A STAR ALLIANCE MEMBER

AIR NEW ZEALAND

ANNUAL

SHAREHOLDER REVIEW

2016

A record result

Air New Zealand's earnings before other significant items and taxation[1] for the 2016 financial year were $806 million, compared to $474 million in the prior year. Earnings before taxation were $663 million. Net profit after taxation was $463 million, an increase of 42 percent. Operating cash flow was robust at $1.1 billion.

2016 was a busy and exciting year for us, with capacity growth of 12 percent across our network. The international network has played a pivotal role in this growth, and this year we saw the launch of three new international services – Houston, Buenos Aires and Ho Chi Minh City. During the year we also entered into two new revenue share alliances with Air China and United Airlines that cover all services to China and the United States, respectively – an important step as these countries represent the second and third largest tourism markets for New Zealand.

Air New Zealand is not alone in the launch of new services, and we are experiencing increased competitive pressure from international carriers. We believe that additional services can be beneficial to New Zealand when the demand is there and when tourism service providers and tourism bodies work well together to grow markets. With the investments we have made over the past four years into such areas as the fleet, upgraded lounges, airport kiosks and our high levels of service, we are in a great position to compete.

In June 2016 we sold a 19.98 percent stake in Virgin Australia to Nanshan Group, a privately-owned Chinese conglomerate with interests across a diverse range of industries. Air New Zealand continues to hold a 2.5 percent stake in Virgin Australia and we will look to sell our remaining shareholding in due course.

The company's balance sheet remains very strong with 48.6 percent gearing and liquidity at $1.6 billion. Our investment grade credit rating of Baa2 remains stable and is among the highest in the airline industry.

However, we recognise there will be pressure on earnings in the short-term as the market adjusts to the new competitive environment. We have a proven record of adapting our business to perform well across a variety of trading conditions and the current environment is no different. Our people continue to be core to our success and we are proud to have a highly engaged and motivated team who are willing to go the extra distance to provide a world-class travel experience for our customers. As a result of the superior commercial results achieved this year, the Board has again awarded a Company Performance Bonus.

Our strategy of a simplified and modern fleet continues to provide benefits to our network, our customers and our cost structure. The growth in our network is delivering significant efficiencies to our airline. In this coming year we will exit the Boeing 767 fleet, replacing these with the modern Boeing 787-9 aircraft. Over the next five years we plan to invest approximately $2.1 billion in new aircraft.

In May 2016 we were pleased to reach closure of a long-standing US class action cargo compensation claim. Despite a settlement of US$35 million, Air New Zealand has not admitted to or been found to have committed any wrongdoing related to the allegations.

The Board is pleased to declare a fully imputed final dividend of 10.0 cents per share. This delivers a total dividend for the 2016 financial year of 20.0 cents per share, an increase of 25 percent from the prior year.

In addition, the Board has declared a fully imputed special dividend of 25.0 cents per share following the sale of the Virgin Australia shareholding and a review of our capital structure, gearing and liquidity.

In May we welcomed Dame Therese Walsh to the Board. Dame Therese brings considerable management and governance experience, developed in both the public and private sectors. Her involvement in major international sporting and tourism events underline her commitment to New Zealand and the tourism industry. She will be a valuable addition to our team.

We look forward to the year ahead – it will be challenging, but our business has never been in a better position to compete.

Tony Carter
Chairman

Left to right: Tony Carter (Chairman), Christopher Luxon (CEO), Rob Jager, Linda Jenkinson, Jonathan Mason, Jan Dawson (Deputy Chair), Paul Bingham and Dame Therese Walsh.

[1]Refer to the Financial Commentary on page 18.

Q&A with our CEO

Chief Executive Officer Christopher Luxon discusses key questions on Air New Zealand's performance and priorities for the future

Q. 2016 was a record year for the airline, both in terms of network growth and profitability – what achievements are you most proud of?

A. This was a huge year of growth for our airline. We launched three new international routes – Houston, Buenos Aires and Ho Chi Minh City, contributing to 16 percent growth in our long-haul international network. Growth is energising and it has been exciting for the company to be back on a strong growth trajectory.

Even more exciting has been the progress we have made with our customers, with record levels of satisfaction across the board – from our Airpoints™ programme, the check in process at our redesigned kiosks, our upgraded lounges, improving the inflight experience through new and refurbished fleet and enhancing our inflight cuisine and wine experience.

However, this strong connection with our customers is really due to our people, and their willingness to go above and beyond on a daily basis. We quite simply have the best people working at Air New Zealand. I'm especially proud that we keep improving our culture, which was reflected in this year's employee engagement survey results, placing us in the top quartile of Asia Pacific companies that measure employee engagement.

Finally, we recognise the important role we play in connecting New Zealand and New Zealanders with each other and the world, and we appreciate the trust and confidence that our customers place in us. Maintaining our strong brand is critical to our ongoing success, and I'm thrilled that Air New Zealand was again named by the Colmar Brunton Corporate Reputation Index as having the #1 corporate reputation in New Zealand for the second year in a row.

Q. What trends do you see driving change in the airline industry and at Air New Zealand?

A. I believe there are two significant global trends that are shaping our business. The first is the exponential growth in digitisation which is disrupting whole industries – Uber has become the largest taxi company in the world without owning any cars and Facebook has arguably become the biggest media company in the world with user generated content. Adjacent to digitisation is the trend towards increased personalisation. Customers want an offering that is relevant to them. Our challenge is how to deliver a personalised experience when we have 15 million separate customer journeys!

To help address these two trends, this year we have created a new Digital function to ensure through our data and analytics we are better able to understand the needs of an individual customer and develop more customised products and services going forward.

Q. How will the increased competition impact Air New Zealand in the short-term?

A. Competition has increased because the outlook for tourism demand to our country remains very strong. Additionally, the lower fuel prices mean that New Zealand is more viable as a long-haul destination. This bodes very well for our business over the medium and long-term, but it will put pressure on our earnings as the market adjusts to the increases in capacity.

We have a long history at Air New Zealand of adapting quickly and responding appropriately to changes in the market, and now is no different. One of the important short-term levers we have available is capacity management, and the flexibility to adjust short-haul and long-haul routes if demand levels are not keeping pace with supply. We have begun exiting our remaining Boeing 767 fleet and will continue to focus on achieving greater efficiencies from our simplified fleet structure and across our business, which will partially ease some of the pressure on earnings.

What we do know is that while other airlines come and go from New Zealand, we've been here 76 years in the good times and the bad times, and we'll be here for another 76 years too!

