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PRESENTATION

Operator

Thank you for standing by, and welcome to Air New Zealand 2018 Interim Results Call. (Operator Instructions) And with that, I would now like to turn the call over to Air New Zealand's Head of Investor Relations, Leila Peters. Please go ahead.

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

Thank you, and good morning, everyone. Today's call is being recorded and will be accessible for future playback on our Investor Center website, which you can find at www.airnewzealand.co.nz/investor.

Also on the website, you can find our interim results presentation, financial report, media release and relevant stock exchange disclosures.

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

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

And with that, I'll turn the call over to Christopher.

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

Well, thank you, Leila. Kia Ora, and good morning, everyone, and thanks for joining us on the call. Before we begin, I'd just really like to take a moment to welcome and introduce our new CFO, Jeff McDowall. I'm sure many of you have gotten to know Jeff over the past few years, and some of you will meet him soon, I'm sure. But it really is awesome to have him now in the role of Chief Financial Officer. He's a highly commercial leader who's been with us at Air New Zealand now for 17 years and is already a tremendous value to our Executive team.

As I get into the result, I'm really pleased to report a very strong performance for the first 6 months of 2018. And before getting started, I would like to extend my deepest thanks to all of our staff for their professionalism in dealing with what has been a number of rather extreme operational events over the past few months.

We've had some unprecedented weather events of late, which sadly are becoming the new normal, along with the fuel pipeline disruption and the unscheduled maintenance on some of the Boeing 787s. And all of these events are outside of our control, but it's our people who have been absolutely remarkable, I think, in dealing with each issue with the focus of doing what's right and best for our customers. And it's their agility of that can do attitude and it's that resilience that, I think, is really setting us apart and drive such strong loyalty for our airline.

This morning, I'm going to give an update on what we are seeing in our market since we last reported in August, how that has tracked and what our view is for the rest of the year. Equally as important is revenue to our performance as the focus on cost, and we had good results in that area as well, which Jeff will discuss shortly. We'll also give an update on our capital program, key financial metrics and hedging. And finally, I'll provide some comments on the full year outlook before opening the call up for questions.

In the Appendix of the presentation, there are a number of slides that we will not be specifically speaking to, which provide key financial and operational details, and I do recommend that you take the time to review that information.

Now touching briefly on the financial highlights of the first 6 months. We recorded an interim result that continues to demonstrate the strength and resilience of our business, with operating revenue of $2.7 billion, an increase of 5.6%. Earnings before taxation was $323 million, a decline of 7.4%. However, if we back out the $22 million gain in the prior period related to the divestment of our remaining shares in Virgin Australia, the result would have been roughly the same. And as many of you know, during this period, we also experienced some disruption to our operations following a temporary shutdown of refining New Zealand's pipeline into Auckland. That's had a small impact on our earnings of approximately $5 million related to our insurance deductible, and if this is adjusted, our underlying result would have been slightly ahead of the prior period. As we've stated in December, the unscheduled engine maintenance with some of our Boeing 787-9 aircraft have not had a material impact on earnings this period.

Moving on, net profit after taxation was $232 million. And operating cash flow was extremely strong at $479 million, an increase of 27%.

Going deeper into the earnings before taxation, we had an extremely high-quality result after adjusting for the Virgin Australia gain, which I already discussed, as well as the $72 million impact from increased fuel prices. Looking at earnings on this comparable basis, we delivered a 27% increase, which was driven by a very strong revenue performance. At the same time, the business successfully dealt with some significant operational constraints, which I already mentioned. So overall, I am extremely proud of this result, and how it set us up for success for the rest of the year.

Moving on to the key drivers of the result, passenger revenue increased 6%, reflecting improved pricing dynamics as well as the stabilization of competition in some of our long-haul markets. Demand was up 2.7% on capacity growth of 3.4%, and RASK increased 2.5% overall. Similar to passenger revenues, our cargo business delivered positive yield and strong volumes, resulting in 10.7% increase in revenues. And supporting the positive growth in our revenue base was another very solid unit cost performance. As Jeff will expand on shortly, our unit cost increased 4% in the period driven solidly by fuel price increases of 18%. And if you exclude the impact of fuel prices, cost per ASK was flat as efficiencies achieved throughout the cost base offset the impact on inflation. As we discussed at our Investor Day last year, our target is to offset inflation, but in the next few years, we are aiming for mid-single-digit network growth on average. And that will help drive good economies of scale across our fixed cost base, and we are confident we will continue to achieve good CASK improvement.

