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AIR.NZ - Preliminary 2016 Air New Zealand Ltd Earnings Presentation

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## PRESENTATION

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**Operator**

Welcome to the Air New Zealand 2016 annual results call. (Operator instructor) With that, I would now like to turn the call over to Air New Zealand's Head of Investor Relations, Leila Peters. Thank you, please go ahead.

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**Leila Peters** *- Air New Zealand Limited - Head of IR*

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. Also on the website you can find our full annual results pack, shareholder review, media release and relevant stock exchange disclosures.

Speaking on the call today will be Chief Executive Officer, Christopher Luxon and Chief Financial Officer, Rob McDonald. 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 our cautionary statement provided on slide 2 of the presentation. With that, I will turn over the call to Christopher.

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**Christopher Luxon** *- Air New Zealand Limited - CEO*

Well thank you Leila and kia ora and good morning everyone. This year we reported record earnings before taxation of NZD806 million, which is an increase of 70%. This morning I will start off by discussing the key drivers of the year's result and then we'll touch briefly on some important initiatives we're working on in the coming year. Rob will update you on the financial results and then I'll provide some further comments on the outlook. At that point we'll open the call up for any questions that you may have.

Moving on to the highlights for the 2016 financial year, operating revenue was NZD5.2 billion, an increase of 8.2% after adjusting for the impact of divestments. Earnings before significant items and taxation were NZD806 million prior to adjusting for the impact of Virgin Australia and a longstanding legal claim. Net profit after taxation was NZD463 million, an increase of 42%.

We continued to generate very strong operating cash flow in the period at NZD1.1 billion. Finally, the NZD806 million in earnings delivered a very strong pre-tax return on our invested capital of 22%. All in all, a record result and an absolutely outstanding performance from all of our team.

Turning to slide 5, this result was driven by strong capacity growth, a significant decline in fuel prices and also efficiency improvements that continue to generate benefits throughout the business. Passenger revenue increased 8.9%, resulting from a 12% increase in capacity that was closely tracked by demand growth of 11%.

Capacity growth from international long haul was driven by the entrance into our new markets of Houston, Buenos Aires and Ho Chi Minh City, as well as the annualisation of the services to Singapore. Capacity growth in the short haul sector resulted from the upgrade into larger aircraft related to our fleet program, as well as our increased frequency on select routes.

The impact of our increased capacity, combined with escalating competition that occurred in the second half of the year did put pressure on our per unit passenger revenue, or RASK, in several of our markets, resulting in a year-on-year decline of 2.3% compared to the prior year or a 6.1% decline, excluding the benefit of foreign exchange. Finally, on the revenue side, cargo continued to perform strongly this year, with revenue increasing 10% on strong volume growth of 4.1% and favourable foreign exchange.

If I can turn to costs, per unit operational costs or CASK, improved 10% this year, after removing the impact of divestments. The largest driver of the improvement was a 40% decline in fuel prices. This decline more than offset the cost of additional volumes related to the increase in capacity. Operational efficiencies also contributed NZD222 million as we continued to realize meaningful benefit from our fleet simplification and our ongoing focus on productivity and costs.

As I look at the external factor impacting our business today and categorize them into the headwinds and tailwinds, the key drivers have remained largely unchanged for the past six months. Inbound tourism to New Zealand continues to be robust, growing 11% in the year ending to June, with Air New Zealand and our partners bringing in almost 45% of those visitors to our shores.

The increase in value over volume of our visitors is also growing strongly, international visitor expenditure increased about 18% in the last year, as tourists are spending more time travelling around New Zealand, which benefits both our domestic network and the overall economy.

Our commitment to growing tourism in New Zealand is not isolated to new destinations or fleet investments. In fact we work very closely with Tourism organizations both within New Zealand and globally on marketing partnerships to stimulate demand, with the major focus being shoulder season promotion.

Domestic tourism is also an important focus for us as it provides the opportunity to reduce the seasonality effects that we face. We have increased our collaboration with key regional stakeholders as Air New Zealand helps support the economic development of regional New Zealand through the sponsorship or promotion of local events such as the World of Wearable Arts or this year's inaugural Air New Zealand Marathon at Hawkes Bay.

Then finally, touching on the external tailwinds impacting our business, while one can never predict with certainty, the current outlook for fuel prices to remain lower for longer is a positive for our profitability. At current prices, fuel looks to be relatively neutral for us in 2017 compared to 2016 which incorporates some volume increases.

Now if I can turn to the headwinds and here I'll start from the bottom and work my way up. The Kiwi exchange rate relative to the US dollar, while somewhat improved, is still an overall headwind to our costs compared to the prior year, especially given the NZD112 million hedging benefit we recognized in 2016 and will not see in 2017.

Now if I can look at the revenue headwinds, as we approach the peak season this year, tourism demand is expected to meet or to exceed last year's record levels. That's good news for our business, however we need to ensure that key stakeholders are working together on plans to mitigate infrastructure stress into the future. While not an immediate risk to visitor demand, this issue does have the potential to impact growth in international tourism in the medium term.

So Air New Zealand is working alongside other tourism related businesses to help drive the discussion and to look at infrastructure investment models, but we'll not be able to do this on our own. It is important that a coordinated approach occurs through the effort of industry leaders and the government to ensure we find the right solution for all of New Zealand so that our country can continue to benefit from sustainable tourism growth in the future.

Finally, to put current market conditions into context, one has to look back to 2016 to recognize that the benefit that we received from lower fuel prices, together with the relative benign competitive environment which would not increase until the latter part of the year, made for a very favourable outcome.

Now looking at 2017, we're still seeing lower fuel, but now we have the competition that naturally comes with it. As a result, we expect RASK will be pressured through to 2017 as the market adjusts to the overall growth in capacity. At this time, it is simply too early in the year to be certain as to what the RASK decline will be, as there are many factors that can impact what happens in the year.

For example, we've said previously that capacity is one of the biggest levers we have to address short term RASK pressure and as I'll discuss later on, we're using that lever in 2017. Impacting the long haul routes, we've announced our plans to exit the 767 fleet from March, which will provide operational benefits as well as provide our customers with a consistent wide-body product between our Dreamliner and our 777 fleet.

We have delayed our commencement of the Manila service and we're redirecting capacity within our destinations in North America. On short haul, we have even greater flexibility given the shorter booking curves and are constantly assessing the capacity in those markets given demand trends.