Q. Can you discuss how the introduction of the Health and Safety at Work Act earlier this year is impacting the airline?

A. Our goal is to be a world-class company, and that has included having a world-class safety culture which will always be an inherent value in the company. Anything that strengthens the safety of people in New Zealand and at Air New Zealand will have a positive influence on the business. I am excited about the progress being made within our business to encourage a mindfulness among our people that results in 'safety as a shared value.' By building an organisation that lives and breathes safety in their everyday thinking, we can reduce the likelihood of harmful incidents while at work and create an even more collaborative and congenial culture.

Q. Can you discuss the airline's strategy for leveraging the strong tourism traffic into New Zealand?

A. Tourism to New Zealand continues to grow strongly, with visitor growth up 11 percent this year. We take a very active role in supporting the growth of tourism to New Zealand, which is focused on three main areas.

The first is ensuring that the value of tourism and the average tourist spend increases at a faster pace than the volume of tourists arriving. That is happening, as we are focusing on attracting more free independent travellers who are interested in spending more time in New Zealand, flying to different regional centres to enjoy the variety of experiences our country has to offer.

Secondly, Air New Zealand has also been working hard with key regional stakeholders to encourage increased travel into our regional centres. We want to see tourists and the benefits of tourism dispersed across all of New Zealand. We will continue to engage and collaborate with local councils, chambers of commerce, airports and other regional stakeholders to ensure that each region has compelling tourist propositions to offer visitors. We also continue to invest in turboprop aircraft, resulting in approximately 250,000 additional seats on our regional network alone in 2016. This year we also made some adjustments to our domestic schedule to ensure better international connectivity into our regional centres, and vice versa.

And finally, in partnership with Tourism New Zealand, we're improving our marketing and promotion of New Zealand in the shoulder seasons. We sponsor events that encourage more visitors outside of the peak season. For example, at the second annual Air New Zealand Queenstown Marathon which was held in November 2015, 14 percent of the participants came from overseas. Tourism has increased during our traditional shoulder season, which is encouraging and illustrative of how we can work smarter to maximise the benefit of tourism not only for Air New Zealand, but for New Zealand as well.

Q. Why did you exit most of your investment in Virgin Australia in 2016 and how does this impact the trans-Tasman alliance going forward?

A. While we are supportive of the transformation that Virgin Australia has undertaken over the past five years as it has evolved from a low cost carrier to a diversified airline group, Air New Zealand sought to exit our equity position in the first half of 2016 so that we could focus on our own growth opportunities.

(Continued over page)

Regarding our alliance with Virgin Australia on the Tasman, the short answer is that nothing will change. Our shareholding in Virgin Australia was not linked to the alliance agreement between our two airlines. From a customer perspective, it is business as usual when crossing the Tasman, either on an Air New Zealand or a Virgin Australia aircraft. It is a relationship that benefits the customers of both airlines and we look forward to continuing to work closely with Virgin Australia on the Tasman.

Q. What are some of the challenges facing New Zealand tourism that could impact Air New Zealand's long-term strategic plan of connecting New Zealand and New Zealanders to the world?

A. Tourism is a large and growing part of New Zealand's economy, contributing almost $30 billion in economic benefit, but the significant growth in the past few years does pose some challenges.

As I said, over the short-term we believe we can help mitigate the stress of strong tourism growth on New Zealand, by focusing on greater value over volume, marketing the shoulder season better and increasing regional dispersal.

However, it would be naïve to ignore that continued growth of our tourism industry over the medium term is at risk if New Zealand does not proactively work on resolving key tourism capacity management issues. We need to ensure adequate investment in the infrastructure that supports our tourism industry, such as public facilities, car parks and public transport, and hotel rooms to name a few.

We can't forget that New Zealand is competing with other destinations for tourists and that tourists have a choice as to where they visit. Delivering a world-class experience to overseas visitors is the best way to ensure the sustainability of tourism growth into our country, and the benefits this industry holds for our economy. This is a responsibility jointly owned by the industry, Government and communities and will require co-ordinated solutions.

Q. Can you explain how Air New Zealand is investing in digital and what customers can expect in the future?

A. Our airline has a great history of innovation – Economy Skycouch™, our safety videos, the Airband™ and the automated biometric bag drop just to name a few. When we look to the future of our airline and the industry in general, the digital opportunity is very exciting.

We believe there is significant value that can be accessed through improving our customers' digital experiences, focusing on greater personalisation, expanding our ancillary products and continuing to invest in loyalty and data analytics. These focus areas are critical to improving the customer experience and providing a more personalised and enjoyable travel experience.

We are proud of the strides we have made this past year, bringing Avi Golan on-board to lead this initiative as our Chief Digital Officer, and the work being done to reorganise the Digital team. We are still in the early stages, but this is an area we are extremely focused on and you can expect to hear more from us as we continue down the digital journey.

Q. What are the most common issues you are hearing from customers these days?

A. Over the past four years, we have used customer feedback – both positive and negative - in our decisions about investments we are making into the business, such as inflight entertainment, aircraft interiors and wine selection on our flights. Now we are also looking to help improve customer satisfaction in areas outside our control. Frequent customer pain points that we are focused on include the transit process at Los Angeles International Airport for those travelling on our Auckland – London flight, the length of immigration queues at Auckland International Airport, and the differential in experience at some of our partner lounges. These are issues that Air New Zealand cannot resolve by ourselves. However, we are doing everything we can to spur improvements.

Christopher Luxon
Chief Executive Officer

Meet the newest members of our team

In 2016, we welcomed Jodie King and Avi Golan to Air New Zealand's Executive Team.

Jodie King
Chief People Officer

Executive role
Jodie King joined Air New Zealand in 2012 as an HR General Manager and member of the People Leadership Team, before being appointed as Chief People Officer in February 2016. In her current role, Jodie is focusing on implementing the High Performance Engagement Framework, which has changed the way we manage our ongoing relationship with our union partners. Additionally, continuing to build collaboration across the business and empowering our people to strive and remain highly engaged will be integral to our continued success.

Before joining Air New Zealand
Jodie has had a significant international career. Having left New Zealand for a two year OE in the United Kingdom, she ended up living there for 16 years and working at KPMG in leadership and consultancy roles across a range of industries, including infrastructure, oil and gas, banking and retail with companies like London Underground, BP, easyJet, Royal Bank of Scotland and Diageo. This has seen her support businesses in countries as diverse as Russia, North America and Switzerland.

