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INTERIM REPORT 2017–18

FOR THE PERIOD ENDED 31 DECEMBER 2017

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1 CHAIR AND CHIEF EXECUTIVE'S REPORT

Summary of performance

The first half of the 2017/18 financial year can be characterised by a focus on safety and innovation, with an eye to the future of airspace management.

Airways New Zealand maintained excellent safety, operational and financial results for the half year ending 31 December 2017. Continued growth across the aviation industry, while contributing to the positive financial result, has brought with it challenges, making the strong safety and operational results even more pleasing.

Importantly, the air traffic control (ATC) operation has delivered a continued, positive safety record, with a stable level of loss of separation events and no near collision incidents. We have maintained the availability of our services at a level of 99.95%, achieved against a backdrop of continued air traffic growth.

Over the half year, we invested $21.5 million in technologies that will maintain our current high levels of service and ensure greater safety, resilience and efficiency in the future. In August, the Board approved an increase to the capital expenditure budget from $45.5 million to $49.3 million.

November saw the installation of a digital tower demonstration at Auckland Airport. Operating digitally-enhanced tower services from a separate location has the potential to improve the performance of the aviation system. In the future, it could also enable us to extend the hours of regional tower services.

December saw the start of a three-month trial of New Zealand's first UAV (unmanned aerial vehicle) traffic management platform. We are working with commercial and leisure drone users to explore how to safely integrate drones into the wider air traffic control network. This is essential future planning, as the number of UAV flights recorded by Airways has increased from 30 to 600 per week over the past three years.

The $58 million project to deliver our new air traffic management (ATM) system remains on target to become operational in domestic airspace in 2020 and oceanic airspace in 2021. It will enable us to implement a new model of operating from two centres, providing greater resilience and improving flexibility by standardising air traffic control functions. With air traffic forecast to grow by 50% over the next decade, this project will equip Airways to address future aviation needs proactively and safely.

A further key project completed in this period is the deployment of Automatic Dependent Surveillance Broadcast (ADS-B) infrastructure at 12 sites across the country, surpassing radar with satellite-based navigation technology.

In October, the Board was pleased to welcome Graeme Sumner as he took up the Chief Executive role.

Financial performance

The Group reported a Net Operating Profit after Tax (NOPAT) of $18.1 million for the half year, a 31% improvement on the prior year's $13.8 million and $2.5 million ahead of budget. The pleasing result has been driven by increased air traffic volumes, increased profits in our commercial businesses and a one-off gain on the sale of surplus land in Queenstown.

Flight volumes are forecast to grow by 2.4% from the prior year, with domestic growth offset by cuts on international routes.

Our commercial businesses made a strong contribution to the result, with significant growth in the delivery of air traffic control training services. This business is delivering training to 11 customers in seven countries, and our New Zealand training campuses are at full capacity with both domestic and international students. Additionally, in October, our Aviation Services business won the contract for the third phase of the World Bank's Pacific programme. This programme supports the growing ADS-B network in the Pacific, bolstering our presence in the region.

As well as business growth, the commercial portfolio is also seeing ongoing cost efficiencies achieved through restructuring in the previous year.

While these businesses are currently behind the stretch targets set, they have delivered a NOPAT result of $3.4 million, up from $1.9 million in FY17.

The full year NOPAT forecast remains in line with our Statement of Corporate Intent target of $27 million.

Acknowledgement of our people

Strong results like this are not possible without the hard work of our talented staff, across all departments. A special mention must go to our people for their dedication to our core role of keeping the skies safe and moving aircraft as efficiently as possible. July unleashed wild winter storms, with high winds, flooding, fog and snow affecting the country. Delays and disruption were inevitable, but minimised by the hard work of our technology and ATC staff. September's challenge was the damage to the Marsden Point fuel pipeline. By enforcing stricter air traffic sequencing, we conserved the equivalent amount of aviation fuel to enable nine return flights from Auckland to Wellington daily. The Board offers its thanks and appreciation to our people.