While we're confident that demand will be strong over the medium term, the current year will be choppy as the market adjusts to the increase in overall capacity that has come on board during a relatively short period of time. Now having said that, we have several unique competitive advantages that set us apart from other airlines and I want to highlight these.

First, our alliance driven Pacific Rim network further strengthened in 2016 with the addition of Air China and United Airlines as revenue share alliance partners and that is an important pillar to our growth strategy. These alliances have provided us the ability to perform in key international markets, such as Singapore, Hong Kong and Houston, for example, with the help and the support of airlines who are the leaders in these markets.

Secondly, our strong corporate brands and our renowned Kiwi service continue to drive increased loyalty from our customers and the investments we've made in the past few years on upgrading the customer experience, have driven record results on our customer satisfaction levels and this will certainly keep us in very good stead against our competition.

Third, the depth and breadth of our domestic network is the cornerstone to our business and this has just gone from strength to strength in the past year, with an improved schedule, increased frequency and more modern aircraft, allowing us to benefit from increased tourism flows.

Fourthly, our Airpoints program is viewed as the most valuable loyalty program in New Zealand and as such, it is a greater incentive for customers who often travel to choose us. Additionally, Airpoints provides us with valuable data that allows us to know and understand our members better and to provide them with the travel experience that they really want.

Finally, our simplified and modern fleet with an average age of seven years by the end of 2017 is contributing significant efficiencies to our business. We have continued to realize improved productivity, bit by bit and year by year through our operations, giving us an extremely competitive cost structure with which to compete. Bottom line is, our business is agile and has a proven record to adapting to succeed in many different environments. We are certainly fit to compete and certainly fit to win.

We use a strategic framework internally known as Go Beyond, which starts by putting in perspective what is important for New Zealand, for our customers and for our business. These are the fundamentals that drive our long term strategy and you can see them summarized on the top level of slide 8.

As I've said many times before, the success of Air New Zealand is inextricably linked to the success of our country and because of this, we've signed up to a mission bigger than just our Company and that is to supercharge New Zealand's success socially, environmentally and economically.

We can do that through our promise of connecting New Zealanders with each other and New Zealand with the world, through a world class travel experience. In order to do that, we need to have a world class organization that can deliver strong commercial results and excellent customer experience in a highly engaged and high performance culture.

The bottom layer of this chart actually speaks to our broad focus areas. These are the means by which we aim to achieve our objectives over the medium term and we'll look to unpack these areas in greater detail later on in the year. But today I just wanted to touch very briefly on these as they pertain to key initiatives that we're working on.

If you can turn to slide 9, you can see some of the achievements for 2016 and how they fit into these key focus areas of customers at the core, expand the travel experience, execute the plan, fighting fit and winning team. A number of initiatives for 2017 are a continuation of last year, such as the lounge program, which has been very successful with our customers. We've received positive feedback and strong uplift in customer satisfaction for the six lounges completed to date.

During this year, we'll have a similar amount of refreshed lounges, including Melbourne, Wellington regional and Queenstown. Beginning in February, we will also commence with refurbishing the interior or our 777-300 aircraft, including the installation of the Panasonic eX3 inflight entertainment system that customers already enjoy on our Dreamliner and our 777-200 fleets.

Most notable with the conversation of the premium economy seats on that aircraft, to match the same style that we now have on our Dreamliners, as well as our 777-200 fleets, which were also recently refurbished. This is a continuation of efforts to provide customers with a consistent inflight experience regardless of which long haul destination they are flying to. The refurbished premium economy will result in 10 additional seats, an increase of over 20% in that class compared to the current configuration, bringing the total seat count for the 777-300 to 342 from 332 seats.

Additionally, we'll be rolling out a refreshed website and a mobile app later this year that is focused on improving the digital interaction that our customers have with Air New Zealand, whether it be on the phone, tablet or laptop. There continues to be a lot of focus on how we can expand and enhance the travel experience for our customers across all aspects of their journey and with our Airpoints program being the most valued loyalty program in New Zealand, there is an exciting opportunity to expand our coalition of partners to provide our customers with increased opportunities to earn Airpoints.

In June we announced our new partners, Mercury, Z Energy and Foodstuffs, who will become activated later this year and join other strong New Zealand brands that already participate in the Airpoints program. Our membership base of over 2.2 million Airpoints members also provides us with opportunities to enhance our customers' experience with valuable insights that can improve their travel.

This year we will also be working on refining the personalization of offers to our customers through the more intelligent use of our data. Lastly, we're working on expanding the ancillary product offerings that we provide to our customers.

Turning to our markets and our Pacific Rim focus, while 2016 was definitely a year of great new market development and 2017 will be focused on digesting that growth, strengthening those new routes and developing the market through our strong network of revenue share alliances and targeted marketing campaigns. In addition, we're expanding our Australian sales presence to drive increased traffic to North and South America through our Auckland hub.

Now supporting all of these areas is a culture of efficiency and agility that allows us to grow while still maintaining strong oversight on costs. We're half way through a significant capital program that has provided us with a simplified and modern fleet across all aircraft types. This has driven efficiencies that are improving our unit costs each year. This year we'll receive three additional 787 aircraft, bringing our total to nine by the end of the year. We've also made the decision to exit the remaining four 767 aircraft by March of 2017, which will bring additional operational efficiencies to our wide body fleet.

Finally, as I've mentioned before, we know we cannot sustain truly great commercial results and high customer satisfaction levels without ensuring that our people are highly engaged, they are connected to the mission of our business and that they feel they are personally developing and striving to achieve. I'm extremely proud that in 2016 Air New Zealand ranked in the top quartile of companies in Asia Pacific for employee engagement.

We'll look to further build on our engagement this year with an important component of that development coming from deepening our high performance engagement agenda with our union partners. Last year we successfully negotiated 22 collective agreements and have approximately 10 agreements in scope for this year.

Within this scope of a truly winning team is caring for our people and their safety and we are challenging ourselves to supercharge health and safety. Which has resulted in a revamped safety vision, mission and policy to align with our belief that safety, as a shared value, is the best way to ensure everyday mindfulness of safety exists across our entire organization.

So I guess in summary, while we'll still see RASK pressure this year as the market adjusts to the increased competitive environment. The bottom line is we are focused on key initiatives that will actually help us navigate through this transitionary year and we are pulling together a number of our capacity levers with the flexibility to do more as the year progresses.

Finally, all of these activities are in line with our medium and our longer-term objectives, so we'll see continued progress as we look out further on the horizon to a more stable RASK environment. As always, we'll continue to be ruthlessly focused on driving profitable growth.

