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AIR.NZ - Interim 2020 Air New Zealand Ltd Earnings Call

EVENT DATE/TIME: FEBRUARY 26, 2020 / 9:00PM GMT

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Air New Zealand 2020 Interim Results Investor Briefing. (Operator Instructions) I'd now like to hand over to Air New Zealand's General Manager of Investor Relations and Financial Planning, Leila Peters.

Leila Peters - *Air New Zealand Limited - General Manager of IR & Financial Planning*

Thank you, and good morning, everyone. Today's call is being recorded and will be accessible for future playback on our Investor centre website, which you can find at www.airnewzealand.co.nz/investor-centre. Also on the website, you can find our interim results presentation and financial report, media release and the relevant stock exchange disclosures.

Speaking on the call today will be Chief Executive Officer, Greg Foran; and Chief Financial Officer, Jeff McDowall.

I would like to remind you that our comments today will include certain forward-looking statements regarding our future expectations, which may differ from actual results. We ask that you read through the forward-looking cautionary statement provided on Slide 2 of the presentation.

I would also like to draw your attention to the fact that a number of prior period comparative figures have been restated throughout the presentation to reflect the retrospective disestablishment of aircraft fair value hedges, which we disclosed to the market on the 28th of January.

The group has also adopted NZ IFRS 16, the new leasing standard, from the 1st of July 2019. In accordance with the transition, provisions of the standard comparatives have not been restated. I urge you to read through these statements on Slide 3.

Within the presentation, there is also a supplementary information section that includes slides that we will not specifically address during the webcast. These slides provide key financial and operational details, and we recommend that you take the time to review that information.

Before I hand things over to him, Greg, I would like to take this opportunity to welcome you to your first Air New Zealand investor call. I'm sure that I'm not alone in saying that we are very excited to have you here and look forward to having you meet our investors and analyst community in due course.

With that, I will now turn the call over to Greg.

Gregory S. Foran - *Air New Zealand Limited - CEO*

Thank you, Leila. Kia ora, and good morning, everyone, and thanks for joining us on today's call. It's a great pleasure to be here, and I do look forward to meeting with many of you over the coming months.

I don't think I've made any secret of the fact that I am incredibly excited to have returned home to New Zealand as the CEO of one of New Zealand's most iconic and loved companies. Many of my happiest childhood memories involve my family and I traveling around our beautiful country, seeing everything that the regions and centers have to offer. And I'm thrilled to lead a company that provides that opportunity to all New Zealanders as well as visitors to our country.

Having now spent almost a month in the business, taking every opportunity I can to meet Air New Zealanders and customers alike, one thing that really stands out to me is the fact that we have an incredible culture here with a team of enthusiastic, dedicated employees who are focused on delivering an exceptional but still very kiwi customer experience every day.

If there's one thing that my career has taught me, it's that the power of an exceptional culture, which, in turn, leads to the creation of an exceptional customer experience, cannot be undervalued. Whether you're in the retail industry or the airline industry, creating the right customer experience is the key to delivering a long-term sustainable success. I see this role as a fantastic opportunity to take the lessons I've learned in my career to date and use them to help develop and enhance all of the things that make Air New Zealand so special.

Now I would be remiss if I did not acknowledge the obvious uncertainty facing Air New Zealand at the moment with regards to COVID-19 and its expected impact on the airline. You may have seen the announcements we made both last week and on Monday regarding changes to our network in direct response to the reduced demand we are seeing. We have the ability to scale these adjustments up or down depending on how the situation progresses. You can be certain that the team is closely monitoring our forward bookings profile to ensure that we have an appropriate level of capacity in the market.

At this point, it is clear that there will be an adverse impact to the current year's financial performance as a result of COVID-19, and Jeff will provide more detail on our thinking regarding that impact later in the presentation.

From my perspective, Air New Zealand is a resilient business with a strong core in its domestic market, and we've demonstrated the ability, time and again, to respond quickly to changing market conditions. We have a highly capable and experienced team who have dealt with challenges such as this before, and I'm confident that we will weather this storm, too. That's not to say that it won't be challenging. It will be, but the strategic advantages we had spent years investing in and enhancing will help us deliver during this time.

I will now hand over to Jeff to discuss the first half results.

Jeff McDowall - *Air New Zealand Limited - CFO*

Thanks very much, Greg, and kia ora to everyone on the call. Earlier this morning, we released Air New Zealand's financial results for the first 6 months of the 2020 financial year to the market. It was a solid result with earnings before other significant items and taxation of $198 million, reflecting the resilience of our business and the execution of our strategy despite a challenging economic backdrop.

