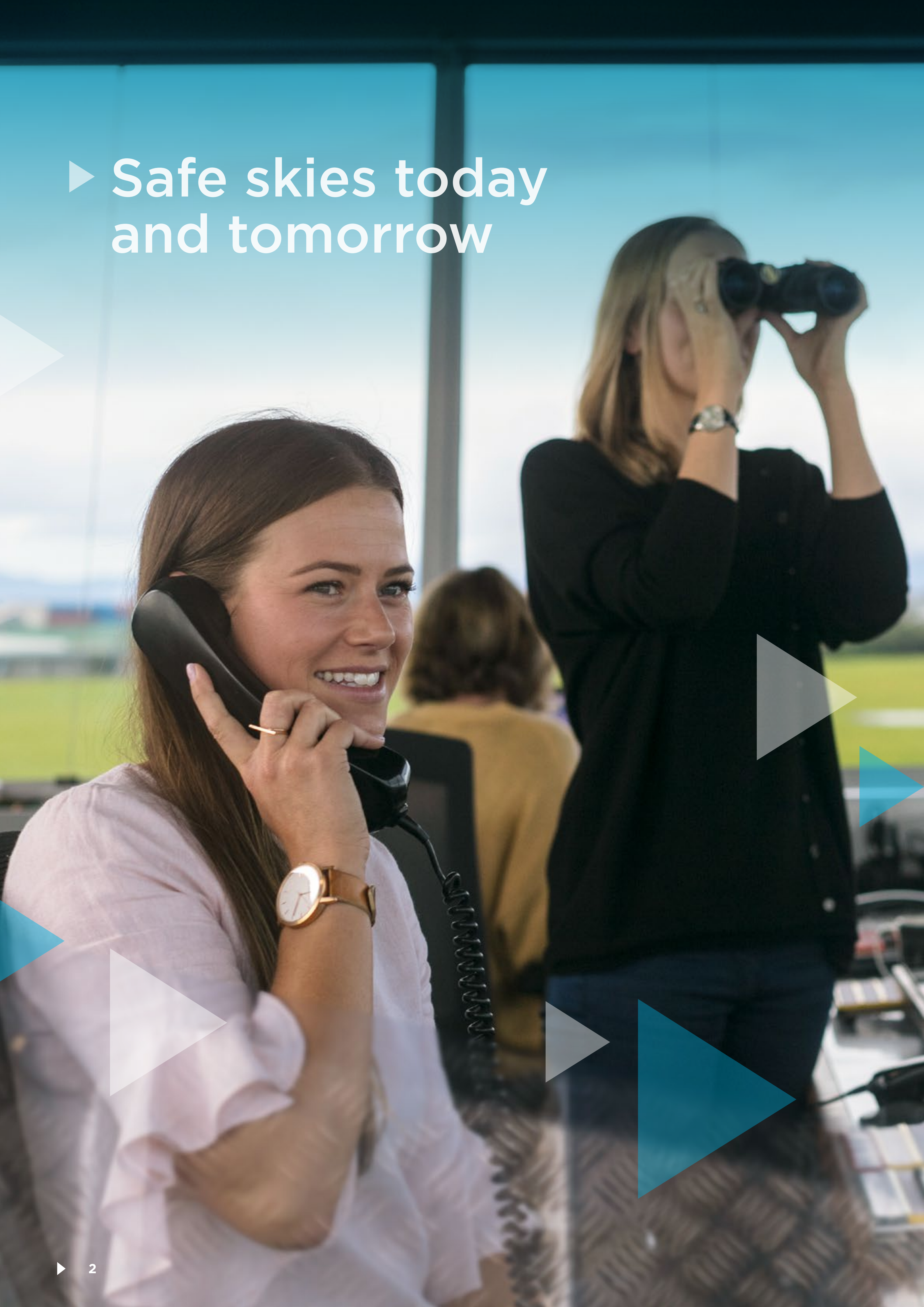
AIRWAYS

Statement of Corporate Intent

2019/20 ▸ **2021/22**

Contents

Safe skies today and tomorrow



Introduction and nature & scope of activities

Airways Corporation of New Zealand Limited (ACNZ) is a state-owned enterprise (SOE) established under the State-Owned Enterprise Act 1986 (the Act) and is a public company registered under the Companies Act 1993.