Now I would like to spend some time unpacking our revenue performance. Overall, I'm very pleased with the positive RASK momentum we saw this period. Looking across all our markets, there are more revenue tailwinds than headwinds, and our team has been very focused on market development to continue generating demand as well as delivering pricing actions to recover the increasing cost our business faces.

As the chart on the left shows the positive improvement in the fourth quarter of last year continued into the first half of this year, and we were able to capitalize on short-haul demand, especially in markets where we enjoyed strong market share. This strength more than offset some of the softness we experienced with some of our long-haul markets, which I'll get into next.

The table on the right summarizes the RASK performance in our key markets during the period. And starting with the domestic network, which had the strongest growth in the period from a RASK perspective, we did see broad-based demand across both our jets and regional routes reflecting strength in inbound tourism as well as continued strength in the New Zealand economy. About 3/4 of that growth was driven by longer seat to flying to places like Queenstown and Dunedin. And additionally, we did not observe a slowdown in domestic demand during the election period, which historically has been the case.

The Trans-Tasman market saw a significant turnaround compared to the prior period, with revenue improvement outpacing the increase in capacity. And the key driver of the improvement was the rationalization of competitive capacity on the Auckland and Sydney route, which we were able to leverage due to our strong market share on the Tasman. Beyond the Sydney route, we also saw good demand for point-to-point traffic across our Tasman network as tourism between Australia and New Zealand continues to be strong at about 4%.

Turning to the Pacific Islands, which is a good performer for us based on the strong New Zealand outbound traffic. In the first half of the year, we saw positive RASK as we grew those routes by 11%, which was an excellent result.

Now moving on to the long-haul network. Each of our Asian markets had different dynamics this period. Shanghai and Hong Kong experienced some softness as we continue to let the entry of new competition from Chinese carriers, which commenced in November of 2016. As I mentioned back in August, our focus is to strategically develop the Japan market further with the launch of their Haneda service in July 2017. This new route resulted in significant capacity growth for the period and will be working to capture demand to match the capacity over the next 12 to 18 months. And lastly, our Singapore route experienced strong connecting traffic coming from India and Southeast Asia, which was more than offset by the impact of increased competition on traffic to and from Europe. Overall, our Asian routes saw a slight decline in RASK as a result of the various dynamics I just described.

And turning to the Americas and Europe, which experienced a minor decline in RASK in the period due to a mixed environment across these markets, we saw improvement in the Americas with the stabilization of competitor capacity in the U.S., and strong performance in our Vancouver and Buenos Aires routes drove positive RASK. Our London route, however, came under pressure due to increased competition on the transatlantic but continues to be a strong and profitable performer for us.

Now I'll turn it over to Jeff to go through the details of the results.

Jeff McDowall

Thanks very much, Christopher. Kia Ora, and good morning, everyone. This is my first results call as Chief Financial Officer and has to say I feel really privileged to be in this role at such an exciting time.

Now I'd like to walk through the key movements, which affected our performance during the period. To better understand the dynamics of each components, we've isolated the impact of foreign exchange.

Starting with revenue. There was an increase of $157 million, which is driven by improvement across the board. Capacity growth of $70 million and passenger RASK improvement of $64 million were also boosted by $23 million contribution from cargo and other revenue.

Labor cost increased by $12 million due to a combination of activity from capacity growth and rate increases, which were partially offset by improved productivity. On capacity growth of 3.4%, our total labor cost increased by only 1.9%, and our headcount increased by less than 0.5 percentage point, which is an excellent result.

Fuel cost increased $79 million or 20%. The average price of fuel increased by 18% or $72 million. Increased fuel consumption also impacted the fuel spend, with volume up 1.8% or $7 million. This reflects capacity growth, which was partially offset by fleet efficiencies.

Maintenance, aircraft operations and passenger service costs increased by $44 million. Approximately half of this was associated with the additional capacity. Maintenance expenditure increases were driven by high engine costs and fleet growth. As we have communicated in prior results calls, maintenance cost can be lumpy and do not follow a linear relationship to capacity growth in the same way as some of our other variable cost items.

Sales, marketing and other expenses increased by $7 million related to increased Loyalty Programme activity, commission volumes and property costs, which were partially offset by lower advertising costs.

Ownership costs increased by $11 million, driven by increased depreciation from new aircraft, higher digital investment and lounge refurbishments.

Share of Associates consist of earnings from our investment in the Christchurch Engine Centre, which increased $5 million due to an increased volume of engine work compared with the prior period.

The impact of foreign exchange rate changes on the revenue and cost base in the period resulted in a nonfavorable foreign exchange movement of $18 million. After taking into account of $5 million improvement in hedging, overall foreign exchange had a net $13 million negative impact on the growth results.