Now let me hand you over to Rob who will walk through the financial results in greater detail, then I'll come back to briefly discuss the outlook for the business.

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**Rob McDonald** *- Air New Zealand Limited - CFO*

Thanks Christopher. Kia ora and good morning. Before I get started, I want to take a moment to discuss our deliberate shift away from yield in our reporting and the move towards passenger revenue per ASK, or what we refer to as RASK.

As most of you are aware, yield is simply the average fare paid per ASK and while this metric can be used to assess changes in our average fares over time, it is not very useful for comparison across markets or other airlines as it does not factor in loads. RASK, by comparison, is the best measure of passenger revenue performance and is better aligned with our focus on managing the business for revenue maximization, rather than simply yield or load factor.

We aim to maximize the revenue achieved for each flight and this is what we will refer to when we're discussing the performance of the business this year and going forward. In this year's financial result documents, we have provided the yield figures, as we have historically always done, simply for comparison purposes, but next year we will only be referring to RASK in our financial results, as well as our monthly investor updates.

Now I'll walk through the key movements which affected our performance during the period. Please note that these numbers isolate the impact of foreign exchange and divestments. Revenue increased by NZD189 million in the year, with passenger revenue increasing NZD193 million, driven by capacity growth of 12% which was partially offset by a decline in RASK.

Labour costs increased by NZD65 million due to a combination of activity, rate increases and a larger company performance bonus. These items were partially offset by improved productivity and our total labour cost increased 5.4%.

As Christopher mentioned, the reduction in fuel cost was a large driver of incremental profitability, declining NZD379 million compared to the prior year. The average US dollar fuel price decreased by 40%.

Including the impact of hedging, fuel-related savings were NZD456 million. These savings were partially offset by increased fuel consumption relating to growing our capacity, although it is important to note that volume of fuel increased only 7% on 12% capacity growth due to the improved efficiency of the new aircraft.

Aircraft operations, passenger services and maintenance costs were NZD107 million higher, driven by increased capacity, price increases and the growth in the fleet. Sales and marketing and other expenses increased by NZD32 million, this resulted from higher commission costs due to significant revenue growth, costs relating to new route development and increased focus on digital technologies.

Ownership costs were NZD42 million higher due to increased depreciation as we expanded the fleet, and this was partially offset by lower average borrowing rates.

Associate equity earnings improved by NZD42 million, with continued growth in earnings for the Christchurch engine centre of NZD16 million and a reduction in losses from Virgin Australia of NZD26 million. The overall negative impact of currency movements was NZD28 million, which benefited from NZD112 million hedging gain in the year.

Finally, the impact of divestments that occurred in 2015 resulted in a net adverse impact of NZD4 million. The net result of all these movements is an increase in earnings before other significant items and taxation of NZD332 million.

Looking deeper into our unit cost performance, the cost per ASK adjusted for divestments improved 10% during the period. I've already discussed the impact of lower fuel prices which was partially offset by the adverse impact of the weaker New Zealand dollar.

Looking at the two major components within our control that are within the circle, you can see that the price impact drove a modest CASK increase of 1.6%; however, this was more than offset by efficiencies which contributed savings of NZD222 million. The net result of the two component yielded an improvement in CASK, excluding fuel and FX, of 2.6%, which has a significant impact on our business. The total reduction in per-unit cost, excluding divestments, delivered savings of NZD406 million.

Moving to our domestic network, this was a very strong year for Air New Zealand in terms of capacity growth of 8.5%. This growth was delivered through operating larger aircraft, the addition of some growth aircraft, and the optimization of our schedule. Demand grew slightly behind capacity, resulting in a 6.5% decline in RASK as we lowered pricing to stimulate demand.

Our domestic jet on-time performance has increased 0.5% this year to 90.5%. Our regional on-time performance decreased to 85.3%, down 3.9 percentage points compared to the prior period. As the changes to our regional schedule take effect in the next few months, we expect to see some improvement in this area.

Moving on to the Tasman and Pacific Islands, capacity grew 5.1% in the year, mainly due to increased frequency of the wide-body aircraft as well as up-gauging to the larger 787 aircraft on our Honolulu service. Demand lagged capacity growth at 3.8% and we saw RASK decline 1.1%. Excluding the benefit of FX, RASK decreased 2.6% with much of that pressure seen in the last few months of the year as the competitive environment increased.

Tasman and Pacific Island on-time performance continued to improve at 86.7%, up 2.7 percentage points from the prior year.

Our international network experienced exceptional growth in 2016 of 16% with much of that occurring in the first half of the year. Demand was also impressive, tracking capacity growth with a marginal increase to overall load factors while RASK increased 1.6% in the year due to the benefits of FX. Excluding the impact of FX, RASK declined 5.7% and similar to the Tasman, much of that decline occurred in the second half of the year.

Turning to cargo, the business continued to perform very well with revenue up 10%. This was comprised of volume increasing 4.1%, yields declining 0.6% and the benefit of FX contributing 6.6%.

Increased volumes was a result of fleet up-gauge to larger aircraft that have more cargo capability as well as the commencement of new routes such as Houston which help support the demand for New Zealand exports such as produce, meats and seafood. We also continued to see strong activity for high-value imports such as electronics into the New Zealand market.

Now, I'd like to briefly summarize the changes that occurred with respect to our financial interest in Virgin Australia towards the end of the year. In June we sold 19.98% of Virgin Australia to Nanshan Group. Our remaining interest at the end of the year was 2.5% and it's our intention to sell that stake when appropriate. Going forward, the investment in Virgin was simply getting to be too large a percentage of our total equity than we were comfortable with, and as we've stated previously, we'd prefer to focus on our own growth opportunities.

Air New Zealand had a very strong operating cash flow in 2016 of NZD1.1 billion, which equates to NZD0.96 per share. Our cash flow along with the proceeds we received from the sale of our interest in Virgin contributed to our net cash on hand of NZD1.6 billion, an increase of 21% on the previous year.

Our gearing was 48.6% at the end of the year, an improvement of 3.8 percentage points and remains well within our target range of 45% to 55%. The improvement in gearing was a result of our strong operating profit in the year.

We maintain a credit rating of Baa2 from Moody's with a stable outlook. Not only is our investment-grade rating one of the highest in the aviation industry, but more importantly it provides us with good access to the financial markets. As you can see from our debt maturities, there are no significant levels of debt repayments coming due on the horizon other than the NZD150 million retail bond maturing in November.