The shareholders are the Minister for State-Owned Enterprises and the Minister of Finance, each of whom holds 20.55 million fully paid shares of $1.

Airways' core role is as New Zealand's air traffic control (ATC) provider, facilitating safe and efficient air transport through New Zealand's flight information region (FIR). ACNZ also has four 100% owned subsidiaries – Airways International Limited, Airways Training Limited, Aeropath Limited and Airshare Limited (refer Appendix C for further detail on the Group structure).

This Statement of Corporate Intent (SCI) refers to the Airways Group (Airways), including ACNZ and our subsidiaries. It is prepared in accordance with the Act and sets out Airways' business goals and objectives for the period 1 July 2019 to 30 June 2022.

OBJECTIVES, VISION, PURPOSE AND VALUES

Airways has established the following vision, purpose and values:

Vision
Create the aviation environment of the future

Purpose
Safe skies today and tomorrow

Values
We value safety, each other, excellence and success

Furthermore, as an SOE, Airway is expected to:

- be as profitable and efficient as comparable businesses
- be a good employer
- exhibit a sense of social responsibility

DIVERSITY

Airways recognises the value of a diverse and skilled workforce and is committed to creating and maintaining an inclusive and collaborative workplace culture. This enables Airways people to be the best they can be at mahi (work) and directly supports our value of Each Other - *'Appreciates the role of other people and their ideas. Acts inclusively and values diversity. Earns trust, accepts differences and gets on with others.'*

AIRWAYS' STRATEGY

We will work with partners to provide global aviation customers with safe, integrated airspace management through our proactive safety culture, expert knowledge and technology enabled solutions. Airways will grow profit to $32m by 2024.

SAFETY

Safety is paramount throughout the aviation industry, with continuous improvement in safe travel and operations a key priority for all participants. Against this backdrop, Airways keeps safety at the forefront of all it does and has established a proven track record of excellent safety results amongst its peers. Airways embraces 'Just Culture' principles relating to safety performance and management.

Strategic context

Technology, competition and new operating models are driving industry change from a number of fronts:

Rapid Growth in the use of Unmanned Aerial Vehicles (UAVs)

UAV (drones and autonomous vehicles) usage continues to grow exponentially, bringing with it significant challenges to ensure safe integration of UAVs into the airspace. To achieve this, there is a need to develop a national UAV traffic management framework which addresses aerodrome safety, airspace management and national UAV infrastructure. Our vision is to create a world-leading UAV industry that is safe and commercially viable. Our role in this vision is to work with our aviation stakeholders to develop a safe, transparent and efficient UAV management system for New Zealand.

Future aerodrome services

With airspace becoming more congested and complex, digital technologies are emerging that will help simplify the controller environment and enrich their role with information which has not traditionally been possible to overlay. These digital technologies also allow services to be delivered centrally and clustered in a way that enhances safety and delivers operating benefits.

Value chain disruption

Increasingly, the traditional silos of the ANSP value chain are being challenged and broken down. There are now more non-traditional players entering the market as they seek to influence market growth and dynamics, and this is particularly true for the UAV market (drones and autonomous vehicles). This creates opportunities for Airways both domestically and internationally, but also introduces completion from non-traditional sources. Technological advancements reduce traditional barriers to entry (physical location and capital investment), introducing competition into the value chain.

Using data, automation and artificial intelligence to improve services

Industry investment into, and adoption of, new technologies (such as conflict detection, separation assurance monitoring, and advanced flow management) is occurring at a rapid pace. These new technologies use data to deliver automation and artificial intelligence, improving safety and increased workforce productivity. Customer demands for greater efficiencies will continue to drive ANSPs to invest in these technologies and transition away from traditional ATM models that rely heavily on human input and judgement.

Airways' business units

Airways is a State-owned Air Navigation Service provider (ANSP) responsible for delivering air traffic management (ATM) services within New Zealand's airspace.