Our revenue performance was strong, driven by growth in the recently launched [and new] markets such as Korea, [Christchurch,] Singapore, Chicago and Taipei as well as strong demand across our Domestic and Pacific Island networks. That demand, in conjunction with the actions we've taken to stimulate additional leisure traffic with our domestic fare restructure, helped contribute to a 2.8% increase in passenger revenue despite the slower demand growth environment and the impact of ongoing unrest in Hong Kong.

Total revenue growth was impacted by continued weakness in the global cargo market, which resulted in the decline of 9.4%, excluding foreign exchange in our own cargo business. The cargo business has been challenged for the last 12 months or so, predominantly driven by trade tensions between the U.S. and China, which has reduced demand and put pressure on yields.

On the cost front, I'm pleased with the results we're seeing from our business review initiatives, which have contributed to the improvement in our underlying unit cost performance for the first half. This is despite the fact that we faced increased domestic air navigation and landing charges this year.

As you'll be aware, fuel costs were lower this financial period, which is a positive. However, the benefits of this have essentially been offset by the impact of the weaker New Zealand dollar over the same period. It's really been the continued focus on our cost base that's led to increased efficiencies and economies of scale and ultimately delivered an underlying unit cost improvement.

I would like to take this opportunity to thank the team at Air New Zealand for their continued and relentless focus on driving sustainable cost savings, and that's despite the external challenges the business has faced and continues to face.

As we will touch on later when discussing the outlook for the remainder of the year, I'd really like to reiterate Greg's earlier sentiments. Air New Zealand's a strong, resilient company that's adjusted its business in response to a number of external challenges in the first half. However, as we've communicated to you in the past, we're not satisfied with this lower level of earnings, and we'll continue to take necessary actions to navigate these short-term headwinds.

At our Investor Day last May, we articulated 3 focus areas from a network perspective that will guide our thinking on capacity growth. They were, firstly, to grow into attractive new markets, thereby accessing untapped pools of demand. In the first half of this year, we saw good momentum from that strategy with revenue growth across recently launched markets performing ahead of our expectations.

Next, we look to drive cost-efficient growth through upgauging to NEO aircraft on some of our short-haul services. The ongoing replacement of older A320 aircraft on the short-haul network with newer NEO aircraft is providing good efficiencies and economies of scale, which is especially helpful to our cost competitiveness as we face elevated levels of market supply on the Tasman.

The last element to our network growth strategy was to moderate growth on our existing routes and drive strong RASK improvement. This was most apparent to markets that we had grown considerably over the past 4 to 5 years such as the overall Domestic market and the Pacific Islands as well as Japan.

Now to provide a brief update on our previously communicated cost initiatives. As I mentioned earlier, we're seeing good progress across all 3 pillars. As you will remember, the overall goal of this program is to structurally reduce the cost base by approximately $60 million across a 2-year period to align our cost base with the new lower demand growth environment. These cost savings are in addition to our usual daily diet of cost savings and efficiencies that help us to offset inflation.

So in terms of the first pillar, we're on track to regain efficiencies in our operations following the impact of the global Rolls-Royce engine issues on our network across the last 2 years or so. A large part of that inefficiency was driven by labor costs, specifically having elevated levels of staff and crew available to support our customers and operations throughout the disruption.

Despite the additional TEN engine maintenance backlog this half, we still expect to deliver approximately $20 million in savings related to this initiative in the 2020 financial year. A large part of the savings achieved to date have been from the ability to make more proactive network planning decisions with fewer last-minute changes to aircraft type later in the planning cycle, which as we discussed last year is really inefficient from a cost perspective. Also, the need to hold additional levels of both crew and other operational staff has dropped off as we [built] some certainty back into our schedule.

Then turning to the second pillar, which is a 5% reduction in overheads. The focus here is to ensure that we have the most efficient and effective cost structure to support the business in a lower demand growth environment. We're expecting to deliver on these improvements from an earnings perspective in both 2020 and 2021.

Then if we turn to the third component, where we have commenced a targeted review of the operations cost base. As mentioned before, this will involve some supply chain consolidation as well as improved labor utilization and optimization of our facilities. While a portion of these savings are on track to be delivered in 2020, the majority will now be delivered in 2021.