As a result of increased earnings, strong cash flow generation and a robust balance sheet, the Board was pleased to announce a fully-imputed final ordinary dividend of NZD0.10 per share, bringing the 2016 full year ordinary dividends to NZD0.20 per share, an increase of 25% on the prior year's ordinary dividend.

In addition, the Board has declared a fully-imputed special dividend of NZD0.25 per share following the sale of the Virgin Australia shareholding and a review of our capital structure, gearing and liquidity.

Turning to our fleet plan. As Christopher mentioned earlier, we are well through a significant capital expenditure program which is delivering an ideal fleet for the New Zealand market. With the simplification driving fewer fleet types, we gained efficiencies not only with regard to fuel burn but also within our operations, and you're seeing those efficiencies come through in areas such as improved labour productivity.

Based on our current forecast we expect CapEx relating to aircraft and associated assets over the next five years to be approximately NZD2.1 billion, based on a US dollar exchange rate of $0.715. As you can see from the bar chart on the upper left side of the slide, the CapEx spend significant drops after the 2019 financial year. In fact, based on the delivery schedule, the real decline of CapEx starts in the front half of the 2019 calendar year.

Looking briefly at the historical progression of our fleet ownership profile, we can see a clear shift towards owned versus leased aircraft, with effectively more aircraft coming directly onto our balance sheet. The rationale for this shift is when we intend to operate an aircraft through the majority of its lifecycle, ownership generally provides greater flexibility at a lesser overall cost of ownership than an operating lease.

Ownership also provides greater flexibility to operate and manage the timing of the exit of the aircraft due to the detailed return condition requirements in most leases. However, operating leases are often attractive when seeking to add aircraft to a fleet mid-cycle to maintain funding diversity and in some cases to access fleet where a new delivery slot is not available. Hence we do expect to continue with a portion of the fleet on operating lease.

With regard to fuel hedging, we participated in 87% of the available fuel price decline; that was a great result. We continue to utilize collars for our fuel hedging, which we feel comfortably positions us to capture further fuel price declines while protecting us against any potential material spikes. Looking at 2017, we're currently 68% hedged for fuel.

In terms of foreign exchange, our largest exposure is the US dollar. For 2017 we have US dollar hedges in place for approximately 80% or $575 million at a rate of $0.675 against the New Zealand dollar.

Finally, I wanted to summarize this year's result by briefly putting it through the lens of a financial framework which we outlined to you at our investor day in May. We are focused on profitable growth while maintaining capital discipline in our balance sheet, with the ultimate goal of providing sustainable, strong returns for our shareholders over the long term. That is not to say that each and every year we'll hit all these targets, but rather through the cycle we look to these metrics to assess our performance.

Now let me hand you back to Christopher to discuss the outlook for the remainder of the year.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Thanks, Rob. Turning to slide 26, we have provided our current market outlook for the year, along with our capacity plans by sector. We currently expect the domestic market to maintain a similar competitive environment as we saw last year.

Based on forecasts for continued strong tourism growth into New Zealand, we anticipate increasing our capacity approximately 7% to 9%. More than half of that growth is related to increased stage length as we redirect some capacity to Queenstown and Dunedin based on demand with the remaining capacity growth related to bringing on the larger ATR turboprops into the regional centres.

Turning to the Tasman and the Pacific Islands, we expect the competitive pressure in that market to persist in 2017. As a result, we will look to increase capacity approximately 3% to 5% this year. The majority of this increase has related to bringing on the largest 787 aircraft for Honolulu as well as select services to Australia.

And finally on international long haul, as I discussed in my earlier remarks, we expect the competitive pressure to increase in 2017 with new services to Auckland coming from Chinese and Middle Eastern carriers, as well as a full year's impact of direct competition on our Los Angeles service.

We plan on increasing our capacity approximately 4% to 6% in these markets. Over two-thirds of that increase is the annualisation impact of Houston and Buenos Aires for the year. Putting it all together, we currently expect total capacity for the Group to increase about 4% to 6% this year.

Now turning to the outlook for the year, based upon the current market conditions we expect 2017 earnings before taxation to be in the range of NZD400 million to NZD600 million. This range includes the assumption of fuel at $55 per barrel. Given that we are still early in the financial year, this range reflects the uncertain impact of the competitive environment, and while not at the level of 2016 earnings, 2017 will still be a solid year, and I am confident that we have never been in better shape to compete and to win.

To reiterate, our business is agile with a proven track record of adapting to many different trading environments in order to success and this year will be no different. So can I just say thank you for listening, and now operator, please open the line up for any questions.

## QUESTION AND ANSWER

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**Operator**

Thank you very much. (Operator Instructions) The first question is from Paul Turnbull from First New Zealand Capital. Go ahead, thank you.

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**Paul Turnbull** - ***First New Zealand - Analyst***

Hi, Christopher and Rob. Just looking at your yield numbers, obviously we saw a deterioration as the year progressed and we've seen the month of July come out and that looked quite disappointing. Is July yield a reasonable indicator as you look across first half 2017 for (inaudible) markets?

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Good morning, Paul, how are you? Thanks for the question. I guess what's -- where do we see the world now, I guess given our conversations, at the investor day and what do we see?

The first thing I'd say is they're sort of known knowns; obviously the competition we're seeing around Jetstar launching in December, Emirates in March, American in July, we've got that pretty well dialled in. I guess the surprises have really been the maintenance of capacity by the Chinese carriers over the low season, albeit they've now maxed out their ASAs.

But normally that capacity would go away, and it's stayed over this winter period. And I think probably Emirates' direct services to Europe has probably impacted the Tasman a little bit more as well. So July and Q1 I would argue will be the greatest and probably fully loaded. Competition starts being lapped, as does our own capacity when we start to hit the Summer peak, and then obviously into the second half of 2017.

So that's kind of the way that we're thinking about it. I mean obviously as we've talked to you about at Investor Day, we have several capacity levers to pull, our mix to manage, and this is a bit of adjustment. But yes, the op stats in July I would say would be as fully loaded as we would imagine.

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**Paul Turnbull** *- First New Zealand - Analyst*

So if you look at say tactical pricing from American Airlines, your expectation would be that some of that dissipates as they move further away from that initial launch date?

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**Christopher Luxon** *- Air New Zealand Limited - CEO*

Yes, I think some of those things are -- you know, as I said, some of those competitors are very much known knowns, and we expected behaviour, and we've got that very well gripped up, I would argue. But as we go through to the summer peak, and we start to lap some of the competitive entries as well as our own capacity from last year, I think this is probably as bad as it gets in July. Rob, what would you say?

