

Question and Answer

Operator

[Operator Instructions] We will now move to our first question from Russell Shaw from Macquarie.

Russell Shaw

Macquarie Research

A few questions from me. Just the first one, your unearned revenue, so I guess your forward bookings look like they're up 10% on a 3% capacity growth. Can you just sort of take us through whether that's mainly coming from international or domestic or both? I mean, it does look like your January domestic yields are up as well which is encouraging.

Robert Stuart McDonald

Former Chief Financial Officer

Russell, just -- it's Rob here. Just around the unearned revenue, it's probably 2 issues. One is our forward bookings are stronger than the year before, and frankly the year before, the high season which is critical, was a disappointment. And you saw from the January stats some pretty solid growth across the whole network, including domestic, so that is a reflection of that year-on-year growth of the what we call TSA but unearned revenue.

Russell Shaw

Macquarie Research

Great, and then the second question on your additional 777-300 lease orders. I assume those are new planes in. And Christopher, can you perhaps just walk us through what the planning is there, whether it's around new routes, increased frequencies or just as perhaps an additional insurance policy in case the other 787-9s get pushed back any further?

Christopher Mark Luxon

Former Chief Executive Officer

Well, listen, the announcement of those 777-300s is really about us wanting to reach for more levels of growth on the Pacific Rim. They are brand new aircraft. They're additional leased aircraft that will come into the fleet from the middle of next year and again we will focus those and work out where to send those in the coming months. We've got some time to work that out. But we're looking at the Pacific Rim region whether it be in the Americas, in Asia, in Australasia, and saying there's quite a lot of emerging opportunities that we think we can participate in. What I would say is they are very clearly designed as incremental growth aircraft for us to help realize that vision. But the Boeing 787 issue is a different issue in the sense of, if I can just remind you, that we're taking delivery of the Boeing 787-9 from the middle of next year. And that is some time away. I think if I was taking delivery of aircraft in the next 3 to 6 months, we might be more concerned. But all of our conversations with Boeing, which is a very positive relationship, it's very deep, works at a number of different levels, giving us a lot of reassurance that our delivery of those aircraft is not at risk at this point in time. I'm also very comfortable in those conversations that we're having that Boeing are developing some very good fixes I think that ultimately will get them through this issue. So it's a definitely an aircraft we're fully believed in and we still think it's incredibly -- it's going to be a great aircraft for us and a good game changer in terms of what it will do for our business, 20% more fuel efficient, what it's going to do for our customer experience. And I'm quite confident at this point that we don't have a risk around delivery of that aircraft.

Russell Shaw

Macquarie Research

I presume with those 787s incoming and they'll be, just the first 5 or so will just be straight one-for-one switches with the 76s, is that right?

Robert Stuart McDonald

Former Chief Financial Officer

Sorry, it's Rob here. The answer generally is yes, but let me just step back to the 777s. At a practical level, the way it works is generally, or will work is what this does do is put a hard stop on the 747s, and they will exit on the arrival of the 777-300s. And I think you probably are fair to assume that they're more likely to go in where the 74s are flying at the moment. And then it really, just things ripple around the network and it becomes where do we put some dips, perhaps new routes as well.

Russell Shaw

Macquarie Research

Great, and then just finally, kind of you're moving off the London Heathrow-Hong Kong route in favor of going the other way. What are you doing with those Heathrow slots? Are you sort of selling them? I mean, is there [indiscernible] or should we expect any profit on sale, if that's the path you go down?

Robert Stuart McDonald

Former Chief Financial Officer

Not in the immediate future. We still retain those slots but they're being leased to Cathay who in June will operate, so obviously the same timing.

Russell Shaw

Macquarie Research

Right. So that did you get a incremental earnings stream from that?

Robert Stuart McDonald

Former Chief Financial Officer

Not that it's of any materiality.

Operator

And the next question comes from the line of Marcus Curley from Goldman Sachs.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Just a few if I can, you mentioned within your profit improvement program that exiting Hong Kong-London was a significant part of one of those elements. Could you give any color on what sort of magnitude that initiative could be worth to you?

Robert Stuart McDonald

Former Chief Financial Officer

It's a question of where we deploy those aircraft which we think can be deployed profitably and ensuring the impact on the Auckland-Hong Kong route which we're confident now with the alliance with Cathay we'll be able to grow that because of both of us. But in terms of the sort of sums, clearly, it's done at more a contribution level but it does in the order of 15 to 20.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

So was that leg loss-making, so there's a loss recovery and then you have profit improvement?

