
<td>123</td>
<td>237</td>
</tr>
<tr>
<td>Other revenue*</td>
<td>73</td>
<td>60</td>
<td>121</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,135</strong></td>
<td><strong>1,898</strong></td>
<td><strong>3,805</strong></td>
</tr>
</tbody>
</table>

### 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)

- **Total**: (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)

- **Total**: **116**  
  - **73**  
  - **148**

### 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).

---

## STATEMENT OF MOVEMENTS IN EQUITY

### 6 MONTHS TO 31 DEC 2006

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

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.
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.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank and short term deposits</td>
<td>1,045</td>
<td>1,054</td>
<td>1,150</td>
</tr>
<tr>
<td>Trade and other receivables</td>
<td>463</td>
<td>417</td>
<td>429</td>
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<tr>
<td>General stores</td>
<td>118</td>
<td>116</td>
<td>121</td>
</tr>
<tr>
<td>Income taxation</td>
<td>28</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other assets</td>
<td>31</td>
<td>23</td>
<td>21</td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td><strong>1,685</strong></td>
<td><strong>1,610</strong></td>
<td><strong>1,721</strong></td>
</tr>
<tr>
<td><strong>Non-Current Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade and other receivables</td>
<td>16</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>2,760</td>
<td>2,416</td>
<td>2,669</td>
</tr>
<tr>
<td>Investments</td>
<td>3</td>
<td>50</td>
<td>54</td>
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<tr>
<td>Other assets</td>
<td>250</td>
<td>364</td>
<td>325</td>
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<tr>
<td><strong>Total Non-Current Assets</strong></td>
<td><strong>3,076</strong></td>
<td><strong>2,842</strong></td>
<td><strong>3,064</strong></td>
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<tr>
<td><strong>Total Assets</strong></td>
<td><strong>4,761</strong></td>
<td><strong>4,452</strong></td>
<td><strong>4,785</strong></td>
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<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank overdraft and short term borrowings</td>
<td>–</td>
<td>1</td>
<td>–</td>
</tr>
<tr>
<td>Trade and other payables</td>
<td>442</td>
<td>516</td>
<td>516</td>
</tr>
<tr>
<td>Transportation sales in advance</td>
<td>537</td>
<td>423</td>
<td>504</td>
</tr>
<tr>
<td>Borrowings</td>
<td>68</td>
<td>88</td>
<td>315</td>
</tr>
<tr>
<td>Finance lease liabilities</td>
<td>39</td>
<td>16</td>
<td>30</td>
</tr>
<tr>
<td>Provisions</td>
<td>101</td>
<td>98</td>
<td>102</td>
</tr>
<tr>
<td>Income taxation</td>
<td>–</td>
<td>72</td>
<td>14</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>105</td>
<td>99</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total Current Liabilities</strong></td>
<td><strong>1,292</strong></td>
<td><strong>1,313</strong></td>
<td><strong>1,581</strong></td>
</tr>
<tr>
<td><strong>Non-Current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade and other payables</td>
<td>30</td>
<td>30</td>
<td>26</td>
</tr>
<tr>
<td>Convertible notes</td>
<td>8</td>
<td>98</td>
<td>98</td>
</tr>
<tr>
<td>Borrowings</td>
<td>516</td>
<td>703</td>
<td>537</td>
</tr>
<tr>
<td>Finance lease liabilities</td>
<td>647</td>
<td>270</td>
<td>478</td>
</tr>
<tr>
<td>Provisions</td>
<td>83</td>
<td>106</td>
<td>94</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>28</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Deferred taxation</td>
<td>423</td>
<td>355</td>
<td>364</td>
</tr>
<tr>
<td><strong>Total Non-Current Liabilities</strong></td>
<td><strong>1,825</strong></td>
<td><strong>1,574</strong></td>
<td><strong>1,610</strong></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>3,117</strong></td>
<td><strong>2,887</strong></td>
<td><strong>3,191</strong></td>
</tr>
<tr>
<td><strong>Net Assets</strong></td>
<td><strong>1,644</strong></td>
<td><strong>1,565</strong></td>
<td><strong>1,594</strong></td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issued capital</td>
<td>2,112</td>
<td>2,107</td>
<td>2,108</td>
</tr>
<tr>
<td>Asset revaluation reserve</td>
<td>9</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Revenue reserves</td>
<td>(477)</td>
<td>(551)</td>
<td>(523)</td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td><strong>1,644</strong></td>
<td><strong>1,565</strong></td>
<td><strong>1,594</strong></td>
</tr>
</tbody>
</table>