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**Rob McDonald** *- Air New Zealand Limited - CFO*

Yes, I think the first quarter is really going to be the presence of the vast majority of the competitive change in the last year. The first quarter last year really had nobody, and this year it's just about got everyone.

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**Paul Turnbull** *- First New Zealand - Analyst*

Sure. Trans-Tasman yield, you mentioned that fourth quarter 2016 saw the bulk of the deterioration. Could you just provide a bit more guidance on what yield looked like for that specific period?

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**Christopher Luxon** *- Air New Zealand Limited - CEO*

Yes, Paul, just on the Tasman -- so the Tasman has I guess the second half, and particularly from March, with Emirates going direct, and then really not changing their capacity in the -- on the Tasman meant a whole lot of seat displacements occurring, which meant clearly they were looking to sell those and yields went down. Also you had the entry of AirAsia X, which also dragged it down.

I think in the coming months there will be some stabilization of that. I think the more disruptive element was with Emirates announcing one month and then simply starting the next. Normally you would see a much greater period between announcement and starting to build -- so you can build the bookings and all that sort of stuff. We didn't see it. It just went straight in a month later; very unusual.

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**Paul Turnbull** *- First New Zealand - Analyst*

Right. Final question for me, your ASK, or your capacity guidance, down from I think it was 8% to 10% at the half-year to 4% to 6% at the full-year for FY17. You sort of mentioned more levers you could potentially pull. Are you suggesting that there is further downside risk, I guess, to that capacity guidance for FY17?

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

I guess Paul I would say around capacity just remember that a big proportion of the capacity we've got slotted in for is actually annualisation of what we've already launched from last year. So we've just got to lap that, but a big component of it is actually that. The second thing I would say is we have always got a really great opportunity to continually adjust and match demand in the New Zealand market place, due to the short booking cycles.

I think the other piece is in the international environment. We've got very good alliance joint ventures in Asia and North America, and we've got opportunities to shift capacity around with those JV partners as well. I think the only other decision that we've made obviously since Investor Day and now is that we've accelerated forward by a year the exit of the 767 fleet. So we've only got three aircraft left. One goes out in November. The other two go out in March next year. That's an example of how we are thinking about it.

As I've said to you guys before, we are ruthlessly maximizing profitable revenue growth, and that's what we get very fixated on. In the capacity space that's the option set that we've got.

**Rob McDonald** - ***Air New Zealand Limited - CFO***

There are a couple of adjustments that are public. One is obviously Manila has been deferred, and also things that aren't -- were never in the public was probably more growth into North Asia than we would now be doing, just given the amount of traffic coming out of there.

**Paul Turnbull** - ***First New Zealand - Analyst***

Okay, thank you.

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Thanks Paul.

**Operator**

Thank you. The next question is from Andy Bowley from Forsyth Barr. Go ahead thank you.

**Andy Bowley** - ***Forsyth Barr - Analyst***

Thanks Operator, and morning guys.

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Hi Andy.

**Andy Bowley** - ***Forsyth Barr - Analyst***

Hi Christopher. A couple of questions from me. The first one, I'm interested in the PBT guidance for fiscal year 2017 in terms of the range that you provided, which is great in terms of the timing, it's a lot earlier than previously.

But you've given us the jet fuel price assumption, and I recognize there are plenty of other drivers that will impact earnings over the course of the next year, but can you talk through what your core yield assumptions are, which apply for both the top end and the bottom end of that range, recognizing some of the comments that you've made previously to Paul's first question?

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**Rob McDonald** *- Air New Zealand Limited - CFO*

Good morning Andy. The range is very much, as you can imagine, of a more optimistic versus pessimistic view around yields. It's -- we're probably seeing what we see at the moment, and one version of it could see a strong high season where the latest competition starts to grow into the growth as the high season comes along. The alternative is that actually the high season, to get the amount of growth in there, you have to have further discounting.

Where the yields are, I think someone used the word disappointing. I probably would have used a word given that the -- with American coming in in July, that was clearly going to have an adjustment, but the adjustments were occurring months before, right through from literally the whole back half. So if you back engineered the yield information coming out of the monthlies, you were sort of getting in the order of a decline of 7%.

So there's quite a lot of yield decline already in the result just reported. It would have to get worse than what we see for it to be on the bottom end.

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**Andy Bowley** *- Forsyth Barr - Analyst*

Should we assume that the comment previously around operating stats in July being fully loaded, is that kind of the mid-point of the range? How conservative is the range in relation to where recent yields have been?

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**Rob McDonald** *- Air New Zealand Limited - CFO*

We're not trying to -- it's fair to see the range is relatively wide, so it does take in a number of things. So we're not trying to give a RASK guidance at the moment.

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**Christopher Luxon** *- Air New Zealand Limited - CEO*

I think Andy it's very early in the year, and we wanted to be really helpful actually by giving you as broad a range as we could at this point in time. Obviously the way to think about it is we've got the absence of the NZD112 million hedging benefit from last year. We've got a competitive dynamic. That dynamic, while early in the year when you look at the quantum, the pace and the nature of it, does impact on RASK, and it's just a question as Rob said about optimistic versus pessimistic parts to that range.

On the cost side what I'd say is that I appreciate you guys will have your house views on fuel, but fuel for us is a very neutral scenario going forward. We're still very confident in our ability to get the cost efficiencies out that will cover cost price increases. So really as -- getting to your question, it's all about RASK assumptions. It's very early in the year. We're just trying to give you a very broad range to try and be helpful, rather than not give you any guidance, which was the other choice.

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**Andy Bowley** *- Forsyth Barr - Analyst*

Great. Agreed, it is helpful, thanks Christopher. Second question, and you mentioned costs and unit costs in particular, 2.6% benefit pre fuel and currency in the last financial year. You kind of mentioned just there that you'd hoped to offset inflationary pressures. How should we think about unit costs on a go forward basis? Can we see further declines like we've seen in recent years?

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**Christopher Luxon** *- Air New Zealand Limited - CEO*

Yes, I mean you know over the last four years we've built a really good cost control mindset into the business, and it is very much a daily practice. So I think we're not the kind of guys that have big set piece cost out type programs, because we're just working it over day in, day out, really as a result. So we're really comfortable with our view that our cost efficiencies will offset the pricing pieces to it.