Turning now to some of the financial highlights of the first half. Operating revenues were $3 billion, an increase of 3% on the prior period. Against the backdrop of the additional headwinds I highlighted earlier, this is quite a strong result. This half, we delivered earnings before taxation of $139 million. Earnings before other significant items and taxation were $198 million, a decline of 8.8%.

As a reminder, in January, we announced several items that will be classified as other significant items for the financial year. A breakdown of those items can be found in the supplementary slides in the back of the presentation. Net profit after tax for the period was $101 million, and reported operating cash flow was $534 million.

Delving a bit deeper into the drivers of our revenue performance. Overall passenger revenue increased 2.8%, driven by strong demand growth of 4%, which outpaced capacity growth of 2.8%. RASK, excluding the impact of FX, was marginally down, which is a solid result in light of the mix of long-haul capacity growth in the period. I'll touch on the cargo business in more detail shortly, but overall, revenues declined 9.4%, excluding foreign exchange.

We've summarized our cost performance here, and I will touch on underlying CASK performance in the coming slides. Briefly reviewing the impact of fuel in the first half. Overall costs increased 1.1% or $7 million. That movement reflects a decline in average fuel price of $28 million, offset by the weaker New Zealand dollar, which drove $20 million of additional cost. Increased flying across the network also resulted in $15 million of additional fuel costs in the period. We saw the benefits of our modern fuel-efficient fleet as well as the mix impact of capacity growth on longer sectors, where fuel volume's growing only 2.3% on capacity growth of 2.8% in the period.

Now I'll briefly touch on some of the key movements which affected our profitability during the year. To better understand the dynamics of each component, we've isolated the impact of foreign exchange. I won't go into the details of every single item here, but a detailed profitability waterfall and commentary can be found in the interim financial report on the Investor centre website.

We've already discussed passenger revenue performance, and I'll cover the cargo business shortly. However, I wanted to point out that within the $76 million of revenue growth, is $26 million in other revenue, which is largely from additional maintenance work for third parties, including on U.S. Navy gas turbine engines.

Labor costs increased by 1.3%, well below our capacity growth. This was driven by our efforts on cost initiatives that I've already touched on as well as reduced incentive payments compared to the prior period. Growth in our full-time equivalent workforce, or FTEs, was 2.7%, which is broadly in line with capacity growth. The majority of growth this year was in [crewing and] airports.

Moving over now to maintenance, aircraft operations and passenger service costs, which increased by $52 million. This increase was primarily driven by maintenance activity associated with the U.S. Navy gas turbine engine contracts as well as the weaker New Zealand dollar and overall growth in the fleet. A significant step-up in domestic air navigation and landing charges in the period also impacted our profitability as we absorbed high single-digit price increases. I would also like to highlight that sales, marketing and other expenses remained essentially flat, highlighting our ability to leverage efficiencies as we focus on productivity initiatives within the airline.

Ownership costs increased by $29 million, driven by new aircraft deliveries. This increase was lower than our earlier expectations partly due to delays in the delivery schedule of some aircraft, which has pushed out the timing of those costs into subsequent financial periods. We're now expecting around $55 million to $60 million of additional ownership costs in the 2020 financial year, which is less than the $70 million to $80 million estimate we provided in our annual results call last August. And lastly, the weaker New Zealand dollar resulted in a net adverse impact of $21 million to profitability in the period.

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If we look at passenger revenue performance by market, and I'm just going to focus on a few here that we haven't discussed already. During the first half of the year, we saw very high levels of demand on our Japan routes as a result of the Rugby World Cup, which drove high double-digit RASK growth as well as strong yields in the first half. This was, of course, partially offset by the impact of the ongoing disruptions in Hong Kong.

The Tasman market continued to experience the high levels of market capacity that followed the end of our alliance relationship with Virgin Australia. In November, we also announced the suspension of our twice-weekly seasonal Christchurch to Perth service as well as the cancellation of our second daily Auckland to Perth flight through December as a result of the additional maintenance requirements on our Trent 1000 TEN engines, which impacted passenger revenues.

For the Pacific Islands, excluding Samoa, further capacity rationalization, particularly on routes such as Honolulu and Denpasar, which had experienced high growth in the last 18 months or so, helped drive strong RASK and yield. Samoa was, however, impacted by the measles outbreak. We also benefited from positive passenger revenue performance on our core domestic market with more moderated capacity driving strong year-on-year RASK outcomes and increased load factors. This was largely driven by continued demand strength in the corporate market and further stimulation of domestic demand following the domestic fare restructure we announced last year. For the last few months of the half, we also added additional capacity on some of our regional routes following the announcement of the withdrawal of Jetstar from the New Zealand regional market.

