



## **2015 ANNUAL GENERAL MEETING 9 SEPTEMBER 2015**

### **CHAIRMAN'S ADDRESS**

The last 12 months have been enormously busy for Airlines PNG. They have been challenging, but they've also been highly promising.

The Board has taken some important decisions over those 12 months to position the airline to become a major force in the domestic aviation market and to set the Company on the right path for growth over the long term – that is, the next 20 plus years.

As you all know last year with the support of Shareholders 2 major changes occurred. First, the Company's capital was restructured so that the Company is now unambiguously PNG owned and a permanent part of the country's infrastructure and economy. Second, the decision was made to re-fleet with the ATR 72-600, meaning the airline will be the only carrier in the country servicing all major ports in the domestic market with new, efficient, highly reliable, state of the art aircraft. That will allow the airline for the first time to offer what is clearly the premium product on domestic routes.

We expect to have 3 brand new ATRs operating by February 2016 and 7 by December 2017. After that the plan is to replace all our Dash 8s and become a 100% ATR operator by 2020. The ATR is the only aircraft currently in production that can fly to all major ports in PNG. ATR have invested heavily to make their product by far the most widely chosen regional turboprop aircraft around the world.

From the Company's perspective, the key points are that:

- we will be replacing 25 year old aircraft with brand new aircraft;
- those new aircraft have lower operating costs overall than our existing fleet and much lower operating costs per seat;
- they will also be much more reliable, have greater capacity and will allow flexible freight and freight/passenger combinations;

From the passenger's viewpoint, the ATR is bigger, more comfortable and faster than our current fleet.

As I stated at the last AGM, after a lot of investigation into the alternatives we came to the conclusion that the ATR was the best aircraft available for operations in PNG on the routes we want to operate on. As the airline will be the only one operating the ATR in PNG, and for that matter the only one operating any new aircraft type, the Board believes it will give the airline a significant competitive advantage into the future.

We have of course been talking about the ATR for some time now – the exciting thing is that it is now only a little over a month before the first of the new aircraft arrives in PNG ready to start operating.

The Board has also taken the decision to rebrand the airline, to reinvigorate its image. Re-fleeting gives the Company this opportunity, as a fleet of new, larger and more comfortable aircraft will improve public perception of the airline's safety and service. Rebranding will reinforce that the airline is offering something new and genuinely improved. A new appearance will also emphasise improvements in the airline's service culture.

There will be a further presentation on the re-branding later in this meeting to give you a feel for the airline's new look.

More recently, the Board has proposed the introduction of an employee share plan, to reward long serving employees for their continuing service and loyalty, and to encourage staff to identify more with the Company and to treat the Company's interests as their own. Engaged and committed employees are crucial to any airline business where customer service and attention to detail behind the scenes are vital. The Company has not been able to reward staff through pay increases as it may have liked to and this is seen as a way of providing long serving staff with a real incentive without draining the Company's limited cash.

Shareholders will be asked to approve the share plan at today's meeting. The main terms of the proposed plan were set out in the notice of meeting. In brief, if Shareholders approve the plan, employees will become eligible for an issue of free shares under the plan after achieving 5, 10, 15 and 20 years of continuous employment. A fixed number of shares would issue to any employee after reaching one of those milestones, regardless of the position or salary of the employee.

There is a cap of 2% of the total issued shares of the Company that can issue under the plan in any year, although in practice the total number of shares that would issue under the plan over the first 3 years, if it is approved, is just over 1% of the current issued capital of the Company. I point out that the plan would not provide for an issue of shares to any current Director, as no Director is an employee of the Company.

I mentioned that there have been challenges over the past 12 months, mostly related to contraction in the aviation charter market in PNG. The economy is going through a tough time with lower world oil and gold prices, and local events such as the Ok Tedi closure. However, the long term growth prospects for the economy look bright with major projects such as TOTAL, the third LNG Train and Wafi-Golpu starting construction over the next few years.

There have also been some issues relating to the recapitalisation of the Company. You as Shareholders would be aware that part of the recapitalisation that was approved late last year was an entitlement offer to all current PNG Shareholders, on similar terms to the share and option issues to the MRDC group and NasFund. At the time of the 2014 AGM in February this year I said the Board expected to be able to issue the prospectus for the entitlement offer very soon. It is entirely reasonable for Shareholders to be asking why, after they voted for the share issues to NASFUND and MRDC based on the commitment that they would get the same rights to new shares and options, that still hasn't happened.

