Question and Answer

Operator

The first question comes from Russel Shaw with Macquarie.

Russell Shaw
Macquarie Research

Couple of questions from me. Just looking at your second half number, there was a pretty steep decline in maintenance costs, first half and second half. I think a lot of that has to do with the 747 retirements. Should we thinking about the second half number of NZD 144 million and annualize that going forward so would that be fairly accurate?

Robert Stuart McDonald
Former Chief Financial Officer

Just thinking about maintenance going forward as the 747 fleet has exited, there is some additional maintenance there. But as you look forward, I mean, there will be other items that come up. Clearly, the 320 Tasman fleet gets little older and some engines coming up with more numbers there.

So probably the way to think about maintenance cost is actually just look at the average age of the fleet and that’s not too different. So often the maintenance can fall depending on where some heavy checks occur or some exits for leases but generally when you're thinking about maintenance going forward, I wouldn’t change it too much.

Russell Shaw
Macquarie Research

Okay. And then just in, I guess, implicit in your forecast the next year, I’ll just confirm your -- that was based on spot rigs fuel [ph] and currency?

Robert Stuart McDonald
Former Chief Financial Officer

Yes. It is.

Russell Shaw
Macquarie Research

Okay. And in terms of your forward-looking threshold and Rob, tell us what the international long-haul demand is? It’s forward-looking threshold, it looks say that stronger than short haul. Is that taken you, maybe just comment on across the regions?

Robert Ian Fyfe
Former Chief Executive Officer

Yes. To give some flavor to that, we’ve seen continuing strong demand through 2012 continues into 2013 and refueled our long haul markets. The two markets that we highlighted that have been problematic for us in FY ‘12 which were Europe and Japan. We’re certainly seeing Japan recover quite strongly now.

Europe continues to be an issue. If you took Europe and Japan out of our long-haul figures in excluding those, we saw those markets up about 7.5% in the 2012 year. So they are looking very strong. Domestically actually we're seeing good solid growth in the now short haul network which is domestic trans-Tasman Pacific islands. We’re looking at around 5% increase in capacity in the coming 12-month period. So that reflects -- raise more confidence in those markets as well.

Russell Shaw
Macquarie Research

Right. And then finally just on your -- has discussions or thoughts been advanced regarding, you expect in the past about potentially trying to get some royalties from your Skycouch and space seats products. Has there been any advancement in those discussions or considerations?

Robert Ian Fyfe
Former Chief Executive Officer

So the issue from a consideration point of view is advancing. And I think we had always signaled that we wanted to get some good operating experience, 12 months of operating experience of those seats under our belt so that we could sell if we are going to look to get those royalties. We could sell the seat but we could also sell the business model with it that actually creates the value with the seat.

And so we've just embarked on a program that we've been talking to some third parties in U.K. and Europe to effectively act as our agent in progressing some of those discussions. So we are moving or about to move into that size to explore those opportunities now.

Russell Shaw
Macquarie Research

Right. And then finally just your Seats to Suit was being trailed on first, Auckland. How is that working appearing on some of those longer haul reach relative to the success, it's enjoyed on the Tasman?

Robert Ian Fyfe
Former Chief Executive Officer

So we're really happy with Perth, and partly as a consequence of Seats to Suite and partly just with the strength of that mining economy we've been increasing our capacity in Perth up to eight flights a week and we can see further potential in that market.

So our initial perspective is that Seats to Suit does extend well to those, what you call mid-haul destinations. So in that regard, if you think Perth, Hawaii, Bali for example and we're still working to looking and save, so what variant of that could be applicable as you move throughout at longer haul routes.

Operator

The next question comes from Rob Mercer with Forsyth Barr.

Robert William Mercer
Forsyth Barr Group Ltd., Research Division

Just in terms of the long haul route. I'm just wondering if you could put some more new strategy around couple of areas, one the decision to go with Shanghai over Beijing -- just, the thought there -- are you doing the right thing? I'd see increased competition from the Chinese airlines coming this way.