Judy Kirk, Chair

Graeme Sumner, Chief Executive Officer

Table 1: Key measures of success

	December 2017 Actual	December 2017 Target	December 2016 Actual
Business performance			
Near collision events	Nil	Nil	Nil
Serious harm injuries	Nil	Nil	Nil
System availability	99.95%	99.95%	99.98%
Customer satisfaction	Measured in June	81%	Measured in June
Financial			
Group NOPAT	18.1	15.6	13.8
Capex: value creating investments ($m)	21.5	22.5	15.7
Return on capital (Statutory business)	10.12%	8.08%	7.6%
Commercial business NOPAT ($m)	3.4	4.2	1.9
Leadership			
Staff engagement	Measured in June	65%	Measured in June
Succession (suitable candidates for senior roles)	Measured in June	>3	Measured in June
Visibility: internal event platforms (per week)	2	≥2	2

Progress on key initiatives

2017–18 initiatives	Status
System Operator	
Enhance safety training	▸ Progressing to plan
Enhance cyber security	▸ Progressing to plan
Progress the Operational Strategy	▸ Behind plan
Implement the new ATM system	▸ Progressing to plan
Develop innovative enhancements to the broader ATM service offering	▸ Progressing to plan
Establish a robust business intelligence (BI) capability.	▸ Progressing to plan
Corporate services	
Leverage strategic partnerships to deliver Destination 2021	▸ Progressing to plan
Develop and roll out an enhanced employee relations and workplace culture strategy	▸ Progressing to plan
Progress the Property Strategy	▸ Progressing to plan
Deliver continuous improvement in core services, systems and processes	▸ Progressing to plan
Commercial business	
Training: grow external revenue through offshore expansion and airBooks	▸ Progressing to plan
Aviation Services: focus sales strategy on capturing market share in Australia and South East Asia	▸ Behind plan
Aeropath: build external revenue base through new products and partnerships	▸ Behind plan
Leverage new partnerships, sales channels and products to diversify revenue streams	▸ Behind plan
Safety and assurance	
Develop the Barrier Model to enhance understanding of contributing factors in safety events	▸ Progressing to plan
Embed Safety by Design	▸ Progressing to plan
Integrate Human Factors into the Safety Management System	▸ Progressing to plan
Implement the Security Smart Programme	▸ Progressing to plan

2 FINANCIAL STATEMENTS

Statement of comprehensive income

(all figures shown in tables are in $NZ thousands unless otherwise stated)

	GROUP		
FOR THE PERIOD ENDED 31 DECEMBER	**Dec 2017 Unaudited**	**Dec 2016 Unaudited**	
OPERATING ACTIVITIES			
REVENUE			
Air traffic management revenue	97,552	93,809	
Net gain on sale of assets	4,185	5	3
Other revenue	9,856	8,278	
TOTAL REVENUE	**111,593**	**102,092**	
EXPENSES			
Employee remuneration	54,393	51,573	7
Employee related costs	3,732	2,854	
Depreciation and impairment	8,943	8,137	
Amortisation and impairment	2,522	2,685	
Other operating costs	15,735	14,793	
Rental expense on operating leases	2,801	2,871	
Net finance expense	90	618	4
TOTAL EXPENSES	**88,216**	**83,531**	
Share of profit from joint ventures	-	421	
NET SURPLUS BEFORE TAXATION	**23,377**	**18,982**	
Taxation expense	5,314	5,198	
NET SURPLUS AFTER TAXATION ATTRIBUTABLE TO EQUITY SHAREHOLDERS	**18,063**	**13,784**	
OTHER COMPREHENSIVE INCOME			
That will be reclassified to profit or loss when conditions are met:			
Movement in cash flow hedge reserve	439	1,089	
Deferred tax on other comprehensive income	(123)	(305)	
TOTAL OTHER COMPREHENSIVE INCOME	**316**	**784**	
TOTAL COMPREHENSIVE INCOME FOR THE YEAR ATTRIBUTABLE TO EQUITY SHAREHOLDERS	**18,379**	**14,568**	