John Palmer, CHAIRMAN  
Roger France, DIRECTOR

For and on behalf of the Board, 27 February 2007
## STATEMENT OF CASH FLOWS

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

### 6 MONTHS TO 31 DEC 2006

<table>
<thead>
<tr>
<th>Description</th>
<th>31 DEC 2006</th>
<th>31 DEC 2005</th>
<th>30 JUN 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flows from Operating Activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receipts from customers</td>
<td>2,151</td>
<td>1,881</td>
<td>3,856</td>
</tr>
<tr>
<td>Interest received</td>
<td>41</td>
<td>33</td>
<td>69</td>
</tr>
<tr>
<td>Payments to suppliers and employees</td>
<td>(1,919)</td>
<td>(1,651)</td>
<td>(3,443)</td>
</tr>
<tr>
<td>Income taxation paid</td>
<td>(14)</td>
<td>(32)</td>
<td>(61)</td>
</tr>
<tr>
<td>Interest paid</td>
<td>(50)</td>
<td>(31)</td>
<td>(79)</td>
</tr>
<tr>
<td>Rollover of foreign exchange contracts*</td>
<td>(107)</td>
<td>33</td>
<td>131</td>
</tr>
<tr>
<td><strong>Net Cash Flow from Operating Activities</strong></td>
<td>102</td>
<td>233</td>
<td>473</td>
</tr>
<tr>
<td><strong>Cash Flows from Investing Activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disposal of property, plant and equipment</td>
<td>59</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>Finance lease receipts</td>
<td>–</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Acquisition of property, plant and equipment</td>
<td>(292)</td>
<td>(488)</td>
<td>(764)</td>
</tr>
<tr>
<td>Secured deposit</td>
<td>(5)</td>
<td>(5)</td>
<td>(15)</td>
</tr>
<tr>
<td>Acquisition of investments</td>
<td>(3)</td>
<td>(4)</td>
<td>(4)</td>
</tr>
<tr>
<td><strong>Net Cash Flow from Investing Activities</strong></td>
<td>(241)</td>
<td>(490)</td>
<td>(772)</td>
</tr>
<tr>
<td><strong>Cash Flows from Financing Activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shares issued</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Borrowing and finance lease liability drawdowns</td>
<td>255</td>
<td>335</td>
<td>589</td>
</tr>
<tr>
<td>Borrowing and finance lease liability payments</td>
<td>(200)</td>
<td>(72)</td>
<td>(163)</td>
</tr>
<tr>
<td>Dividend on Ordinary Shares</td>
<td>(22)</td>
<td>(24)</td>
<td>(49)</td>
</tr>
<tr>
<td><strong>Net Cash Flow from Financing Activities</strong></td>
<td>34</td>
<td>240</td>
<td>370</td>
</tr>
<tr>
<td><strong>Net Movement in Cash Holding</strong></td>
<td>(105)</td>
<td>(17)</td>
<td>80</td>
</tr>
<tr>
<td>Cash balance at beginning of period</td>
<td>1,150</td>
<td>1,070</td>
<td>1,070</td>
</tr>
<tr>
<td><strong>Cash Balance at End of Period</strong></td>
<td>1,045</td>
<td>1,053</td>
<td>1,150</td>
</tr>
</tbody>
</table>