By leaving one, you obviously though about it and decided to go with this, focusing on one key route, being Shanghai. But does that leave you a little bit vulnerable to than their competitive landscape shifting in the future?

Robert Ian Fyfe
Former Chief Executive Officer

So let me respond to that Rob. And I was just going to say before responding to that question just for anyone that's interested. John Palmer has just joined us here on the phones at this end as well, if anyone has anything they want to ask specifically of John?

John Leonard Palmer
Former Director

So in terms of China, China is clearly a huge market and what we tend to find is the market is split with airlines dominating particular geographic areas. So the dominant area in Southern China and surprisingly is China Southern having predominately from Guangzhou.

The predominant airliner in Shanghai is China Eastern and the predominant airline up in the north of China having out of Beijing is Air China. As we have looked at how we deploy our assets, our philosophy is always to operate routes where ideally, we can get those routes to daily service as quickly as possible.

When you operate at a daily service, we do find that that stimulates greater volume, particularly in the business market. The business traveler wants to travel when they want to travel not with the way the airline chooses to fly.

And looking at how we could most effectively get to daily service than it was to focus our assets, and the market in Shanghai was more attractive of the two markets. For two reasons, one is there is clearly a competitive threat in that market from China Eastern, and in the Beijing market we have Air China who is our star alliance partner and we have a very good relationship with Air China.

So the opportunity to explore the potential for working collaboratively in future on the Beijing market with Air China as I say, is the star alliance partner is a real possibility for us. So there is a number of ways we could service it, that route.

For now, we have a range of co-chair arrangements with Air China connecting Chinese cities out of Shanghai. But we think the competitive profile is manageable, when clearly we had considered that issue in coming to this decision.

Robert William Mercer
Forsyth Barr Group Ltd., Research Division

And the other market being the U.S. in order to -- you guys have still big, I guess, co-partner bringing customers from the U.S. to here. I think you must in order of 70% of your passenger numbers coming from that market? So this -- and I'd say that the improvements of Virgin America is making in the area, John, they are doing a great job. So pretty much endorsed it. The partnership you've been secured the -- so what's the fragility around what might happen with United Airways as you sort of brought a stronger partnership with Virgin America?

Robert Ian Fyfe
Former Chief Executive Officer

Yes. The key, Rob, I mean, United are fully aware what we doing with Virgin. The key is in offering customers a choice of onward travel options. And the Virgin America proposition, is a very different proposition both in terms of the price position as well as the product position. And it certainly very attractive to people particularly on the shorter haul, 1, 2, up to 3 hour flight routes.

Ultimately, I think that for United Airlines, their competitive positioning against Virgin America is a big question for them. If they improve their competitive position against Virgin America in terms of their price position, that would ultimately be reflected in their underlying rates and that would probably drive more customers in their direction.

So we actually think it's quite healthy tension there. We also have a co-chair relationship with United Airways who are our Star alliance, sorry, USA Airways I should who are a Star alliance airline as well. So United don't have the entirety of the volume.

The other comment I'd make in there is actually even pre-dating this arrangement with Virgin America. Our connecting volumes with United have been declining over the last three or four years as customers have been choosing other airline options to connect onto, even irrespective of whether we have interline relationships with them or not. So we obviously need to reflect what their customers want.

Operator

The next question comes from Jason Familton with First NZ Capital.

Jason Familton
Jarden Limited, Research Division

Two or three orders post kickoff, so for just on, to clear for NZD 130 million of improvement in 2013. Is it a run rate of the year when you makes the lead this year or is it a benefit that you expect to achieve in that year?

Robert Ian Fyfe
Former Chief Executive Officer

So that benefit we expect to achieve in that year. The only point I'd make to that and I think that people understand these -- sort of as we frame these initiatives. These initiatives are very much in addition to the things we know about -- the exit of the 747. So loss of putting the currency hedges behind us.

But equally, we have a whole lot of other -- we'll have a whole lot of airport charges coming through this year, quite sharp increases as well, just general inflation. So it's sort of your -- you've' got to put that in part as well.