Robert Stuart McDonald

Former Chief Financial Officer

It was probably, in fact, with [indiscernible] to in Hong Kong-London that [indiscernible] saw periods that particularly with the higher oil prices and the more difficult economic conditions, that saw periods where negative contribution.

Christopher Mark Luxon*Former Chief Executive Officer*

I think, Marcus, I'd say that's a very clever -- I think a very smart and intelligent solution that we put together there. We've come out of a route as Rob alluded to that was losing significant amounts of money and has been unprofitable for some length of time, redeployed those aircraft into much better route structures and then obviously formed a very good relationship and alliance with Cathay that actually enabled us to strengthen Auckland-Hong Kong, while actually exiting Southern China in a much deeper, richer way as well. So those 2 decisions about exiting out of Beijing, moving to daily services in Shanghai, coming off London-Hong Kong are quite material because they have been routes that we've struggled with for some time.

Robert Stuart McDonald*Former Chief Financial Officer*

I should say the economic story around the withdrawal was really only a FY14, you'll only see the impact there.

Marcus Curley*Goldman Sachs JBWere Pty Ltd, Research Division*

As opposed to second half of '13?

Robert Stuart McDonald*Former Chief Financial Officer*

Yes.

Christopher Mark Luxon*Former Chief Executive Officer*

Yes.

Marcus Curley*Goldman Sachs JBWere Pty Ltd, Research Division*

Secondly, you've touched on forward bookings already, but I suppose when we look at long-haul yield progression during the half and into January, you really only started to see, let's say, a significant list in long-haul yields in the last few months, i.e., double digit. Could you give some little color around what's driving that and if you're -- and how sustainable that is into the second half?

Christopher Mark Luxon*Former Chief Executive Officer*

So I think, Marcus, I would say it's actually been an improving international business for longer than what you're saying. I think it's been strengthening over the course of a good year or so. And to be really honest, every part of every geography, we've been working really hard to retool and improve quite a bit. So if I take each of the different geographies, there is different remedies that we've put in place but to make sure that those businesses are on track and are in profitable growth sort of mode. Japan, the recipe has been much more about generating some cost savings, moving to a much better partner in ANA. We've got terminal alignment, ground handling alignment, catering alignment, but most importantly, we've got the power of their sales and distribution network now selling our services very, very well and the connectivity between the 2 companies is very good. And then we've completely retooled our sales organization in Japan and built it around sales and distribution channel. So we've been able to get that business right size, move back to daily services in December and get that cell sort of humming along quite well. In China, slightly different story, we've hired a local general manager there that knows the marketplace incredibly well and the industry and the government. And has been able to build a very good sales team there. Coming out of Beijing was important because it's enabled us now to build to a daily service in Shanghai. We've gone from 3 to 7 services in a week in the space of 9 months, which is pretty impressive as we've had to create a lot of demand and generate that revenue on the ground there. And

we would now have more than 50% of the direct Chinese services, or Chinese customers coming into New Zealand, which is a really good outcome. So we're competing well there. The Hong Kong thing we talked about. Europe obviously we've got less exposure to the risk that's sitting in Europe that will be there for some time and with the Hong Kong exit, but we've been able to strengthen also the LA-London route, purely through having a very good product quality relative to British and American carriers that we're finding a lot of corporate customers just moving between LA-London are actually wanting to use. So and then North America continues to do well but that's really driven, you would have seen in January, 17% increase in inbound Americans to New Zealand, 6% increase in New Zealanders going up to America. So it's working on both ends of it.

Robert Stuart McDonald

Former Chief Financial Officer

I think the only other point I'd add to that, again, is just the previous high season which is essentially what we're talking about was a disappointment and so it's off that base you're looking at it.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

And just is the mixed business economy a big part of year-over-year improvement?

Christopher Mark Luxon

Former Chief Executive Officer

No, it's been relatively broad based.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Okay. And finally, I suppose when you look at your, I suppose, guidance -- I know it's an airline, so obviously it's always difficult to forecast, can you give any sort of [indiscernible] perspective on what -- I think the language is significantly ahead or comfortably exceeding? What that means?