It comprises the following businesses and support functions:

Core business	Commercial businesses
▶ Delivers safe, resilient and efficient air traffic services to NZ airspace users, including airlines & other commercial aircraft operators, the general aviation (GA) community, the Royal New Zealand Air Force and airports. ▶ The service offering comprises: – Enroute and approach services in the NZ FIR (~60% of core revenue) which are protected by statute – Aerodrome services, provided on behalf of airports, including air traffic control into and out of aerodromes and the provision of lighting and navigation infrastructure – Enroute services in the Auckland Oceanic FIR, on behalf of the International Civil Aviation Authority (ICAO) – The safe integration of drone activity into New Zealand's airspace ▶ Governed by a Service and Pricing framework which provides for a 'fair return on investment' and is reviewed through consultation with customers every three years.	▶ Utilise Airways' intellectual property and expertise to provide products and services to the international ANSP and wider aviation industry ▶ Create value by investing in a balanced portfolio, operating internationally and achieving commercial returns ▶ The portfolio of businesses comprises: – *Airways Training*, delivering world leading Air Traffic Control (ATC) training to both ANSPs, and directly to ATC students through an outsourced academy model. – *Aeropath*, providing aeronautical information management and procedure design services. – *Digital products*, utilising cloud based technologies to deliver a range of services to ANSP's including simulation, revenue management, recruitment and selection, industry language skills and interactive digital learning. – *Aviation Services*, providing ANSPs and airports with outsourced air traffic services and support in the development and maintenance of technology.

Corporate services	▶ Act as a trusted advisor to Airways' board, management and staff, providing fit-for-purpose advice and support to Airways' Board, management and staff within a robust governance framework. ▶ Services are structured functionally in the form of People, Finance, Legal, Public Affairs and Strategy teams to create value, manage risk within approved mandates and protect Airways' brand.
Safety and assurance	▶ Provide leadership, advice and assurance on safety management/maturity, safety performance and Just Culture to Airways and the board. ▶ Ensure Airways becomes predictive in safety: moving from reactive to proactive and then to predictive practices; learning through what could happen, as well as what has happened; and tailoring improvements in system design to ensure the best return on investment.

ATM CAPITAL DEVELOPMENT

Airways has embarked on a 10-year operational strategy, designed to deliver quantum improvements in the safety, resilience and efficiency of our Air Traffic Management (ATM) services. This strategy will see Airways operating state of the art technology and systems, from two interoperable centres.

The key components of this strategy for the 2020 – 2022 period include:

- Completing the transition to a new ATM system (Skyline X) operating in the domestic and international oceanic airspace, from new IL4 operational facilities in Christchurch and Auckland and airport control towers.
- Simplification of airspace design and procedures, in preparation for the transition to interoperable capability in both Christchurch and Auckland.
- Embracing new technologies to deliver fit for purpose solutions at all aerodromes, including digital towers and other service offerings. This will include the capability to deliver digital services from centralised locations and cross-rated teams, improving the flexibility of available services and improving resilience.
- Safely and efficiently integrating drone and UAV operations into manned and unmanned airspace through the introduction of new detection and surveillance capability and a new UAV traffic management platform.

COMMERCIAL BUSINESSES

The vision for the commercial businesses is to strengthen the role of trusted advisor to ANSP and other aviation customers, providing them with high quality products and services tailored to their needs and delivery requirements.

For the 2020 – 2022 period, the key focus of our commercial businesses will be on validating and expanding the range of products or services, with a strong focus on embracing cloud technology to provide these on demand, whilst continuing to invest in key customer relationships.

In the longer term, the target product and service mix will be primarily software-based (utilising a subscription or license revenue model); highly scalable (built on a model of 'build it once and sell it many times') and able to deliver long term, repeatable revenue streams. Over time, it will also focus on potentially higher value sectors in the aviation industry including airlines and airports.

FY20 key strategic workstreams

The key workstreams Airways will progress during FY20, and the initiatives and activities that will enable them, are set out in the table below.