Statement of changes in equity

(all figures shown in tables are in $NZ thousands unless otherwise stated)

	GROUP ATTRIBUTABLE TO EQUITY SHAREHOLDERS				
	CONTRIBUTED EQUITY	HEDGE RESERVE	RETAINED PROFITS	TOTAL	NOTES
BALANCE AS AT 1 JULY 2016	**41,100**	**(2,179)**	**61,643**	**100,564**	
COMPREHENSIVE INCOME					
Net surplus after taxation	-	-	13,784	13,784	
OTHER COMPREHENSIVE INCOME					
Movements in hedge contracts	-	1,089	-	1,089	
Deferred tax on other comprehensive income	-	(305)	-	(305)	
TOTAL OTHER COMPREHENSIVE INCOME	**-**	**784**	**-**	**784**	
TOTAL COMPREHENSIVE INCOME	**-**	**784**	**13,784**	**14,568**	
TRANSACTIONS WITH OWNERS					
Dividends paid (4.9 cents per share)	-	-	(2,000)	(2,000)	
TOTAL TRANSACTIONS WITH OWNERS	**-**	**-**	**(2,000)**	**(2,000)**	
BALANCE AS AT 31 December 2016	**41,100**	**(1,395)**	**73,427**	**113,132**	
BALANCE AS AT 1 JULY 2017	**41,100**	**(2,080)**	**76,318**	**115,338**	
COMPREHENSIVE INCOME					
Net surplus after taxation	-	-	18,063	18,063	
OTHER COMPREHENSIVE INCOME					
Movements in hedge contracts	-	439	-	439	
Deferred tax on other comprehensive income	-	(123)	-	(123)	
TOTAL OTHER COMPREHENSIVE INCOME	**-**	**316**	**-**	**316**	
TOTAL COMPREHENSIVE INCOME	**-**	**316**	**18,063**	**18,379**	
TRANSACTIONS WITH OWNERS					
Dividends paid (7.3 cents per share)	-	-	(3,000)	(3,000)	5
TOTAL TRANSACTIONS WITH OWNERS	**-**	**-**	**(3,000)**	**(3,000)**	
BALANCE AS AT 31 DECEMBER 2017	**41,100**	**(1,764)**	**91,381**	**130,717**	

This statement is to be read in conjunction with the Notes to the Financial Statements on pages 11–15

Interim balance sheet

(all figures shown in tables are in $NZ thousands unless otherwise stated)

	GROUP			NOTES
FOR THE PERIOD ENDED 31 DECEMBER	**Dec 2017 unaudited**	**Jun 2017 audited**	**Dec 2016 unaudited**	
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	5,718	1,522	3,772	6
Trade and other receivables	27,646	23,109	28,448	
Prepayments	2,548	2,182	2,679	
Derivative financial instruments	69	68	60	
TOTAL CURRENT ASSETS	**35,981**	**26,881**	**34,959**	
NON-CURRENT ASSETS				
Property, plant and equipment	164,606	154,887	143,542	
Assets held for sale	98	2,943	-	
Intangibles	21,128	21,471	21,350	
Inventory	1,429	1,392	1,397	
Investment in joint venture	-	-	1,811	
Other non-current assets	84	84	84	
Derivative financial instruments	2	4	38	
TOTAL NON-CURRENT ASSETS	**187,347**	**180,781**	**168,222**	
TOTAL ASSETS	**223,328**	**207,662**	**203,181**	
LIABILITIES				
CURRENT LIABILITIES				
Trade and other payables	12,771	12,312	12,689	
Employee entitlements	17,096	18,103	16,707	7
Current tax liability	2,326	2,110	3,082	
Derivative financial instruments	185	380	147	
TOTAL CURRENT LIABILITIES	**32,378**	**32,905**	**32,625**	
NON-CURRENT LIABILITIES				
Loan facility - unsecured	40,000	39,000	39,000	
Deferred tax liability	8,990	8,867	7,561	
Employee entitlements	8,938	9,024	9,016	7
Derivative financial instruments	2,305	2,528	1,847	
TOTAL NON-CURRENT LIABILITIES	**60,233**	**59,419**	**57,424**	
TOTAL LIABILITIES	**92,611**	**92,324**	**90,049**	
NET ASSETS	**130,717**	**115,338**	**113,132**	
EQUITY				
Share Capital	41,100	41,100	41,100	
Reserves	(1,764)	(2,080)	(1,395)	
Retained Earnings	91,381	76,318	73,427	
TOTAL EQUITY	**130,717**	**115,338**	**113,132**	