**Rob McDonald** - ***Air New Zealand Limited - CFO***

Yes, I think there's more annualisation to come that will obviously help. I think the 787s -- three more 787s replacing 767s, so there's a big cost delta on seat mile costs on that. Another point that I've made several times in the past is a portion of our labour base is incentivized and indeed the Company performance bonus, the amount of that is based on superior performance. So those adjust as earnings come down.

**Andy Bowley** - ***Forsyth Barr - Analyst***

Great, thanks guys.

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Thanks Andy.

**Operator**

Thank you. The next question is from Marcus Curley from UBS Investment Bank. Go ahead thank you.

**Marcus Curley** - ***UBS - Analyst***

Good morning guys.

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Morning Marcus.

**Marcus Curley** - ***UBS - Analyst***

I suppose one point of clarification, and you've already said it probably Christopher, but just to be 100% clear, there isn't any other non-currency or competitive yield pressure issue that you're alluding to or have factored into the range that is not clear to us from the presentation?

**Rob McDonald** - ***Air New Zealand Limited - CFO***

Are you talking more around an economic --

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

-- hedging benefits --

**Marcus Curley** - ***UBS - Analyst***

No, just is there any other issues in the business that are going against you, that have been factored into this range outside of currency --

**Rob McDonald** - ***Air New Zealand Limited - CFO***

No, not that we're aware of, no.

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

No.

**Marcus Curley** - ***UBS - Analyst***

Okay. Secondly, you talked about a sustainable dividend against that range of profit outcomes. Do you think the NZD0.20 is sustainable as you see it today?

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Yes, I mean if I can pass a few comments and Rob will chip in on the dividend, but I mean -- and if I just maybe back up, because I think there will be a series of other questions maybe on dividends, we'll take the whole thing in its entirety. But we don't think fundamentally a buyback actually helps the share price in the long term. We therefore have chosen this special dividend over the buyback option because of its tax effectiveness. We've been thinking about it for a while, but it's really about the strength of our gearing and our liquidity that really has driven where we've got to on this.

I was a bit interested to see some of the flash reports that were coming out yesterday saying that it would be lower, or it wouldn't be at all due to all the uncertainty. Clearly that's a different view given our own view of our own financial strength, and I think our profile.

So clearly we've got to adjust and absorb competition, and get a resumption of normal conditions in place, but our gearing is strong. The CapEx profile is really clear. Our liquidity is excellent. I think you should be looking at the ordinary dividend that's up 25% as a signal of how confident we're feeling.

We still expect a really solid year, let's be clear. If we land a number anywhere in this range it's going to be our second or third best result ever in 76 years. That's kind of how we're thinking about it, and hopefully the way you should be interpreting the dividend signals that we're sending.

**Rob McDonald** - ***Air New Zealand Limited - CFO***

I'd just go back to the investor day, where I really did try and project that we -- when we're thinking about ordinary dividends this year, we're not thinking about FY16 earnings. We're thinking about through that and further on. It's not to say we would never adjust it either way. It's just that if -- we're a bit like S&P and Moody's, you don't want to set it and then have it flopping around all the time. So it is very much set with a view that yes, it's clearly a solid year we hope in the coming year.

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

I think we also have good visibility over the CapEx profile going forward too.

**Rob McDonald** - ***Air New Zealand Limited - CFO***

Yes, and I think again I'd reiterate what I did at the investor day, is you don't have to look too many years beyond now, and then the free cash flow really does accelerate.

**Marcus Curley** - ***UBS - Analyst***

Thank you. Just on the domestic operations, can you give a little bit more colour in terms of regional versus main trunk in terms of the dynamics that you're seeing at the moment?

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

What will we say about that? We've had a really good -- we're pretty pleased with our performance there. I mean obviously what we've got going on is a massive inflow of tourism and international visitors coming in that's either our own growth but also that of our competitors. Really what our job has been is to expand capacity so that we actually get those tourists disbursed across the country.

The other piece to be very conscious of is mix and we've made conscious choices around that to say look, our corporate markets will essentially grow in line with GDP but we think with this tourism growth, there is really an opportunity for us to reach out to leisure travellers.

What I would say to you is what I've always said to you, every piece of flying we do is profitable, revenue is profitable revenue and that's what we then fixate on. So we're really comfortable with our position actually in domestic New Zealand; we're really, really pleased with it.

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**Rob McDonald** *- Air New Zealand Limited - CFO*

Yes, maybe I'll make a few comments, because there's a number of initiatives gone. I think, in the next day or maybe it's today, the last flight of Eagle, so that's finished. So you've got the swap out of the smallest fleet, turboprop fleet, with entry of bigger size, so that's clearly grown the ASKs.

But we were right upfront when we started that project, that one of the objectives was to bring our costs down and we can do that and we clearly can, it's just a fleet change. Fares will be coming down as well and that's what we've seen and we've been able to produce fare reductions in many towns at the 10% and 15% level. So that's meant a lot of benefit, but equally we're getting a better configuration in our turboprop.

Then we're just seeing good economic conditions in New Zealand generally, so that's helpful and strong tourism flows and, as Christopher said, really strong into Queenstown. That obviously has a mix change, but it's all good.

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**Marcus Curley** *- UBS - Analyst*

Okay and then just finally, one piece of detail, you obviously talked about offsetting inflation-like cost increases with efficiency gains, but could you give us a little bit of colour specifically on labour and what's happening with staff numbers looking into the next year and wage rates?

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**Rob McDonald** *- Air New Zealand Limited - CFO*

I think given now we're going into a much slower growth phase, you'll see staff numbers pretty well level off. Then as I mentioned before, there's a fair bit of incentive payments that are levered to the higher end of earnings and we're clear that earnings are coming down, so those will change. But it's fair to say, I think, Christopher will comment, that labour relations are in good shape, great shape.

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**Christopher Luxon** *- Air New Zealand Limited - CEO*

Yes, I think a couple of things here, Marcus, I think that the first thing to say is total FTEs today are very much the same as what they were in 2012 and yet the size of the business is obviously very, very different in terms of absolutely FTEs as pretty stable. You would have seen in this year, I think our labour was up about 5% and I think we're on 12% capacity. Remember at the half we talked a lot about a bubble of training and labour that we had, we got through that and got rid of all of that and new market developments digested that incredibly well.

So we've settled something like, I think it was 22 collective agreements in the last 12 months. We've got maybe 10 more to go this year. The way we're working with the unions as strategic partners and collaborating is really fantastic. So we're getting good visibility into cost challenges we may see in the business in three to five years' time and we're starting to work on those issues now as teams closest to those problems.