Lastly, a decrease of $22 million was related to a prior period gain from the divestment of Virgin Australia. The net result of all these movements is an incremental decrease in earnings before taxation of $26 million.

Going a bit deeper into our operating costs. Reported CASK increased 4%, which includes the impact of an 18% increase in fuel price. When looking at underlying CASK adjusted for the impact of fuel, our unit cost performance was flat as $33 million of cost efficiencies related to the benefits of fleet simplification, economies of scale and other cost-saving initiatives offset the impact of inflation. Foreign exchange did not have an impact on CASK during the period.

As Christopher mentioned earlier, our CASK performance is impacted by the pace at which we grow the business. For those of you who heard our last Investor Day presentation, what that means is that as we grow capacity in the mid-single digit range, we not only start to offset our inflationary costs but we also get good economies of scale across the fixed costs in our business. Therefore, as we look forward to the rest of this year and we ramp up our growth in certain markets, you can expect to see a better pace of CASK improvement for the full year.

Turning to cargo, which also delivered strong revenue improvement in this period. Cargo revenue increased 10.7%, driven by very strong volume growth of 9% as well as yield growth of 1.7%. The volume growth was driven by improved flights on the Tasman and Pacific Island routes, the commencement of our Haneda service and improved run rate conditions at the Los Angeles airport. We've also delivered good yield growth, driven by improved product mix.

We generated significant operating cash flows of $479 million in this period, which is an increase of 27%. The increase reflected strong cash operating earnings and an increase in working capital cash flow. Additionally, in the period, we had lower provisional tax payments related to a transitional tax change on the treatment of engine maintenance. The reduction in cash taxes reflects a catch-up as our legislative tax role change went into effect. We ended the period with net cash on hand of $1.3 billion, a decrease of $29 million compared to the balance of the end of the last financial year.

I'd like to briefly now discuss our view on liquidity, which reflects an update to what has previously been communicated to our shareholders. Historically, we've targeted liquidity to be in the range of $1 billion to $1.5 billion. This equated to ratio of approximately 20% to 30%, and that ratio included restricted cash. This level is higher than our operations require but was viewed as prudent while we hold an equity investment in Virgin Australia. With the sale of that remaining investment and the review of our liquidity requirement, the board has approved a new target range of $700 million to $1 billion. We will transition to this new level over time. Currently, our plan to start reducing the cash level will be primarily through the purchasing of aircraft. While that will not have any impact on our gearing as the net debt level will stay the same, it will increase the proportion of our unencumbered aircraft. Finally, the way we characterize our liquidity ratio will be slightly amended going forward as it will exclude restricted cash. The new ratio will approximately equate to 14% to 20%. This will be reflected when we report our annual results for the year in August.

Our gearing at the end of the period was 52.4%, a small increase of 0.6 percentage points from last June. This increase was due to the purchase of new aircraft and is well within our target range of 45% to 55%.

We continue to maintain the credit rating of BAA2 from Moody's with a stable outlook, which places us amongst the highest-rated airlines globally.

As a result of a positive medium-term outlook, the airline's financial strength and the capital commitments we have over the next few years, as well as the current trading environment, the board was pleased to announce a fully imputed interim dividend of $0.11 per share, which is a 10% increase from the prior period and represents the highest ordinary interim dividend in the company's history.

Moving on to our fleet update. During the first half of 2018, we received delivery of 2 newly configured Dreamliners and 2 ATR turboprops. On the chart on Slide 15, you can see the phasing of our forecast aircraft capital expenditures through to 2021, which totals approximately $1.1 billion. This figure does not include any assumptions on CapEx related to the Boeing 777-200 replacement program as the aircraft selection is currently in progress.

Just touching briefly on operating leases. We are in the final stages of confirming a new lease agreement for an additional Boeing 787-9 aircraft, which will join the fleet in the 2020 financial

year. This is reflected in the table at the bottom of the slide and will bring the total 787 fleet to 14. With the addition of this wide-body aircraft, we will have a sufficient number of fleet to deliver on our target of mid-single digit capacity growth across our long-haul network until we enter into the Boeing 777-200 replacement, which will start from around 2022.

Many of you would have read about the issues we faced in December last year with the Rolls-Royce Trent 1000 engines on our Boeing 787-9 aircraft. We have had several aircraft undergoing unplanned maintenance over the summer as a result of those issues, and unfortunately, our customers were impacted by disruptions to our services. While I cannot comment on that commercial arrangements, I will say that we've been working closely with Rolls-Royce and are very satisfied with their responsiveness to the issue. This new generation aircraft is a key enabler for Air New Zealand both in opening new routes and in competing on our existing routes. From a commercial and customer perspective, we're extremely happy with the performance of the Dreamliner.