Key strategic workstreams	FY20 initiatives
Implement operations roadmap	▶ Obtain CAA approval for split sector operations and the new Wellington and Auckland TMA sectors ▶ Undertake independent airspace review, prepare plans to support vision
Deliver next generation ATM infrastructure	▶ Complete the ATM software build and deliver all key supporting infrastructure projects including IL4 buildings
Deliver Future Aerodrome Services Programme (FASP)	▶ Develop FASP strategy (detailing a regional solution, required investments, staffing implications, costings and timeline) ▶ Deliver operational digital tower solutions in Invercargill and Auckland to support training and safety assessment in FY21
Non-cooperative surveillance[1] solution capable of detecting UAVs	▶ Implement a solution for Auckland and develop a national strategy and roll out plan
Develop national UAV traffic management solution	▶ Improve the capability and scope of the UTM platform. Deliver the first paid services
Develop national service delivery framework	▶ Move from asset to service based model ▶ Establish appropriate partnership model
Deliver sustainable growth in the commercial business	▶ Validate and expand the range of products and services ▶ Invest in key customer relationships and establish an EMEA sales office ▶ Develop cloud based services offerings for Aviation English and Basic Online
Baseline sustainability & CSR framework and initiatives	▶ Develop and launch a framework for staff initiative fund ▶ Establish a baseline for carbon emissions in airspace controlled by Airways ▶ Using the baseline waste measures developed in FY19, develop appropriate targets for reductions in waste to landfill ▶ Develop baseline measures for energy usage and CO_2 emissions ▶ Initiate, co-design and implement an initiative with the general aviation community which delivers positive outcomes and benefits for a range of general aviation businesses

1. Non-cooperative surveillance involves the detection and tracking of aircraft and other aerial vehicles that are unable or unwilling to provide identification signals back to the ATM system.

Measures of success

Operational Focus	Forecast FY19	Plan FY20	Plan FY21	Plan FY22
Near collisions	2	Nil	Nil	Nil
Staffing service availability[2]	99.88%	99.88%	99.88%	99.88%
Core systems availability	100%	100%	100%	100%
Critical technology services availability	99.95%	99.95%	99.95%	99.95%
Cyber security maturity rating[3]	3	>3	>3	>3
Customer Focus				
Core customer satisfaction	To be measured	>80%	>80%	>80%
Commercial customer satisfaction	100%	>80%	>80%	>80%
Leadership & People				
Staff safety – serious harm injuries	Nil	Nil	Nil	Nil
Staff survey results (targeted areas)	To be measured	>FY19	>FY20	>FY21
Sustainability				
Carbon emissions per FTE	Baseline to be measured	<FY19	<FY20	<FY21
Reduction in waste to landfill against FY19 baseline	Baseline to be measured	5%	10%	20%
Energy consumption	Baseline to be measured	<FY19	<FY20	<FY21
Financial ($m)				
Group NOPAT	23.4	25.7	29.6	29.5
Commercial business NOPAT	7.6	7.8	9.3	10.4
Capital investment	44.0	75.6	72.8	47.4
Dividends	12.0	13.0	14.0	15.0
Dividend yield	4.9%	5.2%	5.6%	6.0%
Return on equity	16.9%	17.1%	18.0%	16.5 %

2. Service availability is measured as the arithmetic average of ATS staff availability for all aerodromes, approach sectors and enroute sectors.
3. Airways' cyber security will be self-assessed against the NIST Cybersecurity Framework which is based on a 4 tier index.

Financial forecasts by unit ($NZm)

Airways expects to deliver a full year group NOPAT result of $23.4m for FY2018/19, in line with budget and SCI targets and $0.5m ahead of the prior year.

Core business NOPAT is forecast to reach $15.8m, with flight volumes and revenue 1.0% ahead of the estimates used to determine FY18/19 pricing and operating costs slightly above budget following the revaluation of long term leave liabilities.

The commercial businesses are forecast to deliver a NOPAT result of $7.6m, up on the prior year result of $5.6m and in line with budget. Positive contributions have come from across the portfolio, including the sale and installation of a simulator in Lebanon and the growth of consultancy and engineering work at New Zealand and Pacific aerodromes.