Balancing life and work
Outside of work, Jodie is energised by spending time with her three young children. She also enjoys travelling around New Zealand, catching up with friends, is a keen skier and tennis player, an avid reader and loves attending comedy or music concerts.

Avi Golan
Chief Digital Officer

Executive role
Avi Golan joined Air New Zealand as Chief Digital Officer in January 2016 and has been leading the Digital Team through a significant transformation as the airline moves to become more design-led, innovative and agile in pursuit of our goal to be one of the best digital airlines globally. To enable that, Avi and his team are working to embed a digital culture into the fabric of Air New Zealand through high performance digital capability, agility and a culture of learning and curiosity.

Before joining Air New Zealand
Previously based in the USA, Avi has held senior leadership positions in some of the most innovative global companies across a range of industries, including Google, Intuit and Nook Digital. He also spent the first part of his career as a product leader in Israeli based start-ups and co-founding the Israeli Entrepreneurs and Founders Foundation (IEFF) in the United States, an organisation that helps technology start-ups be more successful in the Silicon Valley.

Balancing life and work
Avi is a keen athlete having completed five Ironman races and several marathons, including those in Boston and New York. Since moving to New Zealand, Avi and his wife have been exploring New Zealand's great outdoors, with many weekends spent bike riding, hiking and enjoying local food and wine. They have two adult children and a teenage son who is completing his last year of school here.

Continued commitment to sustainably growing New Zealand tourism

Growing the economic value of tourism to New Zealand is one of the most important ways we can help supercharge New Zealand's success.

International visitor arrivals reached 3.3 million in the year ended June 2016.

↑ 11%[1]

The value of tourism has increased at an even faster pace than the volume.

↑ 18%[1]

International visitors spent over $10 billion in the year.[1]

We have played an active role in increasing the demand for travel into and around New Zealand through our partnerships with tourism organisations as well as promoting our national and regional sponsorships both off-shore and within New Zealand. In May we announced a marketing partnership with Tourism New Zealand, with both parties committing more than $10 million each over the next year. Our partnership has seen us jointly undertake increased marketing activity promoting travel to New Zealand in South America and the US following our two new direct services to Houston and Buenos Aires.

A big part of our partnership with Tourism New Zealand centres on regional dispersal – ensuring visitors get out and experience all that our regional centres have to offer. This past September we jointly hosted an event with Tourism New Zealand giving 375 Australian travel agents the opportunity to explore New Zealand's wide variety of destinations and attractions for themselves.

Growing shoulder season travel is also important to the sustainability of New Zealand tourism and in recent years we have been focused on encouraging visitation year-round. This creates a more stable pattern of demand for New Zealand tourism businesses and a better utilisation of our tourism assets around the country. For example, campaigns such as our 'Transition to Winter' have been successful in promoting travel from Australia to New Zealand in the autumn and winter months.

We continue to strongly promote travel throughout New Zealand's regions. We have been investing in additional ATR turboprop aircraft to increase the available seats flying to our domestic ports. Additionally, we help support economic development in the regions through sponsorship or promotion of great local events, such as the Art Deco Festival in Hawke's Bay, the Christchurch Lantern Festival, the New Plymouth Festival of Lights, or Bluff's Oyster Festival. In May, we were pleased to sponsor the Hawke's Bay Marathon, which attracted almost 5,000 participants in its inaugural year and drove increased travel and spend into the local economy during the shoulder season.

Increasing domestic tourism is another important initiative – getting New Zealanders exploring more of New Zealand. One such campaign centres on our partnership with the Department of Conservation (DOC), raising both awareness of DOC destinations and inspiring people to travel to and experience one of New Zealand's Great Walks or Coastal Gems.

As we look forward to the coming year, our focus on the sustainable growth of the New Zealand tourism industry will centre on similar themes of promoting the economic development of tourism throughout the regions. Continued collaboration and careful planning with our key stakeholders will be a major factor in ensuring New Zealand's ability to benefit from the growth in tourism over the long-term.

Wine flight takes off

In February 2016, more than 60 of the world's most influential wine media, trade and sommeliers enjoyed a unique 'Wine Flight' thanks to Air New Zealand and New Zealand Winegrowers.

On board two Air New Zealand Q300 aircraft, VIP passengers from 11 different countries and leading figures in the global wine industry, enjoyed wines from Marlborough, Nelson, Martinborough/Wairarapa, Hawke's Bay and Gisborne, while flying over those regions. The combination of the publications many of them write for and their extensive social media reach will create significant exposure for the New Zealand wine industry and New Zealand as a destination for wine tourism.

[1] Statistics New Zealand, June 2016.

Air New Zealand Alliance partners – Revenue share

AIR CHINA

CATHAY PACIFIC

SINGAPORE AIRLINES

UNITED

Virgin australia

Air New Zealand Alliance partners – Code share

Aerolíneas Argentinas

AIR CANADA

ANA

Lufthansa

STAR ALLIANCE

*Auckland – Beijing operated by Air China.
**Christchurch – Singapore operated by Singapore Airlines.

An international network driven by strong alliance partnerships

Working with the right partners and playing in the right markets are key pillars of our business strategy.

The past year has seen some of the fastest network growth in Air New Zealand's history. Through our carefully chosen strategic revenue share and codeshare alliance partnerships we have been able to deliver this growth at the same time as improving our financial performance, and delivering better outcomes for our customers. A clear win-win.

New Zealand is our home and our hub, but with a relatively small outbound market, meaningful year on year growth relies on tapping into and capturing the much larger inbound traffic pools and tourism growth from our key Pacific Rim markets.

Revenue share alliances allow us to work with strong home market carriers in these key markets. By successfully coordinating our efforts and selling each other's services as if they were our own, both airlines benefit from more efficient use of their capacity and access to new sources of customers as we each leverage our sales strengths for the benefit of the alliance.

Customers gain new destination choices, enhanced loyalty benefits, better connections, more frequencies and time of day options so they can get where they need to be, when they want to go.

Revenue share alliances are a key part of our Pacific Rim strategy and in 2016 we expanded our portfolio to five strategic partnerships that now comprise Virgin Australia, Cathay Pacific, Singapore Airlines, Air China and United Airlines.

Our revenue share alliance with Air China was launched in December 2015, with the alliance introducing a direct service between Auckland and Beijing, operated by Air China. This alliance includes our own Auckland – Shanghai service. In the coming year we will see increases in capacity on both routes, with our Auckland – Shanghai service increasing from daily services to ten times per week during the peak demand season. Additionally, Air China will upgauge the aircraft flown on the Auckland – Beijing service to a larger Boeing 787-9. We are delighted to be working with Air China in what is now New Zealand's second biggest inbound tourism market.