Robert Stuart McDonald

Former Chief Financial Officer

Well, it means sort of what it says is if you sort of add the first half, last year's back half, we're certainly saying we're going to comfortably exceed last year's back half. And I mean I think you should interpret that as we're moving away in a positive way from the double your earnings, more than double on your earnings.

Marcus Curley

Goldman Sachs JBWere Pty Ltd, Research Division

Double earnings in the second half?

Robert Stuart McDonald

Former Chief Financial Officer

No, I didn't say that. I said we're moving away from the previous guidance which was more than doubled to a more positive view that we will comfortably exceed the second half, having fulfilled the first half.

Operator

Our next question comes from the line of Jason Familton from First New Zealand Capital.

Jason Familton

Jarden Limited, Research Division

Just probably 3 for me. The first one just around obviously in the first half you saw domestic yields down and you talked about stimulating demand and then obviously planes were full as a result. Given you're

accelerating the deliveries around the A320s and you've got the A72s as well as planning to arrive, how do you see your yields going forward in the domestic market?

Christopher Mark Luxon

Former Chief Executive Officer

Okay. The first thing is we look at the New Zealand market and we definitely don't want to take it for granted. I think we are genuinely seeing the demand increase because of we've got a superior product and service. We have superior on-time performance and we certainly have much lower pricing or competitive pricing. The focus for us is very much wanting to lower our cost base through this record introduction of these A320s. And so that we can actually keep our pricing very competitive and where we want it to be, to keep the New Zealand public obviously traveling. So a lot of our focus is going into the cost base as we work here in New Zealand.

Robert Stuart McDonald

Former Chief Financial Officer

We don't see a retracement of that yield.

Jason Familton

Jarden Limited, Research Division

Okay. The second one, just I think the mix between depreciation and lease costs is a little bit different to what [indiscernible] but can you just comment on [indiscernible] planes, the aircraft deliveries. Do you anticipate [indiscernible] 6 months and into full year '14 and the decision making around that with the 2 owned or leased?

Robert Stuart McDonald

Former Chief Financial Officer

So the A320s coming in will be on Japanese operating leases

[Audio Gap]

this year's batch will be.

Jason Familton

Jarden Limited, Research Division

Okay, and then obviously the 777-300 [indiscernible] make a decision around the 782s?

Robert Stuart McDonald

Former Chief Financial Officer

We'll do that close to the time but it's likely the first one will be a [indiscernible]

Jason Familton

Jarden Limited, Research Division

And then just the contract services revenue was down half-on-half. Can you just give an update, I guess where you are with the Hawaiian [ph] contract and whether there's anything else to explain that movement?

Christopher Mark Luxon

Former Chief Executive Officer

Some of that movement was actually associated with some of our engineering that the contracts we had in Australia in the previous year had finished and wasn't there. It was a relatively material amount. But the rest of them as well as the gas turbines business has been a relatively difficult environment, so that's the industrial and marine business. In terms of the other parts of ticker [ph] or what we call tick-offs, the contract revenue just renewed with Virgin for 5 years, so that's good news. And we're seeing -- so obviously the Hawaiian contract is still alive. Another contract that was renewed that was very pleasing

was the National Science Foundation, C-130 support the deep freeze operation. So that business is still quite healthy.

Jason Familton

Jarden Limited, Research Division

Just one final one, just I know I forget exactly what the time was, just around the Skycouch and the [indiscernible] economy. I know you've talked previously around potential losses. Are there opportunities? Just wondering where you're up to with regard to that.

Christopher Mark Luxon

Former Chief Executive Officer

Yes, so it's still an ongoing subject, Jason, where we had a couple of airlines that are showing some quite good interest in this. The challenge for us, as we've talked before, is not necessarily in selling the innovation. It's a question of being able to sell a total business model to make the Skycouch work, so that it -- how it interfaces with the GDS systems, et cetera. So we continue to make progress there. There's still very strong interest from different airlines and some we're in quite deep conversations with and it's a question of just being able to work through a business model that helps them sell it. We can do it ourselves on -- quite well, but it's about trying to do it -- help them to get a business model that works for them too. So still ongoing.

Operator

It appears as though that we have no further questions.

Christopher Mark Luxon

Former Chief Executive Officer

Okay. Well, guys, thanks for your time this morning. I hope that you feel as excited about the result as we certainly do. And we'll look forward to catching up with you soon. Take care.

Robert Stuart McDonald

Former Chief Financial Officer

Thanks very much.