Following a comprehensive consultation process with customers and other stakeholders, Airways has recently set core business ATM prices for the FY20-FY22 period. These prices and related revenue estimates are reflected in the financial budgets for the three years from FY2019/20, set out below.

	Forecast FY19	Plan FY20	Plan FY21	Plan FY22
Revenue (Includes internal revenue)				
▸ Core business	196.0	224.1	235.6	245.2
Commercial businesses				
▸ Digital	4.1	4.7	5.2	5.7
▸ Aeropath/Aviation Services	28.4	29.1	30.2	32.4
▸ Training course delivery	8.3	10.1	11.1	12.2
	40.8	**43.9**	**46.5**	**50.3**
Group revenue	**236.8**	**268.0**	**282.1**	**295.5**
NOPAT				
▸ Core business	15.8	17.9	20.3	19.1
Commercial businesses				
▸ Digital	0.4	0.3	0.7	1.1
▸ Aeropath/Aviation Services	5.2	5.1	6.0	6.4
▸ Training course delivery	2.0	2.4	2.6	2.9
	7.6	**7.8**	**9.3**	**10.4**
Group NOPAT	**23.4**	**25.7**	**29.6**	**29.5**
Key financial metrics				
▸ Capital investment	44.0	75.6	72.8	47.4
▸ Group FTEs	783	818	823	816
▸ Group return on capital (GAAP)	17.4%	17.1%	16.5%	16.5%

ACCOUNTING POLICIES

Airways prepares financial statements in accordance with GAAP, with a complete list of accounting policies available in the latest annual report available on Airways' website. In addition to these accounting policies, Airways will adopt the new IFRS 16 lease accounting standard from 1 July 2019. The impact of this standard is set out in the financial budgets above and in the latest annual report.

The financial forecasts and budgets set out in this SCI comply with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards (as appropriate for profit-oriented entities) except for revenue, which is determined at the individual business unit level. As a result, the Group revenue number above includes internal revenue earned by Airways' commercial businesses from the statutory business. This internal revenue is eliminated in the annual financial statements, which are prepared at a Group level only. This has no impact on Group NOPAT.

Airways also uses Economic Value Added (EVA) principles to guide pricing decisions. Further detail is provided in Appendix B.

Dividends

The Directors will seek to return a dividend of between 50% and 100% of Base Free Cash Flow from the Group (normalised for maintenance levels of capital investment), subject to targeting a Group gearing ratio below 35% exclusive of lease liabilities, and 50% inclusive of lease liabilities, over a rolling five year term[4], while giving consideration to the performance of the business and changing financial conditions. Actual dividend payments will also remain subject to both solvency test and banking covenant restrictions.

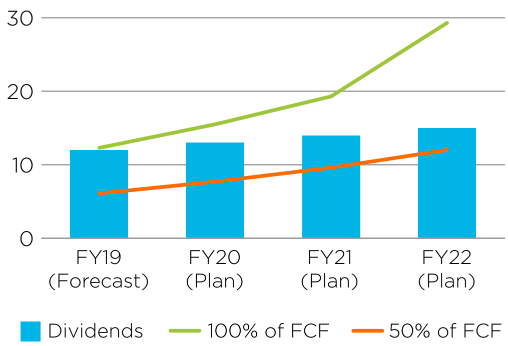
In determining dividend levels, the Board will balance the objective of providing a stable or increasing dividends to the Shareholder against short-to-medium term investment requirements and prudent risk management.

Specific dividend forecasts for the planning period, with respect to base free cashflow parameters, are set out opposite.

Gearing (including and excluding leases) for the 5 years from FY18/19 is forecast to remain within the policy limits outlined above.

The level of dividend will be reviewed annually as part of the business planning process and at each declaration date. Dividends are usually paid in October and February and a final dividend not later than 30 June of each year.

Dividends vs free cashflow limits ($m)



4. Dividends are payable where average gearing over the next 5 year period remains below policy levels and there is no individual year where gearing exceeds 40% exclusive of leases or 55% inclusive of leases.