In July 2016, we commenced a revenue share alliance with our longstanding Star Alliance partner United Airlines, with United flying San Francisco – Auckland. This alliance covers all the mainland US to Auckland routes between both carriers. Our partnership with United and their extensive network and connectivity was a key enabler of our Houston service, launched in December last year using a Boeing 777-200 aircraft. The Auckland – Houston service has proven to be highly popular for travellers looking to access the US Midwest, Northeast and Southern states, resulting in an increased frequency to daily services during the coming summer season.

Finally, our codeshare agreement with Aerolineas Argentinas was a critical factor in developing the new Auckland – Buenos Aires service which commenced in December of last year. This October, the service will offer a Boeing 787-9, and over the coming summer period we will operate an additional weekly service, bringing the total to four weekly return flights. It has been quite a productive year for our international network!

Our revenue share alliances and codeshare partnerships are hugely beneficial for New Zealand's tourism industry. In the year ending 30 June 2016, annual international visitor arrivals surpassed 3.3 million with Air New Zealand and our partners carrying approximately 45 percent of these visitors. Working together, we are able to build capacity in a more sustainable way, generating opportunities for additional stimulation of tourism.

The best fleet for the New Zealand market

We are well through a fleet investment programme that is delivering strong efficiencies while ensuring our customers enjoy a consistent and world-class inflight experience wherever they travel.

Boeing 787-9
Long-haul to Asia, Hawaii, Perth and Buenos Aires*
Number in service: **6**
Number on order: **6**

*Auckland – Buenos Aires service will progress on Boeing 787-9 in October 2016.

Airbus A320/321 NEO**
Short-haul to Australia and Pacific Islands
Number in service: **0**
Number on order: **13**

**The first six A320/321 NEO aircraft will enter the fleet in the 2018 financial year.

Airbus A320
Domestic jet and short-haul to Pacific Islands
Number in service: **29**
Number on order: **1**

Boeing 777 family
Long-haul to North America, London and Hong Kong
Number in service: **15**
Number on order: **0**

ATR72 turboprop family
Regional New Zealand
Number in service: **24**
Number on order: **16**

Bombardier Q300
Regional New Zealand
Number in service: **23**
Number on order: **0**

Note: Fleet in service and on order as at 30 June 2016.

Listening to our customers

Our mission is to give our customers a consistent and uniquely 'Air New Zealand' experience across the entire customer journey. We have listened to the feedback of the millions of loyal customers who fly with us, and are making investments to enhance what matters most – resulting in *all-time high* customer satisfaction scores.

A smooth start to the journey

With a strong focus on ensuring our customer's experience is a seamless journey from the very beginning of their trip, we have redesigned the check in areas in a number of regions as well as in Wellington and the Auckland International Premium check in area. Customers travelling through Nelson, Blenheim, Napier, Invercargill, Palmerston North, New Plymouth and Dunedin can now utilise the self-service bag check kiosk, providing significantly shorter wait times and improved passenger flow. In the coming year, we will continue to roll out our redesigned check in areas in other regions throughout New Zealand. At Auckland International Airport, customers can also access our fully automated biometric bag drop – a world first.

Did you know?
We currently have 235 Air New Zealand kiosks across New Zealand to help our customers check in and get through the airport faster!

A consistent inflight experience across our aircraft

From dynamic lighting settings to our decorative laminates to our seat covers, we are driving a more consistent inflight cabin experience across our fleet. With the delivery of our new Boeing 787-9 aircraft and the refurbishment of our Boeing 777-200 and our regional turboprop fleet, we now have a more consistent look-and-feel, making it easier for customers to know what to expect on their journey, as well as strengthening the brand experience from ground to inflight. In the coming year, we will be refurbishing the interiors, as well as installing the Panasonic eX3 inflight entertainment system on our Boeing 777-300 fleet which will further drive consistency and an improved customer experience across our fleet.

Did you know?
Over the last year our customers ordered 27,934 Ham & Cheese Toasties through the inflight entertainment system – enough to feed 1,862 rugby teams!

A world-class lounge experience

Air New Zealand is part way through a four year lounge upgrade programme, investing in excess of $100 million to redevelop our Air New Zealand lounges across our network. The new look lounges are a fresh and modern reflection of the Air New Zealand brand, and have been designed to deliver a world-class, distinctly Air New Zealand lounge experience for our most valued customers. New-look spaces have been opened in Auckland, Sydney, Brisbane, Invercargill and Hamilton. Looking ahead to 2017, customers can expect to enjoy new lounges in Queenstown, Wellington Regional, Melbourne, Perth and Palmerston North, among other locations.

Did you know?
The newly designed lounges have 14 different seat types to ensure you have the right option to help you relax before your journey!

Great taste while 30,000 feet in the air

We know our customers take their on-board dining experience seriously, and we view our inflight meals as an opportunity to showcase the fresh, high quality cuisine and great wine that New Zealand is known for. To further enhance the wine experience, we now offer a Wine Specialist inflight. Our Wine Specialists have been trained at Villa Maria Estate by wine experts. The training covers characteristics of wine, food and wine matching, the wine making process, and can even offer wine tastings at 30,000 feet. In the coming year, our Business Premier customers can also look forward to dishes designed by our newest consultant chef, award winning restaurateur Michael Meredith. Michael will join our current consultant chef, Peter Gordon who has partnered with the airline for more than 20 years.

Did you know?
4.4 million servings of wine were consumed on our flights in 2016!

A memorable service experience

We aim to have world class customer service where customers feel they are treated with care and respect at all times. With that goal in mind we have begun a training programme for all of our 2,500 Cabin Crew to further embed a service-focused culture to ensure moments with our customers are interactional and memorable.

Did you know?
We have 26 different ethnic groups within our Air New Zealand crew, who speak 32 languages other than English!

airpoints™

Airpoints™

New Zealand's most rewarding customer loyalty programme

2016 Loyalty Awards

Excellence in Management

Best use of technology – Air New Zealand Mobile App

The Airpoints™ programme continued its strong growth in 2016 and now has more than *2.2 million members*. It is New Zealand's most rewarding loyalty programme, with members enjoying more than *840,000 flights* around the globe using their Airpoints Dollars™.