And finally, if we look at the Americas, in particular, North America, we saw a weaker New Zealand dollar impact outbound demand on some of the U.S. routes. This, combined with an overall increase in market capacity of around 5% year-on-year, led to some softness in RASK and yields, albeit off a strong base. Our additional frequency into Chicago, up from 3x per week to 5, delivered strong revenue growth.

So as I mentioned earlier this morning, the continued slowdown in the globe freight market has led to an overall decline in our own cargo business of 9.4%, excluding foreign exchange. A large portion of that decline was driven by reduced flows between China and the U.S. as trade tensions continue. We've also seen a change in pricing behavior with the slowing demand environment, particularly on the Tasman, with higher levels of discounting in the market putting pressure on both volumes and yields. There was also a mix component to the cargo story. Our team has worked hard to source additional demand from some of our secondary cargo markets. However, this has typically been for lower-value products, which have resulted in lower overall revenue.

The other thing to bear in mind when looking at the year-on-year cargo performance is that we're comparing against a strong first half in the 2019 financial year as the slowdown only really started in the second half of last year. In January and early February, we were seeing early signs that the cargo market was starting to stabilize. However, the outbreak of COVID-19 has impeded that recovery.

Turning now to our operating costs. CASK, when adjusted for the impact of fuel price, FX and maintenance for third parties, improved by 0.5%. This contributed $59 million to profit in the period and reflects the benefit of cost efficiencies and economies of scale as we grew our long-haul network during the first half. It's worth noting that while we expect the business will continue to achieve further cost initiatives and efficiencies in the second half of the year, the recently announced capacity reductions relating to the impact of COVID-19 will impact overall CASK for 2020.

Our operating cash flows remain robust at $534 million on a reported basis. When adjusting for the impact of the new leasing standard, which resulted in the reclassification of lease payments, operating cash flow has declined 11% to $423 million. This has been primarily driven by a one-off cash outflow of $55 million as we entered into a maintenance agreement to prepay certain engine parts at an attractive discount as well as the reduced level of earnings. We ended the period with cash on hand of $1 billion, which reflects a slight decline of 4.9% but are still at the top end of our target liquidity range of $700 million to $1 billion. The airline continues to maintain a stable investment-grade credit rating from Moody's of Baa2. Gearing was 54.3% and remains in our target range of 45% to 55%. There was a 2.6 percentage point increase in gearing, which reflects continued investment in aircraft. Our reported gearing has been impacted by both the adoption of NZ IFRS 16 from the 1st of July 2019 as well as the disestablishment of fair value aircraft hedges, which we disclosed to the market in late January. In the supplementary slides, we've provided a reconciliation of the gearing changes relating to this. Finally, the Board was pleased to announce a fully imputed dividend of $0.11 per share, consistent with the prior period.

In the chart on Slide 17, you can see the phasing of our updated aircraft capital expenditures through to 2023, which totaled approximately $1.5 billion based on an exchange rate of $0.65. You will also see that we've reflected some timing changes on our expected delivery of NEO aircraft for the domestic market. Initially, delivery of the first 3 domestic units was expected in the 2021 financial year. However, we are now expecting to receive just 1 unit in that year, with the other 2 units moving now into the 2022 financial year. We have also deferred 2 further units from 2022 to 2023.

Now turning to the remainder of the year. As Greg mentioned, we are facing a large degree of uncertainty with regards to demand across our international and Domestic network as a result of the COVID-19 outbreak. We have seen our forward booking trends evolve at quite a rapid pace over the past few weeks with notable softening in demand across a number of our markets. We believe this reduction in demand is temporary. However, we have taken immediate action to mitigate the loss of revenue from COVID-19. That includes putting in place a number of capacity reductions across our Asia, Tasman and Domestic networks, which we announced to the market on Monday, along with an update to our expected earnings range for the 2020 financial year. We have also taken the opportunity to adjust our schedule to drive more efficient flying using our 787 aircraft on routes such as Honolulu and Bali, given some of those aircraft have now been freed up following the route cancellations and capacity reductions we've made.

It's clear that our Asia network will be the most directly impacted by COVID-19, specifically, our Shanghai route where services have been suspended since early February, following the government's restriction on travel to mainland China. We have also suspended services to Seoul from early March until the end of June.