Jason Familton
Jarden Limited, Research Division

Okay. The next question just on, I guess, safe to sit on the Tasman [ph] -- I'm just wondering what your view on capacity growth in that market? And secondly, what [indiscernible] the benefit you've had from there. Just wondering about further revenue management on that market and your views around it?

Robert Ian Fyfe
Former Chief Executive Officer

Yes. I mean, we have always experienced the Tasman as a very sensitive market to capacity and when capacity comes onto the market, it technically comes in quite large dollops with either the arrival of a new airline or existing airlines putting larger aircraft on the market.

The situation we find ourselves in there is we are experiencing within the Virgin/Air New Zealand alliance, far stronger load factors in the market as a whole. So typically airline factors are ranging in the 75% to 80% range. It defers from month to month, season to season but typically in that range.

The rest of the market in aggregate has typically got load factors around 60% to 65% mark. And I think if we look historically in the trans-Tasman market, we have never seen those sorts of disparities, and that gives us the confidence looking forward that we have now a former resilient business model irrespective of, as I say, the chunks of capacity that either come or depart. And mostly it doesn't guarantee, I guess, profitability or return on capital. I think in a relative financial performance since it does give us some confidence that we can continue to outperform our peers in the market particularly those that are operating on a rational financial basis.

Jason Familton
Jarden Limited, Research Division

Okay. Just a question -- just around those CapEx guidance that you have given. I'm just trying to get the mix between leasing and on balance sheet and the CapEx for the coming year?

Robert Ian Fyfe
Former Chief Executive Officer

In the coming year they're all on the balance sheet.

Jason Familton
Jarden Limited, Research Division

I was wondering on the OneSmart card, just wondering how that contributed to earnings in the half?

Robert Stuart McDonald
Former Chief Financial Officer

So, well, it still very much in a start-up phase, so it didn't contribute to earnings, but that said, in these things, we are very pleased with it. We've got around just over 160,000 people that have activated their card, and so that's a very positive outcome for us. And we're continuing to grow that month by month. People are continuing to grow the amount. People are loading on their card and spending on their card and particularly spending offshore. So it's quickly propelled itself. We would expect to be the number one travel card in New Zealand.

Robert Ian Fyfe
Former Chief Executive Officer

Let say it is operating profitably now. So it has been for the last four months. So there are obviously some set-up costs which is why it didn't contribute to earnings, but as we look forward, it certainly has value.

Jason Familton
Jarden Limited, Research Division

Okay. And just final one, just external survey you did into regional pricing has clearly come out favorable to yourself. Just wondering, was there any markets in there which looked to be attractive for future entry going forward?

Robert Ian Fyfe
Former Chief Executive Officer

We don't look at the markets. So that was Tim Hazledine decided himself what he thought the comparative markets would be, and he thought there were markets that would show similar characteristics to New Zealand or things like Norway and things like that.

So, but to those specific question, having looked at those markets, there were largely far flung from New Zealand, they are not markets that we would look to participate in, in terms of two boat prop [ph] deployment.

Operator

The next question comes from David Fraser with Nomura.

David Fraser
Nomura Securities Co. Ltd., Research Division

Just a quick question, your investment over Tasman announced the other day that they were targeting NZD 150 million additional revenue from interline and co-chair by '15. I was just wondering what sort of opportunities do you think you got in that space given your alliance with Virgin and I guess getting some co-chair from the -- in the New Zealand market and anywhere else that you are looking to get, I guess, additional co-chair and interline from?

Robert Ian Fyfe
Former Chief Executive Officer

Yes. Let me start with the answer to that question. One of the key factors that will be driving Virgin Australia's view on that is they will cut over to a GDS driven system and saver [ph] and then the connectivity to airlines just becomes way, way simpler and way, way simply for us particularly.

And so we would expect and I think is an addition to the alliance as we go forward. We will see more cities in Australia being connected up, and more options for our customers going forward on that. And I think that would be a good source of growth both to the Tasman alliance and make it much more competitive. And that runs both ways of course. So we would hope to see growing traffic from them in their domestic network as they become much, much more competitive in the -- particularly in the indirect space with system that's much more responsive to travel agents.

