



Chairman's address to the 2016 Annual General Meeting of Airlines of Papua New Guinea Limited on 29 June 2016

Since my report to the Company's AGM in September last year a great deal of progress has been made by the Company. We now operate 3 brand new ATR 72-600 aircraft, with a fourth to be delivered in the next 2 month, and another before the Christmas peak season this year. Those aircraft proudly display our new brand and our fresh and distinctive new livery. That new brand was first revealed at last year's AGM, and has been very positively received in the market. Subject to your vote today we will complete that rebranding process by changing the name of the Company itself to PNG Air Limited.

What has not changed is that global economic forces, and the PNG economy, continue to pose challenges for the Company's business.

The Board made a decision 3 years ago to put more emphasis on the Company's RPT business, seeing that as where the Company could develop a business that was both growing and sustainable through changing economic cycles. Up to that time, charter operations had provided around half of the Company's revenue, and the Company's fleet was geared to those operations. However, the charter business in PNG relies on resource industry activity, which is vulnerable to world commodity demand and prices.

Since 2012, falling world commodity prices have seen exploration activity substantially reduce, and caused existing operators to pare back their operations and look to reduce costs wherever they can. Add to that local factors such as the Exxon Mobil LNG project moving into its production phase, and prevailing weather conditions causing the Ok Tedi mine to cease production for many months, and it has been a very difficult time in the charter business in the past 3 years.

The Company's charter revenue dropped by around 70% between 2012 and 2015, falling from being 50% of the Company's revenue in 2012 to approximately 16% of total revenue in 2015. Had the Company not increased its focus on RPT operations when it did, that drop off in the charter market would have been crippling, and those figures by themselves justify the strategic direction the Company has taken.

Across the same 2012 to 2015 period the Company increased RPT revenue by 50% and almost doubled freight revenue, meaning that total revenue reduced by less than 5% compared to 2012, when charter operations were at their peak.

The Company was not just focussed on the revenue side. Over the same period, the Company has reduced direct operating costs by 12% and other costs by over 20%, meaning that in spite of the adverse economic conditions, despite the sharp drop in charter revenue and despite all the effort

going into the essential re-fleeting and rebranding exercises, the Company achieved a small profit in 2015, before tax and abnormal items relating to the introduction of the ATR aircraft.

While re-fleeting with introducing the ATR has been costly, in money terms and possibly more so in terms of management time, it was a necessity. The Company could not have viably continued with its existing fleet. Now, we can be the only carrier servicing all major ports in the domestic market with new, efficient, highly reliable, state of the art aircraft. For the first time we will offer what is clearly the premium product on domestic routes. As the ATR fleet grows from 3 to 5 by the end of this year to 7 by the end of 2017, we will get to the point where most PNG Air flights are on the ATR, and a large majority of our passengers will be carried on the ATR. I have said previously that the Company's plan is to replace all our Dash 8s and become a 100% ATR operator by 2020, and work continues to ensure that that happens.

It is worth noting that figures to date show that the performance of the ATRs has been in line with expectations, and they have demonstrated the ability to generate the cost savings and efficiencies that lead to the ATR being chosen by the Company.

I am very pleased to advise that 2 other matters mentioned at last year's AGM are well under way. After a long period of time, the entitlement offer approved by Shareholders at the Special Meeting in December 2014 is now being made. The Registrar of Companies registered the prospectus for the entitlement offer on 20 June and the process of distributing the prospectus is happening now. Shareholders will begin to receive the prospectus at the end of next week, and will have the opportunity to choose to subscribe for new shares in the Company in proportion to their existing shareholdings on the terms set out in the prospectus. When you receive the prospectus I urge you to read and carefully consider the full document before making your decision on a further investment in the Company. I can only apologise once again on behalf of the Board that the entitlement offer has not been made before now.

Shareholders will recall that the last AGM authorised the Company to introduce an employee share plan. I am pleased to confirm that the first set of issues of shares to eligible employees is going ahead now. This scheme has been enthusiastically received by employees.

I spoke earlier about the challenges faced by the Company in 2015 and before that. Compared to previous years, the results in 2015 were encouraging, and gave reason to believe that the Company is on the right strategic track. The Board firmly believes that that is correct, and that the re-fleeting plan and RPT focus introduced in the past few years give the Company a business that will be viable and profitable into the future. Inevitably, with major projects such as TOTAL, the third LNG Train and Wafi-Golpu in the pipeline, the charter market will pick up, and the Company will have the capacity to re-grow its charter business as opportunities arise. However, not all of the Company's challenges are behind it. Economic conditions in PNG have not yet turned around, and with less cash flowing through the economy, discretionary spending on items such as air travel comes under pressure. Resources sector activity in PNG remains depressed, with new charter contracts few and far between. While the Company has already greatly improving its fleet, its product and its efficiency, and will continue that improvement as the transition to an all ATR fleet continues, it hasn't yet got the full benefit of those improvements, and won't until the global and PNG economies improve.