Reporting to shareholding Ministers

In compliance with the Act and in accordance with the requirements of the shareholding Ministers, the following reports will be presented to shareholders:

ANNUAL REPORT

Within three months after the end of each financial year, an annual report including:

- audited financial statements for the year
- notes to the financial statements including accounting policies
- a report from the Chair which will include:
  - a review of operations
  - changes in the nature and scope of Airways' activities
  - a summary of achievements measured against performance targets
  - comments on the outlook for the next 12 months
  - statement of dividend payable

INTERIM REPORT

Within two months of the end of each half-year, an interim report including:

- an abridged, unaudited statement of Airways' financial performance and position
- a qualitative report from the Directors on Airways' performance compared with the objectives set out in the SCI, any significant changes in intent and scope during the half-year and the outlook for the next half-year

QUARTERLY REPORT

Within one month of the end of each quarter, a quarterly report comprising a commentary and summary of financial statistics indicating performance against targets for the preceding quarter.

INVESTMENT PROJECT REVIEW

Provide a report covering all post-project investment reviews conducted in the previous calendar year greater than $5 million, by 28 February each year.

"NO SURPRISES" POLICY

Inform the Ministers of any material or significant events relating to Airways that may be contentious or could attract public interest.

Policy for share acquisitions

Any share, equity or asset acquisitions (or sales) will reflect Airways' business strategy requirements for achieving our vision. Airways will consult shareholding Ministers on equity investment or capital expenditure above:

- $10 million on an individual item of capital expenditure or investment in New Zealand
- $5 million investment in an individual overseas project, or other significant investments, even if they do not meet the above thresholds

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Compensation from the Crown

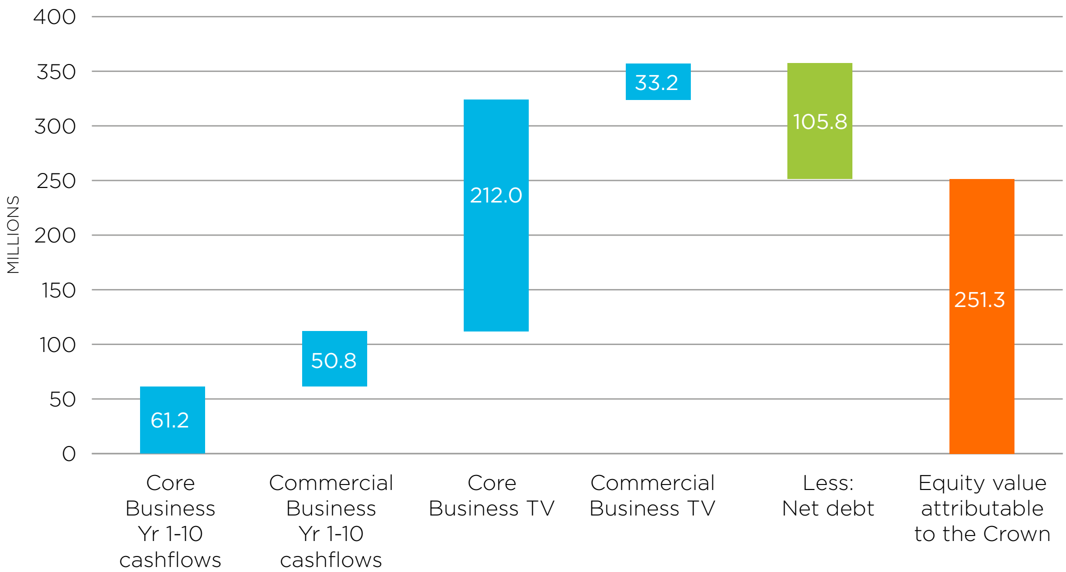
Section 7 of the Act allows the Crown to enter into an agreement with Airways whereby the Crown would pay Airways for undertaking a non-commercial activity. Airways does not currently undertake any such activities but reserves the right to seek payment where Airways is restrained from acting in a normal business-like manner.