This statement is to be read in conjunction with the Notes to the Financial Statements on pages 11–15

Interim statement of cash flows

(all figures shown in tables are in $NZ thousands unless otherwise stated)

	GROUP		NOTES
FOR THE PERIOD ENDED 31 DECEMBER	**Dec 2017 Unaudited**	**Dec 2016 Unaudited**	
CASH FLOWS FROM OPERATING ACTIVITIES			
CASH WAS PROVIDED FROM:			
Receipts from customers	103,708	103,741	
Interest received	14	18	
CASH WAS APPLIED TO:			
Payments to suppliers	(19,081)	(21,862)	
Payments to employees	(59,471)	(57,247)	
Interest paid	(64)	(632)	
Income tax paid	(5,098)	(4,575)	
NET CASH FLOWS FROM OPERATING ACTIVITIES	**20,008**	**19,443**	**12**
CASH FLOWS FROM INVESTING ACTIVITIES			
CASH WAS PROVIDED FROM:			
Sale of property, plant and equipment	7,226	382	3
CASH WAS APPLIED TO:			
Purchase of property, plant and equipment	(14,752)	(12,869)	
Purchase of intangible assets	(6,286)	(2,663)	
NET CASH FLOWS FROM INVESTING ACTIVITIES	**(13,812)**	**(15,150)**	
CASH FLOWS FROM FINANCING ACTIVITIES			
CASH WAS PROVIDED FROM:			
Drawdown of loan facility	1,000	-	
CASH WAS APPLIED TO:			
Payment of dividends	(3,000)	(2,000)	5
NET CASH FLOWS FROM FINANCING ACTIVITIES	**(2,000)**	**(2,000)**	
NET INCREASE IN CASH HELD	**4,196**	**2,293**	
Cash at the beginning of the period	1,522	1,479	
CASH AT THE END OF THE PERIOD	**5,718**	**3,772**	

Interest paid above excludes capitalised interest. Total interest paid for the period was $1,213 (2016: $926).

Notes to the financial statements

NOTE 1 Basis of preparation

These interim financial statements as at and for the six months ended 31 December 2017 are for the consolidated Group ("Airways"), consisting of Airways Corporation of New Zealand Limited and its subsidiaries: Airways International Limited, Aeropath Limited, Airways Training Limited and Aviation English Services. They have been prepared in accordance with:

- Generally Accepted Accounting Practice in New Zealand and NZ IAS 34, 'Interim Financial Reporting' (as a result they comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards, as appropriate for profit-oriented and tier 1 entities. They also comply with International Financial Reporting Standards); and
- The requirements of the Financial Reporting Act 2013, Companies Act 1993 and the State-Owned Enterprises Act 1986.