In addition to the direct impact of cancellations, we've also seen weak inbound demand from other markets in the region, particularly Hong Kong but also in Japan and Taipei, where we have experienced some group cancellations. Singapore has also seen a slowdown in connecting traffic, and we've adjusted our frequency there in response to this. The net of all this is that we've implemented targeted capacity reductions across a number of markets in Asia with a decline in planned capacity of approximately 17% for the month of February through June.

Then if I look at the Tasman, we have observed some softening of demand there in the past 2 weeks or so. We've implemented capacity reductions of approximately 3% on the Tasman over the March to May period.

On our Domestic network, we are seeing weaker demand on our Christchurch and Queenstown routes, reflecting the decline in inbound Asian visitors. As a consequence, we've made a number of frequency changes in these markets, reducing capacity by around 2% over the period of March through April.

It's also worth noting that our Pacific Island network has not seen any notable changes in demand following the outbreak. We're also seeing some increased bookings for our North American services as customers look to transit to Europe via U.S. ports rather than through Asia.

Turning to Slide 20. We've summarized the current thinking on capacity for the second half of the year and what that means for full year capacity. Previously, we had anticipated capacity growth in the second half of the year to exceed what we saw in the first half as new long-haul routes such as Seoul and the Christchurch to Singapore service drove faster growth as well as the impact of increasing the frequency of Taipei and Chicago services compared to the prior year. Based on our current expectations and the capacity adjustments we've announced, we are expecting second half capacity growth to be in the range of 1% to 2%, which would imply 2020 full year capacity growth of around 2%.

Turning to fuel and our outlook for the remainder of the financial year based on our hedging profile. To be helpful, we've provided an outlook of estimated fuel costs for the second half of the year with an assumption of average jet fuel now at USD 65 per barrel, which reflects the current market demand following the impact of COVID-19. Based on the makeup of our hedges, we have also provided an approximation of how moves up or down in fuel price would impact our fuel costs for the second half of the year. At USD 65 per barrel for jet fuel, our fuel cost in the second half would be approximately ended NZD 590 million, which would bring our full year fuel cost to approximately $1.25 billion.

While the situation is uncertain based on our current assumptions of lower demand as well as the benefit of the announced capacity reductions and lower jet fuel prices, the airline currently expects a net negative impact to earnings in the range of $35 million to $75 million as a result of COVID-19. At the midpoint of the estimated range above, which is approximately $55 million, the airline is targeting earnings before other significant items and taxation to be in the range of approximately $300 million to $350 million, assuming jet fuel prices remain at $65 per barrel for the remainder of the year and excluding the impact of IFRS 16, the new leasing standard. The airline will provide an update to this guidance should the current assumptions materially change.

I will now pass you over to Greg, who's going to leave you with some closing remarks.

Gregory S. Foran - *Air New Zealand Limited - CEO*

Thank you, Jeff. Just to close, I wanted to discuss the strategy review that we are currently undertaking. As some of you will be aware, I recently initiated a piece of work around Air New Zealand's strategy to assist us in setting a course for the airline's future. This piece of work or directed diagnostic, as I like to call it, will involve reviewing our strategic opportunities and risks to assess not only where we play but where we can win going forward. We've assembled a cross-functional team from areas of the business such as networks, commercial, customer and operations, just to name a few. This team will lead the strategy review and use the vast knowledge and experience of Air New Zealanders across the whole business to [inform] the diagnostic. Key focus areas will include our route network, sustainability agenda, loyalty proposition, digital ambition, profitability and, importantly, our culture. The strategy review will likely conclude midyear and will tackle some core questions about the airline and how we can best deliver for our customers. I think this is a really exciting time for Air New Zealand, and I look forward to sharing more with you in the coming months.

So with that, can I say thank you very much for listening? I know you will have lots of questions, so operator, please open up the line.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Andy Bowley from Forsyth Barr.

Andrew James Bowley - *Forsyth Barr Group Ltd., Research Division - Head of Research*

I've got a couple of questions, the first of which is for you, Greg, and thanks for your comments on the strategy review just now. But in your opening comments, you made the reference to customer experience being critical to success. Now that you've had the opportunity to talk to staff and customers about the customer experience over the past month or so in terms of the work you've done internally and the e-mails we've been getting as frequent flyers externally, but certainly keen to hear what your observations are about the experience thus far and early thoughts as to how you can enhance what you're seeing and hearing.