The Crown's Investment in Airways

The Directors' estimate of the current commercial value of the Crown's investment in the Airways group as at 30 June 2019 is $251.3 million (June 2018 $238.2 million). Key points about the manner in which that value was assessed are:

- The Free cash flow (FCF) to Enterprise methodology was used to calculate the Net Present Value (NPV) of the entire Airways Group, including all subsidiaries, on an after-tax basis.
- The NPV was based on the expected nominal future cash flows set out in the Airways Group's three-year business plan, with forward projections then also made about years four to 10. A terminal value ("TV") of $245.2 million (present value) was included. A growth rate of 0% per annum was assumed in the terminal value calculation for all business units.
- The discount rate was based on the projected average cost of capital (long-term averages of 6.59% for the core business and 10.23% for the commercial businesses).
- The valuation was prepared by the Airways' management, and reviewed by Ireland, Wallace & Associates Limited, prior to approval by the Board.
- The current commercial value of the Crown's investment of $251.3 million (the equity value) was calculated by taking the enterprise value of $357.1 million and deducting net debt of $105.8 million.

The chart illustrates how the valuation is determined (all amounts are stated at their Net Present Value):



The valuation compares with a commercial value as at 30 June 2018 of $238.2 million. The key reasons for the increase in commercial value are:

- Core business (up $56.3 million): net increases in the capital base used to determine future pricing, with new capital investment of $55.0 million being offset by depreciation of $22.3 million, and an increase in capitalised leases of $33.2 million.
- Commercial businesses (up $9.9 million): lower risk free rate driving less discounting of future cashflows, as well as an incremental strengthening of future cashflow forecasts.
- Increase in Group external net debt (up $19.9 million): increase in net debt used to fund capital investment.
- Increase in lease liabilities (up $33.2 million): with the adoption of the new leasing standard from 1 July 2019, and the imminent opening of two new leased operational sites, the value of capitalised leases and the corresponding liabilities have increased substantially from the prior year. This has not, however, had any impact on the Group's equity valuation.

Valuation sensitivity and range	Range	Low	High
Base valuation		**$251.3m**	**$251.3m**
▶ Change in growth factor used in terminal value calculation for commercial business	0–2%	–	$8.9m
▶ Change in commercial business terminal free cash flow	+/- 10%	($3.3m)	$3.3m
Estimated valuation range		**$248.0m**	**$263.5m**

Appendix A:
Financial Performance Metrics ($NZm)

Year ended 30 June	Actual FY18	Forecast FY19	Plan FY20	Plan FY21	Plan FY22
Profitability					
Total revenue	214.5	236.8	268.0	282.1	295.5
EBITDA	54.5	56.8	70.1	81.6	93.7
EBIT	31.8	33.5	40.2	45.9	49.3
NOPAT	22.9[1]	23.4	25.7	29.6	29.5
Shareholders' returns					
Total shareholder return[2]	14.2%	10.6%	–	–	–
Dividend yield	4.8%	4.9%	5.2%	5.6%	6.0%
Dividend payout	41.8%	50.1%	48.7%	40.3%	44.8%
Return on equity	18.5%	16.9%	17.1%	18.0%	16.5%
ROE, adj for IFRS movements and assets revaluations	18.2%	16.8%	17.0%	17.9%	16.4%
Profitability/efficiency					
Return on capital employed	19.3%	17.4%	17.1%	16.5%	16.5%
Return on assets	14.5%	13.5%	12.4%	11.5%	11.7%
Operating margin	25.4%	24.0%	26.2%	28.9%	31.7%
Net profit margin	10.7%	9.9%	9.6%	10.5%	10.0%
Asset turnover	0.9	0.9	0.7	0.7	0.7
Leverage/solvency					
Equity multiplier	1.7	1.9	2.4	2.4	2.3
Gearing ratio (net) – excluding leases	22.4%	31.1%	39.0%	41.5%	37.6%
Gearing ratio (net) – including leases	–	–	51.6%	52.1%	48.5%
Interest cover (before capitalised interest)	23.4	18.5	19.7	18.2	20.7
Solvency (current ratio)	0.7	0.7	0.8	0.8	0.8
Growth/investment					
Revenue growth	4.6%	10.4%	13.2%	5.3%	4.8%
EDITDAF growth	(2.1%)	4.2%	23.5%	16.5%	14.8%
NPAT growth	(3.3%)	2.1%	9.8%	15.3%	(0.3%)
Capital employed growth	11.0%	21.5%	22.6%	14.5%	1.5%
Capital renewal	2.0	2.2	2.9	2.3	1.2