- Since launching in 1989, the Airpoints™ programme now has more than **2.2 million members**
- More than **50** kiwi retail, banking and travel businesses are now part of the programme
- In the past year, members have enjoyed more than **840,000** flights paid for by Airpoints Dollars™
- Members are based in more than **160** countries
- Our **Airpoints™ Mall** houses more than **140** international and domestic retailers where members can earn Airpoints Dollars™ for their online purchases
- We've launched programmes such as **Airpoints™ for Business**, which reward businesses when their employees fly with us and **Airpoints™ for Schools**, a community initiative allowing members to donate Airpoints™ to school fundraising projects

SAFETY AS A **SHARED VALUE**

Looking out for each other

We believe safety is a shared value and a core business function – an integral and crucial element of everything we do.

A safer workplace is good for our people, for our business, and ultimately, good for New Zealand. As part of our strategy to supercharge New Zealand's success we have a continuous focus on health and safety and support improvements across our business.

Health and safety is an integral part of our culture and daily processes, but it is not only our employees who we need to think about. Our contractors, sub-contractors, suppliers and of course our customers play an essential part in ensuring we maintain a safe operation, and we are working collaboratively with these groups to achieve the best outcome.

In a broader sense, we also have an impact on the wider community, so by building a culture based on mindful leadership focused on risk, we can reduce the likelihood of our people being harmed while at work, on the way to or from work and at home.

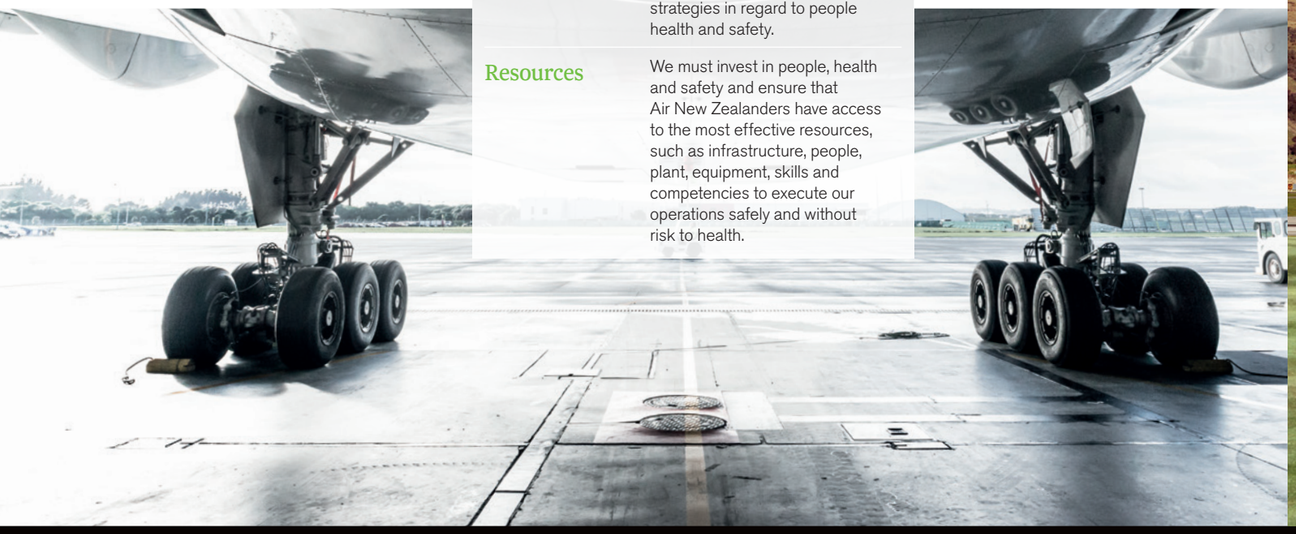
At Air New Zealand, our safety journey this year has involved revamping our safety vision, mission and policy in line with safety as a shared value:

Safety as a shared value

Strategic Pillar	Guiding Principles
Risk	Risk is a constant throughout our operations and we empower our people to be mindful, to question and to keep the safety conversations alive, including when things are going right.
Relationships	Risks are best managed with the meaningful input of those closest to them, and as such we employ High Performance Engagement as the cornerstone of collaboration and engagement strategies in regard to people health and safety.
Resources	We must invest in people, health and safety and ensure that Air New Zealanders have access to the most effective resources, such as infrastructure, people, plant, equipment, skills and competencies to execute our operations safely and without risk to health.

We realise that every facet of our business affects the safety performance, and more than any other single factor, leadership sets the culture of the business. To that end, the Health, Safety and Security Committee no longer holds meetings at Air New Zealand's main offices, but instead, are out and about in the business. The purpose of these visits is for the Board and the Executive members to connect with those closest to the risks and understand and experience the challenges and successes in real time.

A safer workplace is something we should all be striving to achieve. It includes having real conversations, understanding our critical risks and how we can improve our risk controls, being curious about our environment, and questioning what is in place to reduce potential harm to our people or customers.



"Good evening Queenstown"

On 23 May 2016, Air New Zealand flew the first ever commercial flight at night into Queenstown – a landmark event that took several years and the collaborative efforts of many to reach fruition

The Queenstown aviation environment is generally regarded as one of the most demanding for Regular Passenger Transport (RPT) operations.

This is for a range of reasons including the surrounding mountainous terrain – some of which is close in – the relatively short runway and at times difficult wind patterns.

Starting in 2012, we began with a group of other key constituents, to systematically determine what risks would exist with the implementation of night flights into and out of Queenstown, and how each of those risks could be addressed, in what would be called the Foundation Safety Case.

"It was an extensive and extremely thorough risk assessment," according to Manager of Aircraft Operations, Captain Graham Cheal, "The group looked at every possible risk, things from loss of situational awareness, to adverse winds, to runway overrun or possible engine failure."

The Foundation Safety Case proved that if 65 "controls" (improvements or procedures) were put into place, the risk of flying in or out of Queenstown could be reduced to a level comparable with US night RPT risk levels.

The next stage was for Air New Zealand to develop our Operator Safety Case, detailing how we would comply with the controls outlined by the Foundation Safety Case. We invested in technology such as the Head Up Display, which gives increased stability of approaches and better touchdown positioning for landing. We also invested in a Runway Overrun Prevention System which continually calculates the aircraft's energy state (airspeed, wind speed and direction), and will warn the pilot if the landing distance required to stop is greater than the available distance.

Air New Zealand is the only Queenstown night operator to invest in these new technologies.

At the same time, the First Officer, separately, was learning specialist monitoring skills. The Captain and First Officer were then brought together to train as a team.