David Fraser
Nomura Securities Co. Ltd., Research Division

And what about -- I guess internationally I mean we -- Rob just briefly spoke about some obviously working with Air China. Is there an opportunity as well?

Robert Ian Fyfe
Former Chief Executive Officer

I'm sure. I mean, we won't be getting into too many specific conversations. But we are looking increasingly at markets and saying, we believe we can develop markets faster. If we find an airline partner in those key markets as well, so if you look at our passenger profile over two thirds of our passengers are on our international surfaces are inbound passengers coming to New Zealand.

And it's fine to put our network in place and deploy our mettle -- but the biggest challenge is often the sales and distribution infrastructure in those offshore markets to attract the offshore passengers who want to come down to New Zealand. Working with a local airline partner not only does it give you potential access to the capacity from a co-chair perspective, it allows you to start partnering from them in terms of generating demand distribution in sales.

In the new relationship with recently formed with ANA is a classic example of that. We are really struggling to get to rebuild the demand post to Tsunami since that relationships got established three or four months ago, we've almost seen an immediate steep change in terms of our effectiveness in the influence we have in the key trade and distribution partners throughout Japan and the support we getting from them. And that is really given us quite a degree of heart. So we need to use that model more effectively and other markets, China is one example. But there are other markets where we looking similarly to do the same.

Operator

The next question comes from Marcus Curley with Goldman Sachs.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

Just a couple questions, first of all about elements of the result. Rob, can you confirm where, say NZD 40 million worth of revaluation on Virgin sits?

Robert Ian Fyfe
Former Chief Executive Officer

It sits in the -- effectively, in equity, it doesn't go through the P&L.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

So that's not in your adjusted profit number?

Robert Ian Fyfe
Former Chief Executive Officer

No. No. Absolutely not.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

And then secondly, what's your view on Rugby World Cup benefits within the result in terms of what sort of headwind will it be when you look at your guidance for next year?

Robert Ian Fyfe
Former Chief Executive Officer

Let me have a go at that one. Rugby World Cup, I think will be very little headwind. It creates a little bit of year-on-year comparison challenge for us, because not only did we have the Rugby World Cup, we also moved a bunch of school hallways [ph] around and so from a comparative period planning, it's created some challenges, and then we had the election, which is also moved baseline traffic around.

Rugby World Cup, the dynamics were we got a lot of one way travel, but on the backside we had some relatively speaking more-empty aircraft on routine flights. That happened on both on some of our international sectors, but it was probably more prevalent domestically. We are moving a lot of people from A to B for games, accommodation is a shocker. [ph] So we saw a decline in business travel, because business people were choosing not to travel with the perception that they wouldn't be able to get accommodation at their destinations.

So net, net well Rugby World Cup overall was, we believe, positive. There are number of these offsetting factors that mean we do -- When you look overall like year-on-year comparisons, it's not a material factor as we look at FY '13 comparatives, albeit as I say on a month-by-month basis it moved some of the fluctuations around.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

Okay. So you, I think previously, you suggested that number was as high as NZD 40 million worth of benefits so that's -- and with sort of -- in hindsight now we should just not worry about it?

Robert Ian Fyfe
Former Chief Executive Officer

I don't think you should worry about on the go-forward basis. We believe we actually reduced that projection down to NZD 30 million. And we think in terms of the Rugby World Cup related traffic that figure was about right, but they were definitely offsetting deterioration in terms of domestic market in New Zealand outbound travel, and we got a fully accurate assessment of that, but certainly my judgment is that that probably would have eaten away two thirds, also affect benefits. So the net impact would be relatively modest in doing any year-on-year comparisons.

Robert Stuart McDonald
Former Chief Financial Officer

I think Marcus we described that sort of year as a reasonably unsettled domestic environment, that as Rob mentioned the domestic traffic over the Rugby World Cup, particularly bread and butter sort of business travel was quite disrupted, and then it just followed on straight into the election as well.