Turning finally to fuel and our outlook for the remainder of the year based on our hedging profile. To be hopeful, we've provided an outlook of estimated fuel costs for the second half of the year with an assumption of average jet fuel at USD 75 a barrel. Based on the makeup of our hedges, we've also had provided an approximation of how moves, up or down, in the fuel price would impact our fuel cost for the second half of the year. The hedges that we do have are all on the money, therefore the variations that you see in the chart reflects the impact of fuel price on our unhedged volumes. At USD 75 for jet fuel per barrel, our fuel cost in the second half will be approximately NZD 505 million, which will bring our full year fuel cost to around NZD 975 million. As Christopher mentioned earlier, we will continue to drive price actions to offset the increased cost related to the current fuel price environment.

Now let me turn the call back to Christopher to discuss the outlook for the rest of the year.

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

Well thanks, Jeff, and turning to Slide 18. I'll briefly provide our view of current market dynamics for the remainder of this year.

Looking at our short-haul markets, we continue to see really good underlying demand across the domestic, Trans-Tasman and Pacific Islands. On domestic routes, the strong economic climate and continued tourism growth are expected to drive continued demand for travel on the trunk and regional routes. And we are confident that with our market share, our Loyalty Programme and our unmatched network, we will capture more than our fair share of that growth. Capacity increases on the domestic jet routes in the second half will be driven by additional services to Queenstown as well as Christchurch and Dunedin.

Now on the regional network, we are starting to really see the benefits of the investments we have made over the past 3 years in terms of larger aircraft and increased marketing and sponsorship we have undertaken to help promote the regions. While we saw our competitor reduced capacity over the peak summer season, we continue to see opportunity to grow further. We're targeting approximately 7% growth on our regional network in the second half. And in the second half, we will still expect year-on-year improvement on RASK, albeit at slightly lower levels than we saw in the first half due to the increased capacity growth.

Now moving to the Pacific Islands, which we considered to be an extension of our domestic market and is proven to be an incredibly popular destination for Kiwis. We had updated several of these destinations to the Boeing 787s and increased frequency on a number of routes, resulting in 11% capacity growth in the first half, which was very closely matched by 10% demand growth. That is a truly phenomenal result. And in the second half of the year, we'll be ramping up capacity in the off-peak season, which gives us good utilization of our aircraft. Much of this growth will be driven by increased frequency to Honolulu, which continues to be a very popular destination for New Zealanders. And another key contributor to the capacity growth is increasing wide-body flying to Samoa, reflecting the increasing customer demand as we continue to develop that market as well. As a result of this considerable growth going into Pacific Islands, we expect to see some softness in RASK, which will impact short-haul in the second half, but this is all very profitable flying.

Shifting to the Trans-Tasman market, we expect the improved revenue dynamics we saw in the first half to continue as we progress through the remainder of the year. The rationalization and competitive capacity that we saw on the Auckland-Sydney route in July will expand to include net capacity reductions from Auckland to Melbourne and Brisbane beginning next month. We have increased our frequency on these routes, which are performing well and are generating good revenue growth. And also increasing our wide-body capacity on Adelaide is also generating solid demand, particularly for the premium cabins.

Now turning to international long-haul. We expect to see higher revenue growth on a full year basis, supported by strength in the Americas markets. Turning first to North America, we expect stabilization of the U.S. market and strength in Vancouver to deliver good revenue growth in the second half of this year. In December, we began flying our newly configured moving 787-9 aircraft with increased premium seat on our Houston route. We also announced increases for our Vancouver route with the extension of our peak season as well as additional frequencies during the shoulder season. Customer demand for both routes continues to be very strong.

Buenos Aires continues to perform very well as our South American sales region continues to deliver double-digit revenue growth as market development activities gain traction, with added services are the summer and shoulder season to support this increasing demand. And this route has also benefited from our Better Way to Fly campaign, which is focused on targeting Australians traveling via Auckland for long-haul trips to both North and South America.