Gregory S. Foran - *Air New Zealand Limited - CEO*

Yes, sure. Thank you for your question, and thanks for following us. So we've got lots of responses in, as you can imagine, from our leadership across the business and, as you've mentioned, from Elite and Gold customers. And in fact, a lot of our staff, our Air New Zealand staff, have decided let me know. So look, we're collating those in and having a look at them. I guess, my overriding comment is, I think this is a really good business. I think it's in pretty good shape. But like any business, there's always opportunities where you can tweak things and you can adjust them. So we're just going to sensibly go through that list, and in fact, that process is underway at the moment. And as chance would have it, we've got our first meeting on it actually in a few hours' time to go and review some of the points, some of them small, some of them medium size, some of them a bit bigger. And we'll think about these as we pull together our strategy and make adjustments where we think we need to. But it's been a really useful exercise. And I would characterize it by -- it's a good way to often get the unvarnished truth on your business and when you get to that level that creates opportunities for you to take action.

Andrew James Bowley - *Forsyth Barr Group Ltd., Research Division - Head of Research*

Do you see, Greg, any kind of low-hanging fruit in relation to customer experience, more broadly, in terms of what you've observed across the business thus far?

Gregory S. Foran - *Air New Zealand Limited - CEO*

Yes, sure. There -- as I said, there you can generally group these things, and I've done this exercise before into some quick wins. We actually put those in a work stream that we're calling urgent agenda items. And so as I said, there are some of those, and we're just going to sensibly, as I mentioned, beginning this afternoon, start to have a look at those. And where it makes sense, we'll make decisions. And where we need more data, we'll go back and get it. But we'll just sensibly work through those. But there are some.

Andrew James Bowley - *Forsyth Barr Group Ltd., Research Division - Head of Research*

Great. And look forward to hearing about that in due course. So second question probably for you, Jeff, forward-looking in relation to coronavirus you've talked through. Now historically, you've reacted far quicker than your competitors in responding to demand changes. But could you talk about how you see the capacity response from other airlines in relation to coronavirus in terms of both timing and quantum and the possible impact that, that has on you going forward?

Jeff McDowall - *Air New Zealand Limited - CFO*

Andy, yes, that's right. We have typically been quite fast to react to situations like this and I think as we have this time. But we've also seen other airlines, particularly in this region, react really quickly as well. So, for example, on the Tasman, we're seeing both Qantas and Virgin announce some reductions in the last few days. So I think that's appropriate. Yes, clearly, this is a unprecedented event, and airlines everywhere, obviously, managing it and monitoring it very closely.

Just on the Tasman, just one observation I'd make there is that the Tasman has a number of sort of indirect impacts. One is that there have been a lot of, historically, Chinese group customers flying on the Tasman, and they had mostly been on other airlines. We hadn't carried a significant proportion of them. And it's also been a waypoint to Asia for customers originating in other points of New Zealand flying through to Asia. And again, we're relatively less exposed to that than the other airlines. So you can kind of see that in the capacity reductions that the Australian airlines have announced on the Tasman.

Leila Peters - *Air New Zealand Limited - General Manager of IR & Financial Planning*

And then the other thing I would just add, Andy, is if we look further into Asia, markets such as Singapore and Hong Kong, obviously, we work really closely with our alliance partners there. And so we've been working with them through capacity discussions as well.

Operator

Our next question comes from Owen Birrell from Goldman Sachs.

Owen Birrell - *Goldman Sachs Group Inc., Research Division - Metals and Mining Company Analyst*

Yes, just a few questions from me. You talked about the Chinese movements on the Tasman falling, and you're not being as exposed. But clearly, that's probably one of the drivers behind increased discounting on that route. Can you give us a feel for the level of discounting you're seeing more broadly through into Asia or even into the U.S. as carriers try to incentivize volumes on their existing capacity?

Jeff McDowall - *Air New Zealand Limited - CFO*

Owen, that's exactly right. I mean, although, yes the impact for us on the Tasman isn't so much that we carry a number of those passengers, it's just that by them not being there, it changes the supply-demand balance. And so you do see more discounting. And we've seen some -- the Tasman had been in a somewhat oversupplied mode for a little while, and so the pricing had been quite aggressive. And if anything, that has increased somewhat in the last few weeks.

With respect to the U.S., actually, for us, we're seeing that quite strong for a couple of reasons that outbound demand -- and this -- I have to caution all of us by saying, look, it's really early. It's only been 3 booking weeks, really. But we're seeing quite strong demand from New Zealand to the U.S. And yes, you could speculate that some people are choosing the U.S. as a destination in preference to Asia, and that's [giving it] a bit more demand. And we've also seen some New Zealand-Europe traffic choose U.S. as a gateway in preference to Asia. So for both of those reasons, it's quite strong. And we haven't, as a consequence of that, seen any real change or any increased intensity from a pricing perspective.