### Reconciliation of Net Surplus Attributable to Shareholders to Operating Cash Flows:

<table>
<thead>
<tr>
<th>Description</th>
<th>6 MONTHS TO</th>
<th>6 MONTHS TO</th>
<th>12 MONTHS TO</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net surplus attributable to shareholders</strong></td>
<td>74</td>
<td>46</td>
<td>96</td>
</tr>
<tr>
<td>Plus/(less) non-cash items:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortisation</td>
<td>143</td>
<td>127</td>
<td>261</td>
</tr>
<tr>
<td>(Gain)/loss on disposal of property, plant and equipment</td>
<td>(3)</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Share of surplus of associates</td>
<td></td>
<td>(2)</td>
<td>(1)</td>
</tr>
<tr>
<td>Foreign exchange (gains)/losses</td>
<td>(58)</td>
<td>7</td>
<td>57</td>
</tr>
<tr>
<td>Other non-cash items</td>
<td>16</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td><strong>Net working capital movements:</strong></td>
<td>172</td>
<td>181</td>
<td>422</td>
</tr>
<tr>
<td>Assets</td>
<td>(24)</td>
<td>(5)</td>
<td>(24)</td>
</tr>
<tr>
<td>Transportation sales in advance</td>
<td>33</td>
<td>(32)</td>
<td>49</td>
</tr>
<tr>
<td>Deferred foreign exchange (gains)/losses</td>
<td>(49)</td>
<td>26</td>
<td>74</td>
</tr>
<tr>
<td>Liabilities</td>
<td>(30)</td>
<td>63</td>
<td>(48)</td>
</tr>
<tr>
<td><strong>Net Cash Flow from Operating Activities</strong></td>
<td>102</td>
<td>233</td>
<td>473</td>
</tr>
</tbody>
</table>

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

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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.
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.


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.

<table>
<thead>
<tr>
<th>Analysis of revenue by route area</th>
<th>6 MONTHS TO 31 DEC 2005</th>
<th>6 MONTHS TO 31 DEC 2005</th>
<th>12 MONTHS TO 30 JUN 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>554</td>
<td>490</td>
<td>975</td>
</tr>
<tr>
<td>Australia and Pacific Islands</td>
<td>522</td>
<td>473</td>
<td>932</td>
</tr>
<tr>
<td>Asia and Europe</td>
<td>281</td>
<td>245</td>
<td>491</td>
</tr>
<tr>
<td>North America and Europe</td>
<td>574</td>
<td>507</td>
<td>1,049</td>
</tr>
<tr>
<td><strong>Total flight revenue</strong></td>
<td><strong>1,931</strong></td>
<td><strong>1,715</strong></td>
<td><strong>3,447</strong></td>
</tr>
<tr>
<td>Contract services and other revenue</td>
<td>204</td>
<td>183</td>
<td>358</td>
</tr>
<tr>
<td><strong>Total operating revenue</strong></td>
<td><strong>2,135</strong></td>
<td><strong>1,898</strong></td>
<td><strong>3,805</strong></td>
</tr>
</tbody>
</table>
3. ASSOCIATE INVESTMENTS

Significant associate investments comprise:

<table>
<thead>
<tr>
<th>NAME</th>
<th>% OWNED</th>
<th>PRINCIPAL ACTIVITY</th>
<th>COUNTRY OF INCORPORATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Christchurch Engine Centre (CEC) *</td>
<td>49</td>
<td>Engineering services</td>
<td>New Zealand</td>
</tr>
<tr>
<td>Travel Software Solutions Pty Limited **</td>
<td>50</td>
<td>Airline reservation systems</td>
<td>Australia</td>
</tr>
</tbody>
</table>

* 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

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

5. CAPITAL COMMITMENTS

<table>
<thead>
<tr>
<th></th>
<th>31 DEC 2006</th>
<th>31 DEC 2005</th>
<th>30 JUN 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aircraft</td>
<td>1,853</td>
<td>1,287</td>
<td>1,302</td>
</tr>
<tr>
<td>Non-aircraft</td>
<td>26</td>
<td>29</td>
<td>43</td>
</tr>
<tr>
<td></td>
<td>1,879</td>
<td>1,316</td>
<td>1,345</td>
</tr>
</tbody>
</table>

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.
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.
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.

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.
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.
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 Burgess
DELOITE
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.
SHAREHOLDER COMMUNICATION
Air New Zealand’s investor website www.airnzinvestor.com provides shareholders with information on monthly operating statistics, financial results, stock exchange releases, corporate governance, annual meetings, investor presentations, important dates and contact details. Shareholders can also view webcasts of key events from this site.
Shareholders who would like to receive electronic news updates can register online at www.airnzinvestor.com or email Investor Relations directly on investor@airnz.co.nz.

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