In conclusion, the Board wishes to thank all shareholders for their continued support and commitment to the Company, and their continued patience when it comes to the declaration of a

dividend. While the Board and management are very proud of the progress made in transforming the Company's business in 2015, and of the Company's ongoing contribution to the PNG travelling public and the PNG economy, the objective of these efforts is to create a sustainably profitable business, and to add value to your investments. The Board is confident that the Company is on the right track to achieve that.



Chief Executive Officer's address to the 2016 Annual General Meeting of Airlines of Papua New Guinea Limited on 29 June 2016

The Chairman has outlined the Company's financial performance in 2015, achieved despite the ongoing challenges faced in the charter market, and by the PNG economy in general. He has also updated you on the position of the Company's re-fleeting process. I want to share with you some other developments regarding the Company in 2015 and in the first part of this year. Some of these have been positive, while others have added to the challenges we continue to face.

Part of the Company's re-fleeting plan calls for the progressive reduction in the Dash 8 fleet, as new ATR aircraft are introduced. We are achieving this by the return of leased aircraft with one leased Dash 8 returned so far. Negotiations on the return of further Dash 8s are continuing.

While lower commodity prices have contributed to many of the economic problems facing PNG and PNG Air, one benefit has been that fuel prices have been low over this period, although they appear to be firming now. Low fuel prices certainly benefit PNG Air, although those benefits have been offset by depreciation of the PNG Kina. Higher fuel prices will increase the Company's costs in the short term, but if they lead to more resource industry activity and a strengthening of the PNG economy, they will end up benefitting PNG Air.

A recent highlight was the decision by PNG CASA to renew the Company's Air Operator's Certificate and Maintenance Organisation Certificate for 3 years. Until 2014 CASA had only given 1 year extensions. In that year it gave 2 year extension, and it is very heartening that PNG CASA was prepared to further increase the term it would grant. This shows that CASA recognises the strong safety and quality systems the Company has put in place.

The Company has successfully completed all other external audits since the start of 2015, including an audit allowing us to provide services to Repsol. The Company's BARS gold registration remains in place and we are confident it will be renewed when that is due later in the year.

Various new routes have been opened successfully, including most recently Buka to Kieta. We are continuing to work through the regulatory requirements for our first proposed international operations, since we exited Cairns, by beginning Mt Hagen to Jayapura flights. We are also looking at the viability of other regional international routes.

The Company has seen improved performance on some routes, partly through better scheduling, partly from the effect of flying the new ATR on those routes, and in some cases as a result of Travel Air ceasing operations.

In 2015 the Company had reached an agreement in principle to sell the refuelling business operated by its subsidiary, PNG Ground Services. The competition regulator refused to approve that sale and so it did not proceed. Pending any other proposal to sell that subsidiary or its business on commercially acceptable terms, we will continue to operate and to try to expand that business.

With the first part of the re-fleeting process – the introduction of the new aircraft type, and our re-branding – having been completed, and with the Company getting experience as an ATR operator, we need to refine the services we offer so as to win the loyalty of PNG travellers and make more inroads into the business travel market. To try to achieve that, we will soon introduce on-line check-in, and bring in a business class product on the ATR, and we're investigating a loyalty program as well. We are also negotiating with NAC to obtain lounge facilities at strategic ports.

The aviation industry is highly capital intensive and needs substantial capital to succeed in the long term. As the recent example of Virgin Australia shows, support from shareholders to capitalise the airline is necessary for long term viability. The Company continues to have great support from its major shareholders, NasFund and the MRDC group, and from our principal bankers, BSP, but still needs more financing to take us through this phase in our development until the benefits of the re-fleeting program start to be fully realised. We expect to put proposals regarding further financing to the shareholders later this year.

Let me reiterate what the Chairman said about the business mix. I draw your attention to the graph on the screen. Charter revenue which made up 56% of the business in 2011 has since come down to very low levels. While management is putting every effort into winning charter contracts, these contracts don't come up for tender as frequently as we would like.

The new ATRs, ownership by MRDC and NasFund, recent safety and compliance achievements and a strong customer service focus have put the Company in a strong position to win charter contracts, when they do come up for renewal.

The RPT market has also contracted over the last two years, after years of double digit growth up to about 2014. The Board and management are working hard to respond to these short term challenges by taking quick action to lower costs and increase the revenue base.

I draw your attention to the graph on the screen, showing that 2015 saw much better results for the Company than in the previous 3 years. That indicates that the strategy of focussing more on RPT services and management efforts to strictly control costs both contributed positively, despite difficult outside economic circumstances. Because those difficulties remain, the Company is not yet out of the woods.

On a very positive note the PNG Air launch for our first ATR last year in November was a huge success

It was reassuring that when the Prime Minister, the Honourable Peter O'Neill, addressed the launch function he stressed the contribution the airline has made to providing essential air services to more of PNG and the importance of continuing competition. While the Company continues to provide

that competition, and while it offers the high quality service the PNG people deserve, a strong safety and compliance record, a state of the art fleet and a new and dynamic brand, the Company has a bright long term future.