And similarly, for Asia, airlines have really reacted there with capacity changes rather than pricing.

Owen Birrell - *Goldman Sachs Group Inc., Research Division - Metals and Mining Company Analyst*

I guess, a subsequent question to that. It's obviously very difficult for yourselves, but even more so for us, to try and determine, I guess, the balance between what's happening with demand, the levels of discounting and offset by the capacity reductions across the industry. Are you able to give us some sense on, like, even directionally, which way you think RASK is going to go over this interim period?

Jeff McDowall - *Air New Zealand Limited - CFO*

Not really is the short answer. I mean, it's just so early to tell. So I can't really -- I mean, the Asia route, in particular, is very difficult to forecast. But I think, like I said, it's not a market in which airlines are out there trying to stimulate demand. They're really, really reacting with capacity. So the RASK outcome kind of depends on how that balance plays out. Elsewhere in the network, we would expect to see U.S. still tracking strongly and Domestic seeing a little bit of weakness, as we talked about, based on fewer inbound tourists and a little bit of outbound NZ demand to Asia, which connects to Domestic also being weaker.

Owen Birrell - *Goldman Sachs Group Inc., Research Division - Metals and Mining Company Analyst*

Perhaps if I ask this question slightly differently. Based on your current, I guess, booking expectations, where do you see load factors by region? Are they going to be falling? Or are you matching the capacity reductions to the demand profile?

Jeff McDowall - *Air New Zealand Limited - CFO*

Yes. I mean, to the extent that we can, we are doing that, but recognizing that it's a bit lumpy because, yes, typically, if you're operating a daily service, you can obviously move capacity in increments of 1/7, and demand doesn't move in increments of 1/7. So it's never perfect, but we're doing that as much as we can. I mean, it's really difficult. Like I say, it's -- I think it was the 3rd of February when the government introduced border restrictions. It might have been the 2nd of February. And so we've had really 3 booking weeks since then. So it is quite difficult to draw any firm conclusions on what the impact for the next 4 months will be.

Owen Birrell - *Goldman Sachs Group Inc., Research Division - Metals and Mining Company Analyst*

Okay. Just this final question for me. In terms of fleet coming on, how much fleet do you have coming on in the next, say, 12 months?

Jeff McDowall - *Air New Zealand Limited - CFO*

It's actually quite a light period for fleet deliveries. We've got -- in FY '21, I think we have [1 ATR] and 1 A320 delivery, and that's all.

Operator

(Operator Instructions) Our next question comes from Marcus Curley from UBS.

Marcus Curley - *UBS Investment Bank, Research Division - Executive Director and Head of New Zealand Research*

Just a few from me. Can we start with the costs? Just -- Jeff, I just wonder if you could call out, yes, within, yes, the maintenance aircraft, passenger services bucket, yes, the elements that relate to that third-party maintenance and the aviation charges.

Jeff McDowall - *Air New Zealand Limited - CFO*

Yes. So the third-party maintenance for you, and that's why we kind of isolate it out from CASK because it's -- there is a -- if you look at the statutory P&L, there's quite a big uplift for that, but you see an equal uplift in the contract services line and the revenue. So -- which is why we try and isolate out that for the -- isolate that out, sorry, for the purpose of the CASK reduction or the CASK analysis.

If you look at maintenance costs, excluding that, and if you also exclude currency, then what you see is maintenance costs actually growing less than capacity. So that's -- we're quite happy with that picture. The underlying maintenance cost discipline's very much evident.

And then the third thing you called out, as you say, has been one of our big causes of cost escalation, which is air navigation charges, primarily, but also landing charges, to a lesser extent, have had quite a pronounced impact on our operating costs.

Leila Peters - *Air New Zealand Limited - General Manager of IR & Financial Planning*

And Marcus, you'll see that come through in the aircraft operations predominantly, and to a lesser extent, passenger services.

Marcus Curley - *UBS Investment Bank, Research Division - Executive Director and Head of New Zealand Research*

But I suppose the reason for the question is it just seems like there's more cost pressure on the business than I would have thought. And obviously, you're only calling out these 2 elements within the presentation. Outside of these components, do you think you're seeing more underlying cost pressure?