So, domestically while it was -- clearly, offset the benefit of some of the particularly long haul entrant has been trouble. And then yet, you might even factor in after that the share of spend in the wallet after that as well.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

And, yes, within the result, are you able to give us any color on what sort of yield premium was achieved on the new long-haul product versus the existing product? I know, previously you've suggested or ask left of about 8% if I recall correctly. Can you give us any color on what do you think the run rate is at [indiscernible] -- on the rolled out product, obviously ready to be rolled out?

Robert Ian Fyfe
Former Chief Executive Officer

Yes. It's pretty well along the lines we talked about. I mean that was as much mix change, shedding seats down the back and keeping the front end of the plane the same size. And then clearly, probably, and more profound then we had imagined when we put aircraft into operation as the power of the cargo lift element.

Robert Stuart McDonald
Former Chief Financial Officer

So, I think, the probably one of the key indicators of where the value is the fact that fuel consumption on a revenue adjusted basis has improved 19% and fueled on those flights as a component of the operating costs of the flight is 50% to 55%, probably in the range of 55%.

So that's one driver alone. You then get the significant reduction of maintenance costs on those aircraft and as Rob says, getting the revenue gain in the cargo space. So net, net we are saying that material factors when you look the net profit margins in the business.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

Yes. And then just switching to the guidance or your outlook comments, can you give us any color on what yield assumption -- yield growth assumption you've made for long haul, short haul, obviously, you had, I think a little volatile in the last six months? Can you give us color there?

Robert Ian Fyfe
Former Chief Executive Officer

I think the only thing I would say, just as a general comment is that yield assumptions modest and in fact most of the driver of the value is coming from the sort of things we've -- the value enhancement, those coming from the sort of things we've identified in our profit improvement initiatives.

We deliver in FY '13, NZD 55 million of those NZD 60 million overhead costs reduction. We've got a big improvement in the ancillary revenue. The rejigging we are going to deliver the majority of that rejigging of the network performance.

We're getting the fleet benefits coming through from the introduction of the domestic A320s alongside the improvements we've just talked about around the 777-300s and then some improvement in supply chain and other direct costs.

So all those things are driving through to the bottom line, albeit as Rob mentioned, offset by some general wage inflation and increased airport charges and so on. But net, net is material benefit there without us having to look specifically at driving yield hard or driving ticket prices up, albeit, there is some still full year impact we will get our price increase to sort of come through linked to feel during 2012, so there is still some…

Robert Stuart McDonald
Former Chief Financial Officer

Annualization…

Robert Ian Fyfe
Former Chief Executive Officer

…annualization of those which is kind of some general yield momentum. But we are assuming and in our go forward look that the competitive environment remains relatively intense, and we'll get some new competitors emerging on some as well.

Robert Stuart McDonald
Former Chief Financial Officer

So, there is certainly no markets we can't point to that have economic conditions that can sustain any material yield increases. So fuel is where it is.

Marcus Curley
Goldman Sachs JBWere Pty Ltd, Research Division

And so by the sounds of things; please one last question, it sounds like the guidance is based on some declines in unit costs ex-fuel cash unit costs ex-fuel, is that -- so is that directionally correct, unit costs will be down?

Robert Stuart McDonald
Former Chief Financial Officer

Unit costs ex-fuel we would expect to be down in net basis if we look at FY '12 versus FY '11 they were marginally down as well.

Operator

At this time, we have no further questions.

Robert Ian Fyfe
Former Chief Executive Officer
Okay. Well, let's bring it to close. Thanks everyone for participating this morning. We set out in our opening comments to convey some very strong confidence in the year ahead. As I gave those foreign allowances to Marcus' questions, I think it's important to realize, that isn't based on any heroic assumptions about yield or growth or changes in competitive environment as it's a reflection of a range of initiatives that are largely already implemented in the bag and it's seeing the benefits of those flowing through in the FY '13 year. That's not to say, that we don't still have a significant range of initiatives and further improvements that we will be targeting during the reminder of my tenure through the December 31 and then when Christopher takes over from 1st of January. So we sit here very excited and optimistic for the year ahead. And once again, thanks for your participation this morning.