Meanwhile, on the ground, the runway was widened from 30 metres to 45 metres. A comprehensive airfield lighting project, managed by Airways, was completed prior to commencement of the evening flights and contingencies were also put in place in the event of equipment failure. The touchdown of NZ613 on 23 May represented a great result for everyone involved in the safety case, as well as a great opportunity for the Queenstown region. Our expanded schedule now allows for same day connections, as well as reduced connection times from a range of destination across Australia, Asia and North America.

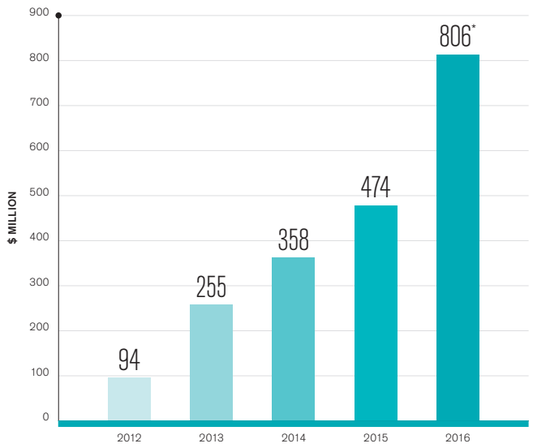
In addition to technology, the airline invested in extensive crew training to gain readiness for night flying in Queenstown. Pilots went through special training, with the Captains exposed to 'overlearning' – repetition of a task to take skill way beyond proficiency.

Financial Commentary

Earnings before taxation for the 2016 financial year (excluding other significant items[1]) were $806 million, an increase of 70 percent on the previous year.

Statutory net profit after taxation was $463 million, an increase of 42 percent on the prior year.

Earnings Before Taxation



* Prior to other significant items of $143 million.

Dividend Record date: 9 September 2016

Dividend Payment date: 19 September 2016

This record result was driven by strong capacity growth, a significant decline in fuel prices and the benefit of scale economies and operational efficiencies.

Revenue

Operating revenue increased by $306 million to $5.2 billion, an increase of 6.2 percent on the prior year. Excluding foreign exchange and divestments, operating revenue increased 3.8 percent on the previous year.

Passenger revenue increased by $368 million to $4.5 billion, an increase of 8.9 percent compared with the previous year. Excluding the impact of foreign exchange, passenger revenue increased by 4.7 percent. Capacity (Available Seat Kilometres) growth of 12 percent reflected the commencement of new international services and up-gauged aircraft within the short-haul markets.

The capacity growth was supported by a strong load factor of 83.7 percent. Passenger Revenue per Available Seat Kilometre (RASK) for the Group declined 2.3 percent, due to strong capacity growth and increased competition. Excluding the benefit of foreign exchange, RASK declined 6.1 percent.

International long-haul capacity increased 16 percent due to the commencement of new international routes to Houston, Buenos Aires and Ho Chi Minh City, as well as a full year's service to Singapore. Demand (Revenue Passenger Kilometres) on international long-haul routes was marginally ahead of capacity growth with load factor up by 0.1 percentage point to 84.8 percent. RASK on international long-haul routes increased by 1.6 percent. Excluding the benefit of foreign exchange, RASK declined by 5.7 percent.

Short-haul capacity grew 6.2 percent during the year, driven by larger aircraft and increased frequency on select services. Demand grew by 4.9 percent, resulting in a decline in load factor by 1.0 percentage point to 82.4 percent. Short-haul RASK declined 3.5 percent, and excluding the benefit of foreign exchange, declined 4.6 percent.

Cargo revenue was $349 million, an increase of $32 million or 10 percent. Excluding the benefit of foreign exchange, Cargo revenue increased $11 million or 3.5 percent on the previous year.

Contract services and other revenue was $401 million in the year, a decline of $94 million, reflecting the impact of divestments. Excluding the impact of divestments and foreign exchange, Contract service and Other revenue declined 3.0 percent, reflecting lower external engineering revenue.

Expenses

Operating expenditure declined by $75 million, a 2.0 percent improvement on the prior year. Excluding foreign exchange and divestments, operating expenditure reduced 4.6 percent on a 12 percent increase in capacity.

While the reduction in fuel price was significant, efficiencies were also a key contributor to the improvement in operating cost, resulting in savings of $222 million in the year. These efficiencies were achieved across the cost base, especially through labour productivity and through a reduction in fuel consumption, arising from the use of newer and more efficient fleet.

Labour costs were $1.2 billion for the year, an increase of $32 million or 2.7 percent. This reflected increased capacity, general rate increases and an increase in incentive payments. The increase was partially offset by improved productivity. Excluding the impact of divestments and foreign exchange, labour costs increased 5.4 percent on a 12 percent increase in capacity. Headcount increased by 331 full time equivalent (FTE) during the year to 10,527 FTE employees, a 3.2 percent increase.

Fuel costs were the largest driver of the improvement in operating expenditure in the year, declining by $243 million to $846 million, or 22.3 percent. Excluding the impact of foreign exchange, fuel costs improved by $379 million. The average US dollar fuel price was 40 percent lower than the prior year, resulting in a $456 million benefit, which was partially offset by $77 million related to increased volume. Fuel consumption increased 7.1 percent on 12 percent capacity growth, reflecting the benefits of fleet efficiencies.

Aircraft operations, passenger services and maintenance costs were $1.1 billion, an increase of $121 million or 12 percent on the prior year. The increase was driven by increased capacity, price increases and growth in the fleet which was partially offset by productivity improvements.

Sales and marketing and other expenses increased by $48 million or 8.6 percent. Excluding the impact of foreign exchange and divestments, Sales and marketing and other expenses increased by $32 million or 5.8 percent. The increase resulted from increased commission costs due to significant revenue growth, costs relating to new route development and an increased focus on digital technologies.

Depreciation, rental and lease expense and funding costs increased by $91 million or 14 percent, as a result of new aircraft deliveries and the adverse impact of foreign exchange rates, partially offset by lower average borrowing rates.

Foreign Exchange Impact

Overall, the impact of foreign exchange movements resulted in a $28 million decline compared to the prior year, with the current period including hedging benefits of $112 million.

Share of Earnings from Associates

The share of net earnings of associates increased by $42 million with continued growth in earnings for the Christchurch Engine Centre of $16 million and a reduction in losses for Virgin Australia of $26 million.

Other Significant Items

Other significant items of $143 million were recognised during the year, related to the partial divestment of Virgin Australia and the settlement of a legacy legal claim.