Now turning to Asia, the capacity growth for this year remains focused on Japan with the launch of our Haneda service into Tokyo. As I said back in August, we are strategically growing the Japan market and recognize that it will take some time for demand to grow into the capacity growth. In the second half of the year, our Haneda services seem to benefit from improved flight timings, which are generating improved demand, so we do expect a stronger performance relative to the first half. Our Shanghai and Hong Kong routes are seeing improvement as we let the competitive capacity that entered the market last year. And our Singapore route is performing well, particularly with traffic to and from Southeast Asia or India. You would have seen our announcement earlier this year that we will commence a third daily service in October 2018, which will be the first schedule jointly operated by ourselves and our airlines partners, Singapore Airlines. This third flight will enable our alliance to be a larger player in the fast-growing Southeast Asian markets. And finally, while it won't impact 2018, we are nonetheless very excited today to announce a new direct service to Taipei commencing in November of this year. New Zealand saw approximately 36,000 visitors arrived from Taiwan last year who currently utilized indirect options to get here, and we feel that this direct route will encourage even more tourism growth. This route serves to further grow and diversify our Asian network, which is a critical part of our Pacific Rim growth strategy.

So overall, we're looking across our international markets. The Americas are doing better. Europe continues to be challenging, and Japan capacity will drive some RASK pressure across Asia with the rest of that region showing good signs of stabilization.

Moving on to Slide 20, we've provided a breakdown of our estimated capacity plans for the second half and full year. I think the chart is really straightforward, but it does show that we will be ramping up our capacity in the second half compared to the first half but still right within the range that we communicated to you back in August. We anticipate capacity growth of approximately 8% in the second half, which would result in about 5% growth at the group level for the full year, and I will highlight again that this capital-efficient growth with improved utilization of our existing aircraft is all profitable.

Turning now to the outlook for the year. As we look forward to the remainder of the year, we are optimistic about the overall market dynamics and are focused on executing the plan we laid out for you in August. Based on current market conditions and despite the increased price of jet fuel, we are still expecting 2018 earnings before taxation to exceed the prior year.

I got to say thank you for listening. And now operator, please open the line up for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Andrew Bowley from Forsyth Barr.

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

I've got a couple of questions. The first 1 maybe -- congratulations on offsetting those fuel costs.

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

Thank you.

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

So first question on revenue, second question on costs. You provided some helpful comments around the RASK directions, for the next 6 months in each of the respective sectors there. But can we just step back? And I recognize you've given a fair bit of kind of granular detail around your expectations on a kind of a market-by-market basis. But stepping back in terms of the broader competitive backdrop, you're accelerating capacity growth through the second half. We've seen a general slowdown over the last couple of years in terms of competitive behavior, but now we're starting to see some competitors increased capacity. Where do you see the market generally? And how do you see it playing out over the next 12 months or so?

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

Yes, well, I mean the first thing, Andy, as we look out for the rest of the year is that we've got tremendous visibility over the cost side of the equation, right? So we have 70% hedged for the next 6 months out to the end of the year. Our cost control initiatives are improving well. We know that we'll see some improvement in CASK as result of the growth from the capacity that we've got on the top line. So tremendous clarity on the cost side. And to be honest, as we go through the revenue side, fairly decent visibility on revenue as well because we've had a very good peak summer season, and we're obviously running the shot clock out towards the end of the year. So -- and we've got good visibility. So all those come down to more upside on the revenue side and how well we can execute between now and the end of the year to impact enhancing profitability. So where we are there is that, yes, you're right, we are putting a lot of capacity into the second half, almost 8% across the whole of the network. But we're doing it in really places where we have real strength and that we are confident that we can drive profitable growth, maximize revenue, maximize profitability. So if you take domestic New Zealand, it's incredibly strong, the underlying economics here in New Zealand. We've got big trunk growth on Queenstown and even Christchurch. We've got good regional growth across New Zealand as well. I think almost 6%, 7% there as well to places like Napier and Nelson. So those are logical places for us to back ourselves to be able to get closer revenue matching capacity as possible. Tasman-PI, been a big success for us this year. We put double-digit capacity and then had double-digit revenue growth, and the same thing is happening in the second half as we sort of do up-gauges. We certainly got -- on the Tasman, we've got a lot of list competitive dynamics happening there. Pacific Islands, obviously, there's big investment and building out Honolulu up here and some other places as well. So net-net, if you talk to me a year ago as you will remember, we were dealing with unprecedented levels of competition coming into the market. There will still be people coming in and out of the market, but Air New Zealand has proven that we can compete with much larger, more resourced airlines pretty well. And I think in general, it's been quite rational behavior in all the market sales that we operate within. In regional New Zealand, we've seen our competitor pulled back here. In the -- across the Tasman, you've seen one of our competitors come off completely. You've seen the American carriers pulled back their services here. We've even seen some targeted, more rational behavior from the Chinese carriers and the Middle Eastern carriers starting to get more that way.

