Airlines PNG

COME FLY OUR WAY

2014 ANNUAL GENERAL MEETING 25 FEBRUARY 2015

CEO'S ADDRESS

Introduction

Thank you Mr Chairman, and good morning everyone.

The Company's previous Chairman, Simon Wild began his address to the 2013 AGM by saying "2012 was a difficult year for the airline stemming from the tragic occurrences of October 2011. The airline experienced tough times driven by the lack of capacity and the loss of public confidence".

Unfortunately, those comments largely continued to apply during 2013. The Company continued to suffer from the after-effects of the 2011 Madang tragedy, and the loss of confidence from the travelling public and the corporate market resulting from it, even though the accident report which came out last year firmly identified the underlying cause of the accident as a design issue.

The capacity situation did improve in 2013 with the addition of our 12th and 13th Dash 8 aircraft, but the delay in entry to service of one of those aircraft prevented us from realising the maximum benefit from this additional capacity.

At the end of 2012 the Company faced various challenges:

- Lack of strategic direction after the accident/failed merger;
- Lost focus on domestic operations, the Company's core business;
- Non-renewal of major charter contracts. During 2012 these included Barrick, Newcrest and Solair;
- High cost structure built up to achieve the merger;
- Cost of unutilised assets, mainly the Twin Otters;
- Loss making non-core operations;
- Depreciation of the Kina against the Australian and US dollars.

In response to those challenges the Company has taken some decisive steps to strengthen its position. Let me list some of those critical changes:

- Expanded domestic services by re-introducing our Madang and Wewak services, starting additional flights to the Islands region and Highlands and adding additional services to Tari;
- Exited international routes and the Virgin codeshare;

- Discontinued Twin Otter RPT services and subsequently ceased Twin Otter operations entirely;
- Added Dash 8 capacity as mentioned;
- Reduced debt levels from approximately K120 million to K60 million, through sale of surplus Twin Otter aircraft, and by selling and then leasing back 5 of the Company's Dash 8 aircraft;
- Achieved substantial annualised cost savings, without compromising safety standards or service delivery;
- Focussed on product delivery with specific focus on On-Time Performance (OTP). This is an area we need to continue to concentrate on.

Financially, while a significant improvement on the 2012 result, and while it can be pointed out that there was both some element of laying foundations for the future, and a number of extraordinary items included, the 2013 financial result remained a loss.

On a consolidated basis, there was an operating loss for the year of K17 million (compared to K29 million for 2012). Many of the actions I referred to previously contributed to this relative improvement.

In addition to the non-renewal of contracts and on-going capacity issues which I have mentioned, the 2013 result was significantly affected by increases in fuel costs and weakening of the Kina. There were significant holding costs from the surplus Twin Otters, and some initial costs incurred in implementing cost cutting measures. The overall loss also included a large impairment charge in relation to the Company's aircraft and spare parts assets, taken up on advice from the auditors.

While I will be able to speak more about the 2014 results at the next AGM (which in the unusual circumstances applying this year is only a few months away) and after those results are audited, it is appropriate that I make some comments on them now. On the basis of the unaudited figures there was a further operating loss for 2014, which can be mainly attributed to

- Reduction of flying under the Exxon Mobil PNG charter contact by more than 50% effective from the second quarter of the year as a result of early completion of the gas project;
- A significant increase in fuel prices during the first half of the year resulting in substantial additional costs;
- 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.

However, let me conclude by saying that despite all this the company is making progress in building a strong business. At the 2013 Board Strategy meeting management was given a mandate to deliver a five–pillar strategy, namely:

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

I can say with confidence that we are progressing well in achieving these strategic objectives. With most of the tough clean-up work behind us I am looking forward to working with my team to delivering long term value to Shareholders in the years ahead.

Muralee Siva
Chief Executive Officer

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CHAIRMAN'S ADDRESS

2013 was a year of significant development for Airlines PNG, and that continued on through 2014 culminating in the Special Meeting of Shareholders held in December which approved the recapitalisation of the Company, and the decision to upgrade the Company's fleet with new ATR 72-600 aircraft.

With the Company's CEO Muralee Siva having given more details in his report of the events and outcomes of the 2013 year, I would like to use this year's Chairman's report to focus on our strategy for the growth of the airline and its future prospects.