In March 2016, Air New Zealand ceased applying the equity method of accounting to the investment in Virgin Australia and transitioned to the fair value method. Subsequently, Air New Zealand sold a 19.98 percent stake in Virgin Australia to Nanshan Group, retaining a 2.5 percent interest as at 30 June 2016. This resulted in a recognised loss of $86 million in the year.

In May 2016, Air New Zealand settled a long-standing US class action cargo claim for US$35 million. Air New Zealand admitted no wrongdoing as part of the settlement.

Cash and Financial Position

Net cash at year end was $1.6 billion, an increase of $273 million on the previous year. The increase was due to strong operating cash flows and the proceeds received from the sale of Air New Zealand's 19.98 percent interest in Virgin Australia, which were partially offset by the investment in new aircraft.

The Group's operating cash flows were strong at $1.1 billion, a decline of $26 million or 2.4 percent on the prior year. Strong growth in earnings were offset by higher tax payments, lower working capital growth and payment of the US class action cargo claim.

Net gearing, including capitalised operating leases, improved 3.8 percentage points to 48.6 percent, as a result of strong profit.

A 2016 fully imputed final ordinary dividend has been declared of 10.0 cents per share, bringing the full year 2016 ordinary declared dividends to 20.0 cents per share, an increase of 25 percent on prior year ordinary dividends. The Board also declared a fully imputed special dividend of 25.0 cents per share.

[1]Earnings before other significant items and taxation represent Earnings stated in compliance with NZ IFRS (Statutory Earnings) after excluding items which due to their size and nature warrant separate disclosure to assist with understanding the financial performance of the Group. Earnings before other significant items and taxation is reported within the Group's audited annual financial statements. Other significant items of $143 million includes $86 million related to the partial divestment of Virgin Australia and $57 million related to the settlement of a long-standing class action. Further details are contained within Note 3 of the Group financial statements.

Change in Profitability

The key changes in profitability, after isolating the impact of foreign exchange movements and divestments are set out in the table below*:

June 2015 earnings before taxation	$474m	
Passenger capacity	$382m	- Capacity increased by 12 percent from growth across the network due to the commencement of new routes, the annualised impact of the re-introduction of the Singapore route, increased widebody services across the Tasman and new domestic A320's and ATR72-600's
Passenger RASK	-$189m	- Overall Revenue per Available Seat Kilometre (RASK) reduced during a period of significant market capacity growth. RASK declined 2.3 percent (6.1 percent FX adjusted). Yield declined 1.8 percent (5.7 percent FX adjusted) as loads decreased marginally - Long-haul RASK increased by 1.6 percent (reduced by 5.7 percent excluding FX). Yields increased 1.5 percent (reduced by 5.8 percent excluding FX) offset by a small increase in loads - Short-haul RASK declined by 3.5 percent (4.6 percent excluding FX). Yields decreased slightly by 2.3 percent (3.4 percent excluding FX) combined with lower loads reflecting the capacity growth
Cargo, contract services and other revenue	-$4m	- Lower external engineering revenue offset by increased cargo volumes delivering a 10 percent (3.5 percent excluding FX) increase in cargo revenue
Labour	-$65m	- Increased activity (net of improved productivity) arising from capacity growth, general rate increases and an increase in incentive payments
Fuel	$379m	- The average US$ fuel price decreased 40 percent compared to last year. Consumption increased by 7.1 percent due to an increase in capacity offset by improved fleet efficiencies
Maintenance	-$41m	- Fleet growth combined with additional A320 and widebody airframe and engine maintenance
Aircraft operations and passenger services	-$66m	- Increase in capacity (including new routes) and landing and air navigation pricing increases offset by productivity improvements
Sales and marketing	-$28m	- Market development for new routes, higher agency commissions reflecting revenue growth and increased loyalty programme engagement
Depreciation, lease and funding costs	-$42m	- Increase in depreciation reflecting the growth of the airline offset by reduced funding costs
Net impact of foreign exchange movements	-$28m	- The net impact of currency movements on revenue and costs offset by higher foreign exchange hedging gains
Share of earnings from associates	$42m	- Improved earnings from Christchurch Engine Centre ($16 million) and reduced losses from Virgin Australia ($26 million)
Other expenses	-$4m	- Increased Information Technology costs due to additional activity
Divestments	-$4m	- Disposal of Altitude Aerospace, TAE Group and Safe Air Group in the prior year and holiday stores in the 2016 financial year
June 2016 earnings before other significant items and taxation	$806m	
Other significant items	-$143m	- Impact of Virgin Australia partial divestment ($86 million) and legal settlement of cargo class action claim ($57 million)
June 2016 earnings before taxation	$663m	

* The numbers referred to in the Financial Commentary on the previous page have not isolated the impact of foreign exchange or divestments.

Financial Summary

Financial Performance

	12 MONTHS TO 30 JUNE 2016 $M	12 MONTHS TO 30 JUNE 2015 $M
Operating Revenue		
Passenger revenue	4,481	4,113
Cargo	349	317
Contract services and other revenue	401	495
	5,231	4,925
Operating Expenditure		
Labour	(1,225)	(1,193)
Fuel	(846)	(1,089)
Maintenance	(350)	(320)
Aircraft operations	(531)	(466)
Passenger services	(246)	(220)
Sales and marketing	(348)	(303)
Foreign exchange gains	112	79
Other expenses	(255)	(252)
	(3,689)	(3,764)
Operating Earnings (excluding items below)	1,542	1,161
Depreciation and amortisation	(465)	(402)
Rental and lease expenses	(244)	(211)
Earnings Before Finance Costs, Associates, Other Significant Items and Taxation	833	548
Net finance costs	(47)	(52)
Share of earnings of associates (net of taxation)	20	(22)
Earnings Before Other Significant Items and Taxation	806	474
Other significant items	(143)	-
Earnings Before Taxation	663	474
Taxation expense	(200)	(147)
Net Profit Attributable to Shareholders of Parent Company	463	327
Interim and final dividends declared per share (cents)	20.0	16.0
Special dividend declared per share (cents)	25.0	-
Net tangible assets per share (cents)	176	166

Cash Flows

	12 MONTHS TO 30 JUNE 2016 $M	12 MONTHS TO 30 JUNE 2015 $M
Cash inflows from operating activities	5,346	5,066
Cash outflows from operating activities	(4,272)	(3,966)
Net cash flow from operating activities	1,074	1,100
Net cash flow from investing activities	(797)	(1,066)
Net cash flow from financing activities	(4)	53
Increase in cash and cash equivalents	273	87
Cash and cash equivalents at the beginning of the year	1,321	1,234
Cash and Cash Equivalents at the End of the Year	1,594	1,321