So that's really why we feel actually it's only right that we do the staff bonus of 2500 to 8200 workers. Yes, labour is in really good shape, is the headline.

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**Marcus Curley** *- UBS - Analyst*

Settlement rates on those contracts?

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

We've managed to negotiate essentially all of them at 2%.

**Marcus Curley** - ***UBS - Analyst***

Okay, thank you.

**Operator**

Thank you. The next question is from Owen Birrell from Goldman Sachs. Go ahead thank you.

**Owen Birrell** - ***Goldman Sachs - Analyst***

Hi guys, just a few questions from me. Just looking at the international markets and I guess the international capacity that you're putting on, I know there was a fair degree of annualized capacity there, but I'm assuming the RASK versus CASK spread on these routes is currently profitable.

But I'm just looking at the global landscape and basically almost every international airline is undertaking a similar strategy of adding on capacity where there's that decent spread that justifies the new aircraft. I'm just wondering, will you entertain small offers on any particular route or does every international route need to be profitable?

**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Hi Owen, good to hear from you. Yes, let me talk that one through. If you go back four years ago, we had a business internationally, it was probably losing close to I think it was NZD2 million a week at one point, NZD100 million a year. We've retooled that very assertively three or four years ago and so all of our international routes are very positive contributors to our network and we don't do unprofitable flying, that's non-negotiable for us.

So we've got a very strong international network that's cost appropriate, right sized, right fleet has helped tremendously. People talk about the theory of a simplified fleet, it's not a theory for us, it's actually real. So we are highly flexible to move 777-300s, 200s, 787s in and out of markets as they change, develop, as the mix of them actually changes, all offering a consistent product to our customers.

At the same time, if you think about our set of alliance joint venture partners that we have, Singapore for Southeast Asia, Air China for Mainland China, Cathay for southern China, United and America, Virgin, we've got a really great set of JV partners, United now in North America. That also gives us opportunity to work with those guys to manage capacity as well. So I think we feel like we're in really good shape with our international network and we'll manage it ruthlessly and commercially.

**Owen Birrell** - ***Goldman Sachs - Analyst***

Just one last question for Rob, the bonus payment to employees of NZD2500, I'm just wondering if you could give us a sense of what the absolute magnitude of that payment is and the treatment, has it been expensed already or is it a 2017 number? It going to be in the personnel line or is it a significant item?

**Rob McDonald** - ***Air New Zealand Limited - CFO***

It's just a touch more than NZD20 million and obviously it's already expensed.

**Owen Birrell** - ***Goldman Sachs - Analyst***

And the cash flow impact?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Sorry? Paid next week.

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**Owen Birrell** - ***Goldman Sachs - Analyst***

Paid next week?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Yes.

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**Owen Birrell** - ***Goldman Sachs - Analyst***

Thanks guys.

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Thanks Owen.

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**Operator**

Thank you. The next question is from Carolyn Holmes from Morningstar. Go ahead, thank you.

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**Carolyn Holmes** - ***Morningstar - Analyst***

Hi guys. Just a couple of questions on the capital expenditure for the fleet going forward and also just on the operating leases. So if I was to look forward, and you mentioned that the average age of the fleet by next year would be 7 years, when's the next big kick up in the Capex cycle. So how long, given that the fleet is supposed to be very efficient; does it last longer, does the average age -- will it lead you down the track so that the next big Capex cycle is not for another 5 years down the track?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Yes, so if you think about the fleet that's completing the end of, or really the year after, the 787s and more than likely, we'll just keep adding to 787s as we see growth opportunities but there's many opportunities to lease as well, for 787s. Then, the domestic fleet, with the CEOs, that's a relatively young fleet, so we'd see that going for some time well into the next decade. We've refitted the 777-200s. They go well into the early part, at least, of the next decade; 777-300s, same thing. So just about everywhere you look, Tasman fleet will get renewed in 2018/2019 and then after that, you really are talking from 2018, another 5 years.

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**Carolyn Holmes** - ***Morningstar - Analyst***

Okay, and then, so in the mid-2020s, then we should be assuming like an ongoing Capex of around about the NZD400 million?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Well, it will sort of, I expect it would go up as we start moving on some fleets at that time.

**Carolyn Holmes** - ***Morningstar - Analyst***

At least into the middle of next decade before the next big kick up in Capex?

**Rob McDonald** - ***Air New Zealand Limited - CFO***

I would hope so.

**Carolyn Holmes** - ***Morningstar - Analyst***

Okay.

**Rob McDonald** - ***Air New Zealand Limited - CFO***

I might not be here.

**Carolyn Holmes** - ***Morningstar - Analyst***

Are you actually buying out any operating leases and transferring them to ownership or are we just waiting for the operating lease to mature?

**Rob McDonald** - ***Air New Zealand Limited - CFO***

Sorry, could you repeat that question?

**Carolyn Holmes** - ***Morningstar - Analyst***

Yes. So, in the last year did you actually buy-out of any of the operating leases and make them your own or do you wait for the, basically, any new aircraft you're buying, is actually on your own books and you just leave the existing operating lease fleet just to run its normal course?

**Rob McDonald** - ***Air New Zealand Limited - CFO***

Yes, it's the latter. We just -- the operating leases just run out and then we just take the owned aircraft on our balance sheet. Often in the past, and particularly as we went through the 737 fleet, prior to returning, we might buy the aircraft and just as a trade-off between return conditions and tear down and stuff like that. So, we just sell the aircraft anyway, it's leaving.

**Carolyn Holmes** - ***Morningstar - Analyst***

Thanks Rob, thanks Christopher.

**Rob McDonald** - ***Air New Zealand Limited - CFO***

Thanks Carolyn.

**Operator**

Thank you. The next question is from Matt Peek from Craigs Investments Partners. Go ahead, thank you.

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**Matt Peek** - ***Craigs Investment Partners - Analyst***

Hi guys. Well done on a record result and managing the business well, going forward. One question I have which sort of relates to the yields and I guess what's disclosed in the monthly figures which we don't get such a good read through on a monthly basis, is domestic --

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Would you like us to do them quarterly mate?

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**Matt Peek** - ***Craigs Investment Partners - Analyst***

Looking at domestic in the second half, obviously Jetstar increased its capacity quite a lot but it was also able to increase its load factors and take share which as you say, you sort of experienced the need to reduce yields to fill the planes. Can you comment to how FY2017 has started comparted to what was happening in the back half of -- the second half of FY2016?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Yes, just on Jetstar coming, that's all turbo prop, really. I think the jet schedule was relatively stable as we continued both to grow our turbo and our jet. It landed pretty well where we expected it to and has settled down now so clearly, I think they talked about their load.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

It was really out of capacity wasn't it?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Yes, yes.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Driving that.