When Shareholders approved the further investments by NasFund and MRDC, that was conditional on the entitlement offer also being approved and on a prospectus for the entitlement offer being submitted to the Registrar of Companies within 7 days. The entitlement offer was approved, and so the recapitalisation was able to occur. The Company had a draft prospectus submitted to the Registrar within the required time.

Unfortunately, ever since we have been unable to have the Registrar complete the registration of the prospectus despite constant contact with him and despite promptly satisfy any requirements he imposed. The Company has incurred substantial costs in external legal fees in that effort. On 8 July 2015 matters came to a head when the Registrar wrote to the Company's lawyers saying "APNG is kindly advised to appoint another Auditor from a different Accounting Firm to audit Airlines PNG Limited financial statements for the years ending December 2013 and 2014 respectively."

Let me point out that the Company's auditors, Deloitte Touche Tohmatsu, are one of the "big 4" audit firms which operate world-wide and are recognised as maintaining the very highest audit standards. Deloitte audits are the gold standard and their PNG audits are subject to the same strict technical review by their Australian audit supervising committee as are their audits of Australian clients. Deloitte do not relax their standards in PNG, because of the effect a poorly conducted audit in any country could have on their reputation around the world. Indeed, the rigour of this review process has contributed to the Company having to seek extensions of the dates for issuing its last 2 annual reports.

To produce its audit report for a year Deloitte undertakes a lengthy process of examining, probing and assessing the Company, at a very substantial cost to the Company.

Having another audit company come in to duplicate the work done by Deloitte for 2 years could be expected to take at least 10 weeks and more importantly to cost approximately K500,000, while providing no corresponding benefit to Shareholders.

The Board is very concerned that given the quality of the audit reports already produced, and the promises implicitly made to Shareholders that if they voted for the recapitalisation the entitlement offer would be made available to them, the cost and delay from getting a further audit does not benefit Shareholders. The Company is trying to have the Registrar withdraw this unprecedented requirement on the basis that it is unreasonable and unjustified having regard to any likely benefit to Shareholders. The Company has also pointed out to the Registrar that when he, as the Acting Chairman of the Securities Commission of PNG, gave exemptions that allowed the recapitalisation to proceed, he did so knowing that the entitlement offer was part of that overall recapitalisation plan, and that the recapitalisation was subject to the Shareholders agreeing to both the investments by NasFund and MRDC, and to the entitlement offer. Shareholders seeing that the Securities Commission had been prepared to give those exemptions would have been entitled to assume the Registrar of Companies would not stand in the way of the entitlement offer.

Until a reasonable position can be reached regarding the registration of the prospectus for the entitlement offer, the Board can only repeat to Shareholders that it is unwilling to incur the great expense involved in getting further audits done to little or no purpose unless every effort has been made to have the Registrar remove this requirement. The Board expresses its regret at the continued delay in issuing the entitlement offer.

In conclusion, I want to repeat the Board's view that considering how critical aviation services are in PNG, and the growth in income levels generally in the country, we believe that there can only be long term growth in domestic travel. Similarly, there will continue to be the need for charter services to move personnel and freight to projects in the more remote parts of the country. With its recapitalisation and with re-fleeting about to actually happen, the Company has set itself to provide the best, most reliable and most efficient service to the domestic travel market. It will also have the capacity to service growth in the market and the capacity to continue to provide the country's premium charter operation.

The Board wishes to thank all Shareholders for their continued support and commitment to the Company, and their patience in relation to the entitlement offer. The Board also acknowledges the patience of Shareholders when it comes to the declaration of a dividend. While the Company remains proud to be continuing to benefit the travelling PNG public and the country by providing competition in the market, and services not otherwise available, the primary aim of the Company in undergoing recapitalisation and instituting its re-fleeting strategy has been to bring the Company to profitability and to add value to your investments. The Board is confident that all the hard work done over the past 2 years, the rationalisation of the airline and the decision to re-fleet and rebrand will position the airline to capture market share, provide a first rate service to PNG and return the Company to profitability.

**Murray Woo,**  
**Chairman**



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### CEO'S ADDRESS

Over the last 2 to 3 years the Company has undertaken a major restructure of its business. This included:

- the capital restructure,
- the re-fleeting and rebranding decisions outlined by the Chairman,
- changing the business plan to grow our RPT services,
- addressing costs and service delivery, and
- concentrating on our core operations.