Jeff McDowall - *Air New Zealand Limited - CFO*

Not really. I mean, if you look at the labor line, for example, we're really happy with how that's played out. So we've got -- I think labor is at 1.3%, and that's, what, 2.8% more capacity. And average [sort of] labor rate increases, if you like, with both (inaudible) and independent employment contract people of between 2.5% and 3%. So absent efficiencies, you would have expected labor costs to increase north of 5%, and that's only at 1.3%. Some of that -- a big chunk of that is the efficiencies that we've implemented, that we highlighted earlier in the year, but also the daily diet of cost initiatives that we look to implement, coupled with economies of scale and also, actually, a reduction in incentive payments, which you'd expect with profitability being where it is.

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Marcus Curley - *UBS Investment Bank, Research Division - Executive Director and Head of New Zealand Research*

Okay. And then just finally on costs. So overhead is up. Is that a reflection -- or other costs, as you like to call it. Is that a reflection of the delayed cost savings in bucket 3? Or is it more to it than that?

Leila Peters - *Air New Zealand Limited - General Manager of IR & Financial Planning*

Sorry, Marcus, when you say overhead expenses, you're talking about other expenses, which -- what are you referring to?

Marcus Curley - *UBS Investment Bank, Research Division - Executive Director and Head of New Zealand Research*

Right. Yes, yes, other expenses [1 5 9]. And I'm just trying to correlate that with the delayed savings.

Leila Peters - *Air New Zealand Limited - General Manager of IR & Financial Planning*

Yes. So that's not -- that line item is not really linked to the 3 pillars of the cost initiatives that Jeff spoke to earlier in the presentation. What that increase is related to is predominantly increase in digital licensing costs and some additional property costs.

Marcus Curley - *UBS Investment Bank, Research Division - Executive Director and Head of New Zealand Research*

Okay. Secondly, you talked about the 787-10 first arrival in '23. Are you reconsidering that given the demand environment at the moment?

Jeff McDowall - *Air New Zealand Limited - CFO*

We have a strategy project that Greg has talked about earlier. So we're looking at everything as part of that. But at the moment, we're certainly still planning for that aircraft to arrive at that time. The purpose of that program wasn't really fleet growth at all. It was replacing the 777-200s, and that is -- and they will exit the fleet by that time. So we're still on track for that.

Marcus Curley - *UBS Investment Bank, Research Division - Executive Director and Head of New Zealand Research*

Okay. And just -- could you just provide a little bit of an update where you sit with the 787 engine issues? You, obviously, in the presentation, referred to some more delays in terms of the second round of maintenance. Is it still having an impact on the business?

Jeff McDowall - *Air New Zealand Limited - CFO*

Yes is the short answer, but in line with what we expected. So to give you an update right now, we have 3 aircraft, 3 787 aircraft out of action, which is in line with what we expected to have at this point. That is expected to get down to 2 aircraft in the next couple of weeks, the first half of March, and then down to one by the end of March. So that is -- I mean, it has been frustrating, as you can imagine. One good thing, if there is such a thing this time around is that we've had much more notice of these impacts. So -- whereas in the past, these things have happened at quite short notice, which has delivered a lot of inefficiency into our cost base and also a lot of customer disruption. This time, we've had much more notice. So we've been able to continue to get the efficiency savings that we were targeting but also provide much better customer outcomes, which, in this case, is included, having Cathay Pacific operate our Hong Kong service, in our place which went a long way to alleviate those shortfalls.

Marcus Curley - *UBS Investment Bank, Research Division - Executive Director and Head of New Zealand Research*

Okay. And then finally for me, obviously, you maintained the dividend. I just wonder whether Greg could comment around whether the capital structure is part of the strategic review or how you're thinking about that in the context of the current review and, obviously, the coronavirus.

Gregory S. Foran - *Air New Zealand Limited - CEO*

Yes, sure. Look, when we set our dividend, we think about it in the framework of a level that's consistent and sustainable. And at this point, the balance sheet is pretty resilient, and the CapEx profile is such that we feel comfortable in maintaining the current level of dividend. We'll get through the strategy project. And as you would expect us to do, we'll then consider what we want to do from there.

Operator

(Operator Instructions) There are no further questions. So I'll pass back to your speakers for closing comments.

Gregory S. Foran - *Air New Zealand Limited - CEO*

I'd just like to thank everyone listening on the call for their time and interest in Air New Zealand. And if you'd like to schedule a call or meeting or any follow-up questions, please direct those requests through to Leila and Kim, our Investor Relations team. Thank you.