Financial Summary (continued)

Financial Position

AS AT	30 JUNE 2016 $M	30 JUNE 2015 $M
Bank and short-term deposits	1,594	1,321
Trade and other receivables	373	369
Inventories	103	120
Derivative financial assets	70	103
Investment in quoted equity instruments	22	-
Other assets	177	69
Total Current Assets	2,339	1,982
Trade and other receivables	61	51
Property, plant and equipment	4,485	4,061
Intangible assets	127	102
Investments in other entities	79	425
Other assets	160	154
Total Non-Current Assets	4,912	4,793
Total Assets	7,251	6,775
Trade and other payables	453	448
Revenue in advance	1,111	1,055
Interest-bearing liabilities	464	253
Derivative financial liabilities	65	40
Provisions	87	54
Income taxation	54	20
Other liabilities	237	258
Total Current Liabilities	2,471	2,128
Revenue in advance	161	150
Interest-bearing liabilities	2,103	2,069
Derivative financial liabilities	4	1
Provisions	216	217
Other liabilities	24	17
Deferred taxation	164	228
Total Non-Current Liabilities	2,672	2,682
Total Liabilities	5,143	4,810
Net Assets	2,108	1,965
Share capital	2,252	2,286
Reserves	(144)	(321)
Total Equity	2,108	1,965

The summary financial information has been derived from, and should be read in conjunction with, the Air New Zealand Group Annual Financial Statements (the 'Annual Financial Statements'). The Annual Financial Statements, dated 26 August 2016, are available at: www.airnzinvestor.com. The summary financial information cannot be expected to provide as complete an understanding as provided by the Annual Financial Statements. The accounting policies used in these financial statements are attached in the notes to the Annual Financial Statements.

Share Registrar

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Annual Financial Statements

The Annual Financial Statements are available by visiting our website www.airnzinvestor.com OR you may elect to have a copy sent to you by contacting Investor Relations.

ELECTRONIC SHAREHOLDER COMMUNICATION

If you would like to receive all investor communications electronically, including interim and annual shareholder reviews, please visit the Link Market Services website **www.linkmarketservices.com** or contact them directly (details to the left).

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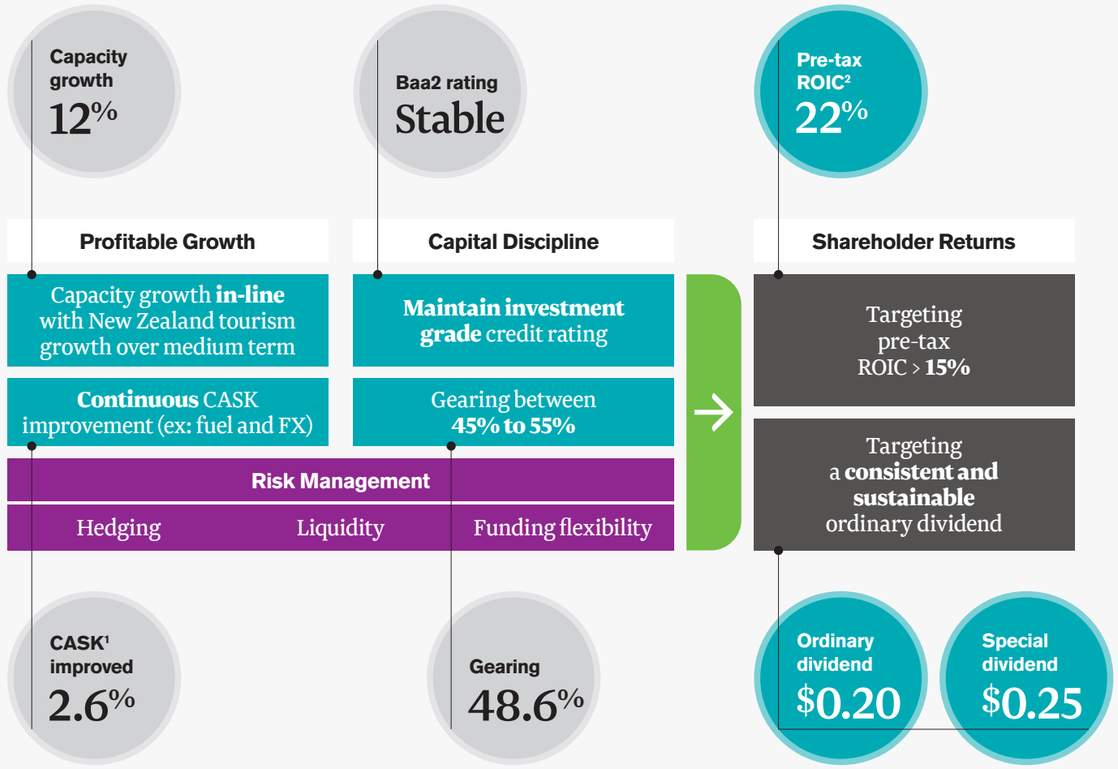
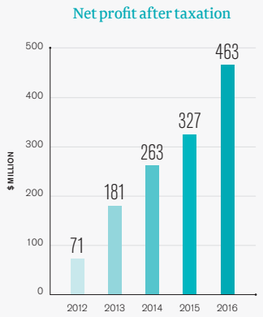
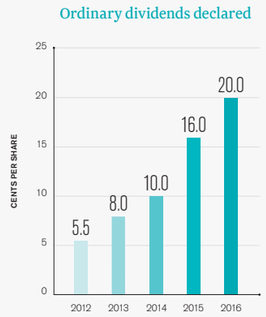
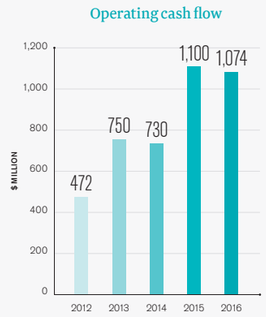
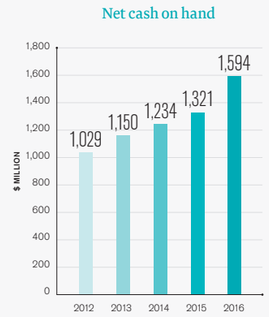
Financial Framework – our 2016 performance











[1] Excluding fuel price movement, foreign exchange and divestments.
[2] Excluding other significant items. Refer to the Financial Commentary on page 18.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