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**Matt Peek** - ***Craigs Investment Partners - Analyst***

Sorry, I didn't quite catch that last part.

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

In terms of our -- the yield impact on us, in terms of both, we had yield decline on jet which was very much a mixed change in our own growth. Then in turboprop, yes, we saw some adjustments in the route they came in terms of pricing as you'd expect, but I think both airlines had loads that were pretty similar and clearly, they don't disclose their yields.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Yes, I think fundamentally Matt, the big take-away is that yield pressure in domestic New Zealand is due to our own capacity that we've added.

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**Matt Peek** - ***Craigs Investment Partners - Analyst***

Right, and how's first half started compared to what we saw in second half then, given that you don't get good read through on the monthly stats?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

In terms of how's the domestic part started?

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**Matt Peek** - ***Craigs Investment Partners - Analyst***

Yes.

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

I mean, domestic economy is pretty buoyant, so.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Yes, we don't -- we're not trying to give an outlook.

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**Matt Peek** - ***Craigs Investment Partners - Analyst***

Okay.

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

All right. Any other questions on the line?

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**Operator**

Thank you. The final question is from Nick Mar from Macquarie. Go ahead, thank you.

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**Nick Mar** - ***Macquarie Research - Analyst***

Hey guys. Most of mine have been covered off but just kind of a more of a high level one. If you were coming in towards the bottom of the range towards the end of this year, what kind of factors would you be -- or what parts of the business are you looking to adjust to try and offset some of that or to improve the outlook into 2018. Obviously it will be quite a challenging position, either on the yield side or on the load factor side, or both. So what would you be doing to try and mitigate that further down the track?

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

I think if it was to come down on the lower end, then you're really talking about an outcome that's more on the pessimistic side of yields. So at that point, we'll have to look at where our capacity adjustment is but often, you don't want to be walking away from markets and wherever that range is, it's still a solid result.

So we'll certainly look at things in a medium-term. It's fair to say that we have been, and I have to say, I don't like to use the words, renewed, or anything, but we're quite focused on costs as well and ensuring that what has been an upward trend in profitability in the last 3 years, that everyone in the organization clearly understands that we're back to more normal trading conditions and it certainly, as we reinforce the strong cost culture we have.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

We'll make sure the business is right sized for the size that it encounters but we're dynamically looking at things like marketing investment in different places as we link that number back to revenue. There's all sorts of things that we do inside the business to make sure that we get it right sized. Was there one more? Sorry Nick. Thanks so much.

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**Operator**

Thank you. The next question is from Jason Familton from Accident Compensation Corporation. Go ahead, thank you.

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**Jason Familton** - ***Accident Compensation Corporation - Analyst***

Good afternoon guys.

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Hi Jason. How are you?

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**Jason Familton** - ***Accident Compensation Corporation - Analyst***

Just a couple of questions from me. Yes, not too bad, not too bad. Just the first one, just around the announcement with the operating stats really, the NZD100 million to be EBITDA increasing roughly 50% in the amount of premium seats on the 787s and 777s. Can you just talk a little bit around the demand you're seeing in those premium cabins and is that what's driving increase or what's been driving --

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**Rob McDonald** - ***Air New Zealand Limited - CFO***

Jason, yes, that's a good question. I just want to clarify one thing because essentially, the NZD100 million is tied to the refurbishment of our 777-300 fleet, so remember they're the aircraft that are typically 3 to 7 years old and we want to go the rough and redo the whole interior fit-out of those aircraft and as part of that, what we've said is we're going to adopt the premium economy product that exists on the 777-200s, which were refurbed last year as well the -- which is same produce that's on the Dreamliner.

So essentially, we get an increase in premium economy cabin seats by I think, about 10 seats from memory. So that's the NZD100 million on the 777 fleet. The second issue is, including IFE upgrades to the same standard set.

So again, what we're trying to do, as you well know, we've been trying to work to consistency across the fleet and then it's about flexibility of deploying the aircraft to the right markets, that we've got the right mix that we kind of want for the market that we're seeing.

The 787 piece is then really around potentially new aircraft that are coming later on. We actually want to increase the size of the premium cabins and diminish the size of the economy cabins because we potential routes with more premium mix in them. So, I just want to be clear on the 777 refurb at NZD100 million and then future aircraft coming, future 787s coming in a different configuration from current.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Yes, so just to add to that, the 787 will run from what now is I think, 302 seats, and that will drop down to 275 seats and as Christopher mentioned, larger premium class. Of course, what that does, is then increase the range of the aircraft because I guess one way to look at the aircraft, they're very -- the first nine that we'll take are very tourist, sort of leisure focused, into those markets and then the next series that we'll configure actually, are a mix more of both business premium and pure leisure as well. But that will take them well into the interior into North America and things like that.

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**Jason Familton** - ***Accident Compensation Corporation - Analyst***

Okay, and just for clarify, that NZD100 million, how is that included in the slide pack on 21, the forecast Capex on aircraft? Is that included or excluded?

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

It is included.

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**Jason Familton** - ***Accident Compensation Corporation - Analyst***

Then thirdly, just on the Manilla services; when you announced that service, you talked about using the 767 on that route. Clearly, you're getting rid of that aircraft ahead of commencement. So, what are the plans there? Are you going to use a 787 now?

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Yes, what I'd say there is, so first of all, we've deferred Manilla because we -- for a number of reasons, but it's been deferred. What I would just say, just to correct that perception, is that every time we deployed a 787 into replace a 767 on every route that we do, it's a really good outcome for us. Much more superior aircraft economic. So, where 767s currently fly, that's where 787s will head.

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**Jason Familton** - ***Accident Compensation Corporation - Analyst***

Thanks guys, for your time.

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**Operator**

Thanks very much. There are no further questions at this time. I will now hand back over to Mr Luxon for any closing remarks.

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**Christopher Luxon** - ***Air New Zealand Limited - CEO***

Guys, I just want to say thank you very much for listening on the call. Thank you very much also for your support, the time and the interest that you've got around Air New Zealand. We really do appreciate it, and for any further questions, I just suggest that you contact our Investor Relations team and pick up any specifics that you may have or any further points of clarification, but again, thanks so much for your time this morning, I really appreciate it. Take care.