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

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

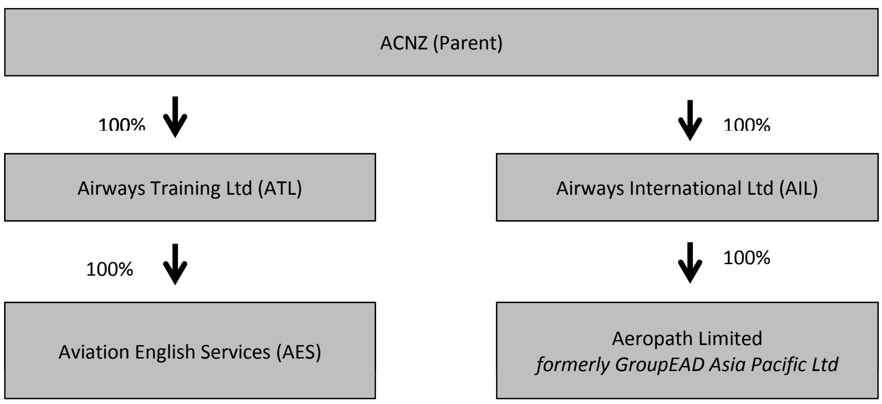
These interim financial statements should be read in conjunction with the 2017 Annual Report.

NOTE 2 Group structure

Airways Corporation of New Zealand Limited is a limited liability company incorporated and domiciled in New Zealand. It is also a State-Owned Enterprise established under the State-Owned Enterprise Act 1986 with shares held in equal numbers by the Minister for State-Owned Enterprises and the Minister of Finance, on behalf of the Crown.

Airways' principal business is the provision of air traffic management services; however it is also involved in a number of related revenue generating activities, including consulting and training.

The Group structure is shown in the diagram below. The percentages indicate ownership.



NOTE 2 Group structure cont.

Entity	Principal activity
Airways International Ltd	Aeronautical information management, revenue management, recruitment and training, and air navigation services and maintenance of systems
Airways Training Ltd	Holding company
Aviation English Services	Provision of Aviation English training
Aeropath Limited	AeroPATH Limited is a separate legal entity that delivers aeronautical information management and procedural design and development services throughout the Asia Pacific region. Aeropath became a fully consolidated, wholly owned subsidiary on 24 April 2017. As at December 2016, joint control existed and the Group equity accounted for its investment at that date.

NOTE 3 Net gain on sale of assets

Net gain on sale of assets includes a gain on sale of $4.4 million from the sale of a parcel of land in Queenstown on 1 July 2017.

NOTE 4 Net finance expense

Net finance expense of $0.09 million includes financing expenses of $1.15 million offset by capitalised interest of $1.06 million (2017: $0.58 million net).

NOTE 5 Dividends paid

A $3 million interim dividend has been delivered to shareholders over the reporting period. Airways expects to pay a total dividend of $11 million for the full year to 30 June 2017.

NOTE 6 Cash and cash equivalents

Airways operates an overdraft facility to manage operational cash flow without the requirement to hold surplus cash on hand. The overdraft facility incurs interest rates on similar terms as long term borrowings and represents a critical component of Airways' liquidity risk management strategy.

NOTE 7 Employee entitlements

Employee entitlements (current and non-current) is largely made up of accrued salary costs, annual leave, long service leave and retiring leave liabilities.

NOTE 8 Capital commitments

Airways had total capital commitments of $86.6 million as at 31 December 2017 ($39.2 million as at 31 December 2016). This programme will be funded through operating cash flow and increased debt, while remaining within current loan facilities and covenants. The increase in capital commitments in 2017 is driven by recently signed contracts for the delivery of a new air traffic management system and a new ADS-B surveillance network.

NOTE 9 Operating lease commitments

Operating leases relate to the rental of buildings, plant and equipment and are on normal commercial terms and conditions.

AS AT 31 DECEMBER	Dec 2017	Dec 2016
Less than one year	5,551	4,742
One to two years	5,204	4,078
Two to five years	7,556	3,213
Over five years	38,263	3,193
TOTAL OPERATING LEASE OBLIGATIONS	**56,574**	**15,226**

Since December 2016, Airways entered into significant new leases for operational and corporate facilities in Auckland and Christchurch.

NOTE 10 Contingent liabilities

Airways has contingent liabilities of $0.449 million for performance bonds (2016: $0.409 million).