1. Does not include a $4.2m gain on sale of surplus land
2. Company valuations are not forecast from 2019–20.

Definitions for the financial performance measures above are at the following link:
https://treasury.govt.nz/sites/default/files/2015-09/fpm-soes.pdf

Appendix B:
Core Business Economic Value Added (EVA) ($NZm)

BACKGROUND

EVA provides an economic measure of performance and explicitly recognises the expected return to investors. EVA underpins our pricing framework, which is premised on achieving a fair return on the capital invested in the core business, reflected by an EVA result of zero.

Key parameters and inputs into the EVA framework have been presented to our customers through the consultation process for the FY20-22 pricing round.

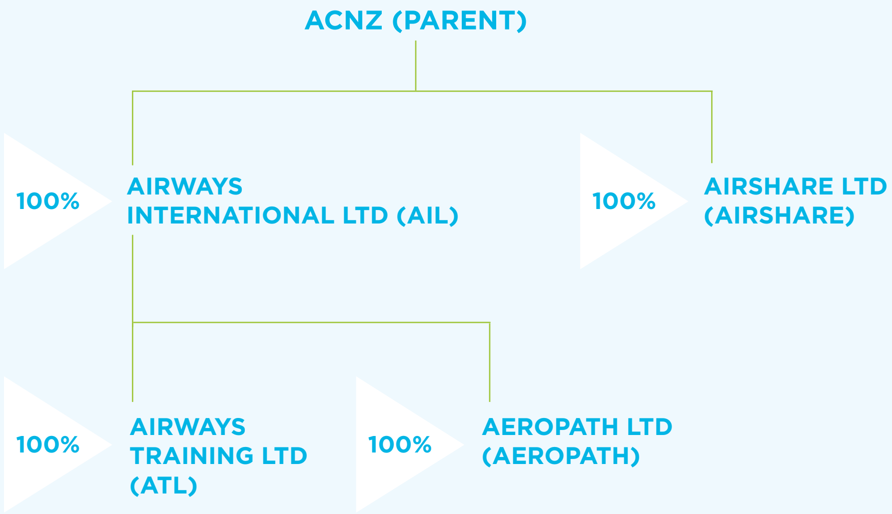
EVA	Plan FY20	Plan FY21	Plan FY22
Total capital employed			
Debt employed	212.4	238.1	235.4
Equity employed	137.3	143.7	150.6
	349.7	**381.8**	**386.0**
Charge on operating capital	**21.5**	**24.1**	**25.3**
Economic value added	–	–	–

Cost of capital – key parameters			
Risk free rate – 3 year Government Stock	1.69%	1.69%	1.69%
Market risk premium	7.00%	7.00%	7.00%
Business risk factor (asset beta)	0.60	0.60	0.60
WACC range percentile	67th	67th	67th
Cost of capital	**6.59%**	**6.59%**	**6.59%**
Return on capital (RoC)	6.59%	6.59%	6.59%

Appendix C:
Group structure

The legal entities that make up the Airways Group, and their respective principal activities, are set out below:

Legal entity	Principal activity
Airways Corporation of New Zealand Limited (ACNZ)	Provision of air traffic management services
Airways International Limited (AIL)	Revenue management, recruitment and training, and air navigation services and maintenance of systems
Airways Training Limited (ATL)	Aviation English training
Aeropath Limited (Aeropath)	Aeronautical information management, procedure design and development services
Airshare Limited	A new entity incorporated 16 November 2018 to deliver unmanned aerial vehicle (UAV) and drone traffic management services (currently not trading)



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POLICY FOR SHARE ACQUISITION
COMPENSATION FROM THE CROWN
THE CROWN'S INVESTMENT IN AIRWAYS
APPENDICES
DIRECTORY

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ANZ Bank New Zealand Limited

Bank of New Zealand Limited

AUDITORS

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

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