Some major changes in that period, including exiting the codeshare agreement with Virgin, the Cairns route and the Twin Otter business, along with other cost saving initiatives have resulted in annualised savings of 36 million Kina. The Company has also substantially reduced debt from 126 million Kina in 2012 to 64 million Kina through the move to more leased aircraft and the sale of the unused Twin Otter fleet.

I am pleased to say that we are starting to see the results of those efforts with profit improvements beginning to flow through. For the half year to June 2015 we have recorded a break even result compared to 10 million Kina plus losses in each of 2013 and 2014. July 2015 was a very profitable month, obviously helped by the PNG Games activity. It's important to remember that we achieved these results despite:

- a reduction in Exxon Mobil PNG contract revenue due to the early completion of the project;
- a general down turn in the economy;
- incurring costs for the re-fleeting and rebranding processes; and
- facing heavy competition from Travel Air and Link PNG.

The Company has invested heavily in the engineering and maintenance planning departments resulting in improved operational performance – for example for August 2015 OTP was in excess of 90% on top of a very good July which produced an 85% result. OTP isn't just good for passengers – it also directly reduces disrupt and delay costs. Our target is to achieve 85% OTP over the long term and then improve further from there.

The Company's high levels of technical competence and capability have allowed us to achieve BARS Gold registration. BARS is the resources industry's own safety audit standard for aviation services. There are 26 member organisations including major mining houses such as Barrick, BHP, Rio Tinto and Newcrest Mining who use this to evaluate aviation service providers.

We have also had PNG CASA extend the Company's Air Operator's Certificate for 2 years, instead of the previous annual extensions, indicating the confidence CASA places in the airline's management and systems.

In 2014 we won the contract to service the Lihir mine which has helped us grow our RPT network. Our main customers remain the grassroots Papua New Guineans who travel with us because of our route coverage, friendly service and competitive airfares. However with an improved network and better service delivery we are starting to see more support from the corporate sector. We expect that support to grow further as we introduce a better product in the ATR and the public begins to experience the improved service that goes along with the upgraded fleet and rebranding.

At the last AGM, I briefly touched on the 2014 results, which were in the final stages of being audited at that time. Now that we have the audited results, I wish to highlight the following:

- There was a further operating loss of 23 million Kina for 2014, which can be mainly attributed to:
  - Reduced flying under the Exxon Mobil PNG charter contact by more than 50% from the second quarter of the year. This was a result of the early completion of the gas project;
  - Deployment of capacity from highly profitable charter operations to more marginally profitable RPT services, which tend to be a higher volume, lower margin business;
  - Commencement of new RPT routes which need time to get established and generate returns;
  - The adverse impact of the PNG Kina exchange rate during the first half of the year;
  - Redundancy costs incurred as part of the cost saving exercise;
  - A general downturn in the economy, increased competition and lack of new charter opportunities; and finally
  - Additional costs connected with the re-fleeting and rebranding programs.

While the Company did have an operating loss during 2014 and faced financial constraints, the support from the Shareholders and other stakeholders kept us determined to achieve the objectives of the "5 pillar" strategy which I presented to you at the last AGM. I am pleased to say that the Company has progressed well in achieving those strategic targets, being:

- Re-structuring;
- Re-financing;
- Re-claiming;
- Re-fleeting;
- Re-branding.

We have completed most aspects of the restructure, and as the Chairman has said the Company has now re-claimed its' clear PNG identity. Re-fleeting is almost with us and the first of our new ATRs will be operating by the end of next month, proudly displaying our new brand and livery, which you'll see a little more of shortly.

However, all of this needs funding and it is the "re-financing" pillar that we are still working hardest on. We are currently pursuing the raising of a further K30 million to fund the ATR introduction,

rebranding and ongoing operation of the Dash 8 fleet up to the point where cashflows from the ATR operations begin to flow steadily. We have engaged BSP Capital as a financial adviser to assist us with this process and we are actively making roadshows to various prospective investors. We expect to announce shortly the first tranche of that new financing.

This country needs a competitive aviation marketplace and the people of PNG deserve choice. Our strategy has been built around supporting the people of PNG with the aviation services they deserve. It's been a challenge but one worth taking as success will see long term benefits for PNG, Shareholders and the Company. With your ongoing support we will build and deliver an airline that the country and all of us can be proud to call our own.

**Muralee Siva**  
**Chief Executive Officer**