NOTE 11 Subsequent events

There have been no significant events occurring since balance date requiring disclosure.

NOTE 12 Reconciliation of the net cash flow from operating activities to reported profit

FOR THE PERIOD ENDED 31 DECEMBER	Dec 2017	Dec 2016
NET SURPLUS AFTER TAXATION	18,063	13,784
ADD NON CASH ITEMS		
Accounting gain on sale of assets	(4,185)	(5)
Amortisation	2,522	2,685
Depreciation and impairment	8,943	8,137
Movement in deferred tax	-	2
Share of loss/(profit) from joint venture	-	(421)
TOTAL ADJUSTMENTS FOR ITEMS IN SURPLUS NOT IMPACTING CASH FLOW	**7,280**	**10,398**
ADD MOVEMENTS IN WORKING CAPITAL ITEMS		
Increase/(decrease) in payables	(418)	(3,350)
Decrease/(increase) in receivables	(4,917)	(1,389)
TOTAL ADJUSTMENTS FOR ITEMS NOT IN SURPLUS IMPACTING CASH FLOW	**(5,335)**	**(4,739)**
NET CASH INFLOW FROM OPERATING ACTIVITIES	**20,008**	**19,443**

3 EVA KEY PERFORMANCE INDICATORS

(All figures shown in tables are in $NZ thousands unless otherwise stated)

FOR THE PERIOD ENDED 31 DECEMBER	PARENT Dec 2017	PARENT Dec 2016
DEBT AND EQUITY EMPLOYED		
Debt employed	74,985	65,427
Equity employed	140,539	129,789
TOTAL DEBT AND EQUITY EMPLOYED	**215,524**	**195,216**
Charge on operating capital	6,938	6,431
Economic Value Added	3,491	5,632
SUMMARY OF PARAMETERS FOR COST OF CAPITAL		
Risk free rate – three-year Government Stock	2.07%	2.05%
Market risk premium	7.0%	7.0%
Company tax rate	28.0%	28.0%
Business risk factor (asset beta)	0.60	0.60
Cost of capital	6.74%	6.71%

EVA measures the extent to which a business is performing above or below expectations. A positive EVA means the business is adding value after allowing for a normal reward to the providers of capital. The EVA reporting framework applied by Airways can be found at the following website:

https://www.airways.co.nz/about/financial-operational-and-safety-performance-reports/

Consistent with the previous year, Airways' parent company EVA result of $3.5 million for the six months to December 2017 is expected to reduce in the second half of the financial year. Air traffic volumes are seasonally weighted to the first half of the financial year, while capital expenditure and associated interest and depreciation costs are weighted to the second half of the year.

The cost of capital of 6.74% for the period ending December 2017 compares to a cost of capital of 6.90% used for determining 2017–19 air navigation services pricing. The movement in the cost of capital is due to changes in the risk free rate.

Reconciliation of EVA to Net Operating Profit after Tax

FOR THE PERIOD ENDED 31 DECEMBER	PARENT Dec 2017	PARENT Dec 2016
NOPAT	14,658	11,905
Deduct: Charge on operating capital	(6,938)	(6,431)
Deduct: Queenstown land sale	(4,263)	-
Deduct: non-cash employee costs	(136)	(596)
Deduct: movement in deferred taxation	(106)	-
Add back: interest costs	276	754
Economic Value Added	**3,491**	**5,632**

4 CORPORATE DIRECTORY

Registered office

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New Zealand

Directors

- Judy Kirk – Chair
- Mary-Jane Daly – Deputy Chair
- Grant Kemble
- Bennett Medary
- Dr Chris Moxon
- Terry Murdoch
- Mark Pitt

Web address

- www.airways.co.nz

Auditors

- Kevin Brown, with the assistance of PricewaterhouseCoopers on behalf of the Auditor-General

Bankers

- ANZ Bank New Zealand Limited
- Bank of New Zealand Limited

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