My predecessor as Chairman, Simon Wild, outlined the Company's strategy in his report to the previous AGM as changing to a "back to basics" business model strategy, where the airline exited loss-making and non-core activities (Twin Otter and international services, and the Virgin codeshare arrangement in particular) and concentrated on:

- Improving safety, and meeting all audit and safety requirements;
- Saving costs across all departments;
- Improving engineering services to increase reliability;
- Expanding our network and connectivity;
- Improving relationships with service providers and regulators;
- Improving the service offered to passengers, particularly on-time performance.

Achieving all of these would in turn see the airline meet the requirements of more of the travelling public, and the needs of the charter market, giving it both a stronger regular passenger transport business, and keeping it as the first choice premium charter provider.

While the Board considers that to be a robust business model, past losses and adverse perceptions from past accidents continue to overhang the Company and affect its performance and its ability to achieve its goals.

Those factors prompted the Board to embark on the restructure and recapitalisation of the Company in 2014, which saw the Company become majority owned by truly national entities, the MRDC group and Nasfund. This gives the Company far more of a seat at the table in discussions with the Government and its authorities, as well as making us clearly a PNG owned business.

Part of the recapitalisation approved by the Shareholders was an entitlement offer to all current PNG shareholders on similar terms to the share and option issues to the MRDC group and Nasfund. The Company is in the last stages of having the prospectus for this offer registered by the Securities Commission and we expect to be sending it out to Shareholders shortly.

The Company's altered strategy also prompted the decision to re-fleet with ATR aircraft. The key point is that we will be replacing 25 year old aircraft with brand new aircraft, and that 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 capacity and freight/passenger combinations.

From a passenger's perspective, these aircraft are bigger and more comfortable than our current fleet. While not so obvious, even more importantly they will be equipped with state of the art avionics for the safest possible operation in PNG conditions.

After a lot of investigation into the alternatives we came to the conclusion that the ATR aircraft was the best available for operations in PNG on all the routes we want to operate on, and as we will be the only airline operating this aircraft type in the country we believe it will give us a significant competitive advantage into the future.

The bottom line on re-fleeting is that it will help the Company achieve greater profitability by providing:

- Lower costs (through the ability to fly more hours, at much lower per seat costs);
- A product that is attractive to the lucrative corporate market; and
- Capacity to:
    - Service organic growth in the aviation market;
    - Increase services on existing and new routes; and
    - Profit from upswings in the charter market.

The Company continues to look at rebranding itself, to go along with the other great changes that re-fleeting will bring about. We are looking at logos, designs and colour schemes that will encapsulate what we offer to the people of PNG and to all who travel with us.

The Board believes there are substantial grounds for optimism for the Company's future.

During 2014 the Company was able to win the contract for RPT services to Lihir island for Newcrest, showing (along with our continuing major charger contract with Exxon Mobil) that we remain a viable option for major corporate clients. This will only increase as the re-fleeting process goes forward.

More generally, the PNG domestic aviation market has grown more than 20% per annum from 2006 to 2014. With 15% forecast GDP growth for 2015, and expected LNG proceeds feeding into the economy, this can be expected to continue, at a time when the Company's competitors in the domestic passenger market face their own uncertainties, with Air Niugini separating off many domestic operations to PNG Link. Re-fleeting also puts the Company into a position to challenge Air Niugini's hold on the premium domestic passenger segment.

While world commodity prices have affected the level of exploration activity in PNG and delayed development of other projects, the recent arbitration court decision clearing the way for Total to be involved in the Elk-Antelope gas field, and the Frieda River project coming on line offer the potential for more charter work in the short term. There is also scope for the airline, as a PNG owned entity, to gain work currently done through non-PNG entities.

The Board and management believes that future growth in the Company's earnings will be driven by:

- Growth in existing markets;
- Increasing the Company's market share on existing routes through an improved product offering and an ability to be more cost competitive;
- Using increased capacity to operate new routes;
- Increased capacity and improved product will also result in achieving a greater share of the corporate market and being more competitive in the charter market; and
- Further efficiency improvements from operating brand new aircraft.

In conclusion, I want to thank all shareholders for their continued support and commitment to Airlines PNG, and for the vote of confidence given at the time of the Special Meeting last year when all of the proposals that were put to Shareholders, many of them making significant changes to the Company, were accepted. While that has let the Company pursue its strategy with confidence, as a Board we acknowledge that the Company has still yet to pay a dividend. We have indirectly benefitted shareholders, and the rest of the PNG public, by providing competition and services not otherwise available, but the firm aim of the Company in adopting its strategy and in taking all of the steps that have been taken since the last AGM is to see the airline return to profitability and to add value to your investments.

Murray Woo,
Chairman