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

Great. And then the second question probably more in Jeff's camp here in the context of costs. And you referenced there, Christopher, that you've got a lot of clarity on costs for the second half. Can I just ask the question around Jeff's comment around CASK improving through, or at least the rate of improvement improving through the year? There's a bit of lumpiness, I guess, in the cost base to some extent, and maintenance cost is a key component to that some -- at least through the first half and second half split in fiscal '17. How should we be thinking about that CASK in the second half? Is it a sequential improvement on the first half? Or is it really just an improvement against the prior year?

Jeff McDowall

I guess the big thing, Andy, in the second half is that our capacity growth is quite a bit higher, 3.5% in the first half and around 8% in the second half. So the economies of scale that we expect that to deliver will be -- well, you'll see flying through in the overall CASK number, and that's kind of in line with the change in the picture that we talked about at the Investor Day back in June. So we expect to see quite significant -- quite a lot stronger efficiencies in the second half as a consequence of that.

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

But relative to first half or relative to second half last year?

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

Well, relative to the second half last year, but also a stronger rate of efficiency improvement than you saw in the first half.

Operator

Your next question comes from Andrew Steele from First NZ capital.

Andrew Steele - *First NZ Capital Limited, Research Division - VP of Equity Research*

I guess just to start with on cargo, the strong results from the first half, and pleasing to see ongoing sequential yield improvement. I was wondering if you could provide color how you're thinking about both cargo, volumes and yields going into the second half.

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

Yes. So, Andrew, what we're sort of seeing is sort of overall very strong dynamics, which actually are quite aligned with what we're seeing in the global cargo market, which has been strengthening over the year, and it's actually strong demand obviously for auto manufacturing goods globally. So we -- the cargo growth is actually -- as you say, is a real highlight because the guys have worked incredibly hard to make sure that we can participate in that global growth. We've done that pretty well. We've also seen really good strong domestic performance. So if I think about regional markets like Nelson, for example, we take a lot of salmon out of Nelson and (inaudible) around the world. We've been able better support that cargo capacity with ATRs as we've increased our regional capacity and made that big $600 million investment in those new aircraft. So yes, I mean, going forward, Andrew, I think we'll see positive dynamics underpinning cargo, which is really good.

Andrew Steele - *First NZ Capital Limited, Research Division - VP of Equity Research*

Okay. Great. And just in terms of, I guess, on the specific cost lines and in terms of, say, maintenance on per ASK basis. How should we be thinking about that moving first half into second half? Is there any sort of particular maintenance phase we should aware of? And just how we -- should I think about that in terms of year-on-year for the second half?

Jeff McDowall

Andrew, the trend will be similar in the second half as you saw in the first half. The first half was up a bit over last year, much of which relates to the A320 engine maintenance, but the broad trend will be similar as we get through the second half of the year. There will be -- as also talking to Andy about, the current scale we see in the second half will mean that the -- that would deliver better efficiency to offset that.

Operator

Your next question comes from Owen Bill (sic) [Owen Birrell] from Goldman Sachs.

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

Just a couple of questions for me. Firstly, just looking at the Trans-Tasman. Can you give us a sense of where do you expect any sort of major change in competition with the Qantas-Emirates partnership being approved?

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

Short answer, no. Obviously, the Tasman dynamics have actually improved when the competitor ex out of Auckland, Sydney and Melbourne, Brisbane. So there has been some capacity -- rational capacity reductions on the Tasman. And as you know, it's a pretty tough battle to Tasman over the last 7 years. Actually, we've got it through the history of it. But no, I don't see any change to that.

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

Excellent. And just on the domestic side -- I'm sorry, the international inbound. Has there been any noticeable disruption to, I guess, the inbound from the tourist tax coming in?

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

No. So we don't -- we actually haven't had a new tourist tax conversation in New Zealand about that ongoing there, but nothing has actually been implemented. But no, tourism -- inbound tourism still remains very strong. It's grown at about 7% for the last 12 months. And at the same time, what's been great is we've got Kiwis going abroad into the tune of -- they have grown about 9% in the last year as well. So no, I mean, we still continue to see a very good inbound tourism growth, and we're importantly seeing Kiwis going abroad. So we feel fundamentally pretty confident about the state of the economy and the underlying structural demand, which is good.

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

And just final one for me for probably Jeff, just in terms of your fuel hedging strategy. I'm guessing there's no change to the way that you guys have been hedging historically under you, Jeff. Or are you looking to potentially take a bit more of an active position in fuel pricing going forward?

Jeff McDowall

Short answer is no. I think we've got a approach which -- and now gives us time -- it's designed through on giving us time to adjust rather than taking a position on the particular direction that the fuel will go. As we look at the first half of FY '19, we hedged pretty much being in the middle of our policy range, which has essentially crept up a bit from the pack that you have. It was 50% last week. And the report date is now a little bit higher for the first quarter but pretty much right in the middle of our range.

Operator

Your next question comes from Wade Gardiner from Craigs Investment Partners.

Wade Gardiner - *Deutsche Bank AG, Research Division - Research Analyst*

Just looking at the -- some of the Appendixes. Can you give a bit of guidance around your FX exposure? You've hedged -- you've provided some numbers there. What's the policy? Sorry, what's the total net exposure? And where do you sit relative to policy and the strategy? That's the first question.

Jeff McDowall

As with fuel, pretty much in the middle of our strategy at the moment. The net -- it's a bit of a long story (inaudible). The net outbound exposure to the U.S. dollar is $600 million, I think. So net shorts by about that amount. So if there is a unilateral move in the U.S. dollar, U.S. dollar gets weaker. Our costs get lower, and so net were a beneficiary from that. If -- but if it's a unilateral movement in New Zealand dollar, it's a bit more of a nuanced story because our revenue currencies can offset the impact of our costs imposed by the New Zealand dollar getting weaker.

Wade Gardiner - *Deutsche Bank AG, Research Division - Research Analyst*

So that's $600 million per half or per year?

Jeff McDowall

Per year.

Wade Gardiner - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. Next question. Just in terms of what Emirates came out with the other day in terms of their Bali services that they're going to put on. Any thoughts here as to how that's going to impact you? Did you have plans to increase at greater than 3 days a week? Or...

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

Look, I think it's still early days for us to work that through a model. The implications of that actually are very small part of our network. Not sure what the Kiwis want to go to emphasize (inaudible) Dubai, Rome in terms of European traffic. But we'll have worked -- to work our way through that. But yes, look, I mean, no, we haven't thought just about in a -- pretty small in the scheme of things.

Wade Gardiner - *Deutsche Bank AG, Research Division - Research Analyst*

And finally -- apologies if you did mention this. But with the engine issues on the 787s, can you give bit of colors to when you're expecting that to be resolved and then to return to service?

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

I think that'll be early mid-April, Wade. We've made great progress on that. We do have a great relationship with Rolls-Royce. We've been able to -- we've got very high levels of technical capability relative to other airlines, and I think we've done -- absolutely a brilliant job on working our way through that. And we'll be, I think, in great shape coming early mid-April.

Operator

Your next question comes from Marcus Curley from UBS Investment Bank.

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

Just a few. Just starting with staff, I suppose it's a pretty impressive result in terms of staff numbers in the half. You're effectively flat against all that capacity growth or some capacity growth. Can you talk a little bit about the direction of staff numbers? And then also, secondly, yes, we're hearing rumors around, I suppose, unions building up ahead of steam in terms of much greater settlement claims next time around. I just wondered whether you can talk to that at all.

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

Yes, I think, Marcus, Jeff can probably jump with more detail. But bottom line, we're expecting labor cost to grow at a slow rate than capacity. That's natural as a business as got growth at the heart of it, which has been -- what you've been seeing in those numbers. Based on our guidance sort of going forward, we actually expect very little to change relative to what we've seen in this first half. I'd say actually our union partners, we worked incredibly hard as -- I know we've tried to explain this before, but we have worked incredibly hard with our unions, and we're finding them really, really great to work with. We've been able to do most of our settling around 2%, and that's been really great. So there's a very good spirit of partnership. We call that high-performance engagement. We are talking -- a lot of other corporates are looking at what we're doing there as we try and strategically partner with union, and it's been working really well. So I'm really proud about the labor position, and -- but more importantly, just way our people have responded from the tough stuff these last 6 months.

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

And, Christopher, just in terms of timing there. Is -- I know you probably got regular renews on this. But would you -- when is the next big taste of that relationship in terms of rollover contracts on the union side?

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

Yes, I mean, we have about 42, I think, different industrial contracts. And obviously, we have -- close to 75% of the staff are unionized. So to be honest, Marcus, it's just constant rolling thunder in terms of -- last week, we ratified our deal with all our cabin crew in London. A few weeks earlier, we ratified regional pilot deals at the announcement (inaudible). We just roll through. This is just normal for us. But there's no big set piece that -- we just -- it's just how we do business. It's sort of 365-day implement relations, really.

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

Okay. Secondly, I just -- obviously, you mentioned your new routes still being profitable. Can you just talk a little bit about Tapei on that basis? I suppose, first and foremost, frequency and support structures to ensure that, that is the case. Obviously, making new routes profitable (inaudible) jet fuel is obviously quite a big hurdle.

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

Yes, I mean, Taipei is something we've eventually looked at over the last year. We think it's a really good way of deepening up our position in Asia. It's quite good because there's 36,000 visitors that come in from Taiwan each year to New Zealand, and there is a very big Taiwanese community here that does a lot of visiting friends and relative as well as some commercial ties to Taiwan. So from an inbound/outbound point of view, it actually is quite attractive. It's also a very wealthy if you think about it more like Tokyo, and we actually think that it went well. So it's an 11-hour flight. We're going 4 to 5 times per week. And I think it's going to be really quite successful. And I think from an outbound New Zealand perspective, a lot to do there, right? I mean, a great city, awesome food, great night life, great national parks, and we've obviously got the Dreamliners on the route. Yes, we just go about the new markets. As I said, we look at a range of new markets every quarter. And this one, we've done all the analysis for and want to launch it like we do Buenos Aires and Houston and set it up for success.

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

Is it a year-round daily service?

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

Yes, it is. Yes, it is.

Jeff McDowall

Year-round that have 4 to 5 a week, Marcus.

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

Okay. And have you got any alliance partners associated with it?

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

Yes, so we have with EVA, who is obviously a very strong star partner in Taiwan as well. But not a deep alliance share, but obviously, a very strong star partner.

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

But would you think about that on this route? Or is it not the way to be considering that?

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

There is no reason to look at a revenue share or a deep alliance in that regard because you obviously don't have 2 airlines flying the same route so -- where they can work together at both ends. But it's just -- it really will -- I mean EVA is a great star partner, a good friend of ours through star, and that went well.

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

Marcus, it's Leila. It's similar to Japan where we worked closely with ANA, but we're the only direct -- we're the only carrier flying direct between Tokyo and Osaka and Auckland, so no need for the revenue JV.

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

Sure. Okay. And then just finally, just with regard to aircraft orders. Obviously, flagged an extra 787. Could you talk a little bit about 2021? Obviously, there's nothing in there at the moment. At what point is it -- is that locked down? I'm not quite sure what the lead time is on new aircraft at the moment. But I just wanted to get some sort of clarity about the scope for 2021 just to actually see aircraft orders.

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

Yes, Marcus, for the -- with the 14 787 in the fleet, and that will give us the capacity that we need to grow at the range we indicated back in June, that sort of 5% to 7 range right until 2022. So yes, we may -- if market conditions support it, we may be able to grow faster than that if the opportunity emerges. But for that approach, the 14 aircraft will get us there. The narrow-body fleet may need some unit growth as we grow that faster, but that had a shorter lead time.

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

And if you're going add aircraft orders, what sort of a lead time that you need to provide at the moment for short-haul aircraft?

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

At least a year. But typically, typically it's 2 years.

Operator

Your next question comes from Nick Mar from Macquarie.

Nick Mar - *Macquarie Research - Analyst*

Much of the questions have been covered. I guess just at a very high level. How do you guys think about the business and the ROIC through the levers like pricing power and kind of cost control as you move through the kind of different fuel environments?

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

Well, I think as you've seen over the last few years, there's a lot -- we've become quite adept at adjusting the business to a pretty wide range of commercial circumstances whether it's been fuel price or competition. So it's hard to be prescriptive about how we had pulled set levers at certain circumstances, but we're really confident in our ability to adjust whether it's with capacity, whether it's with price, whether it's with the way we execute the business, whether it's operationally to a wide range of circumstances. So yes, we continue to hold to the ROIC position that we described to you back in June.

Nick Mar - *Macquarie Research - Analyst*

And I guess just on that for kind of the FY '19 if you are looking closer to $80 a barrel of fuel -- I'm sorry, for jet fuel? How do you guys kind of think about that and feel about the ability to just maintain that through that environment?

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

Yes, good question. We always -- someone always try to ask us the guidance on FY '19 at this point in the year. So I mean, like I say, we -- fuel would be a headwind at that kind of cost. It has come back a little bit since it was $80, but we're really focused on executing '18 at the moment as we start the pending process for '19. We'll again be looking to the levers that we have to adapt to that sort of environment. Fuel will be what it will be. The important thing is that we are really nimble and adept to adjusting to this.

Operator

That does conclude our question-and-answer component of today's presentation. I'll now hand back to Mr. Luxon for closing remarks.

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

Well, listen, guys, can I just say thank you to everyone for listening in on the call and just investing your time and interest in our story at Air New Zealand. As per normal, I just would encourage any of you to schedule a call or a meeting or any follow-up questions you might have, please direct them straight through to Leila and the Investor Relations team. And again, thanks again for your support. Really do appreciate it. And operator, with that, conclude the call.

Operator

Thank you. That does conclude our conference for today. Thank you for participating. You may now disconnect.
