

# AURIGNY GROUP ANNUAL REPORT

2019



## Corporate Details

### The Aurigny Group of Companies ('Aurigny')

The Aurigny Group of companies comprises:

- Cabernet Ltd - holding company (not trading)
- Aurigny Air Services Ltd – airline
- Anglo Normandy Aero Engineering Ltd – aircraft maintenance

Note: throughout this Annual Report references to 'Aurigny' or 'Group' mean the Aurigny Group of companies

### The Board of Directors of

#### Aurigny Air Services Ltd and Anglo Normandy Aero Engineering Ltd:

- Kevin George (Chairman) (appointed 1 October 2020)
- Andrew Haining (Chairman) (resigned 30 September 2020)
- Mark Darby (CEO)
- Malcolm Coupar (Commercial Director)
- Chris Simpson (Finance Director)
- Chris Holliday (Non-Executive Director)
- Meriel Lenfestey (Non-Executive Director)
- John Le Poidevin (Non-Executive Director)

#### Registered Office for all Group companies:

Aurigny Air Services Ltd,  
States Airport  
La Planque Lane,  
Forest,  
Guernsey,  
Channel Islands,  
GY8 0DT



# Chairman's Statement

## Kevin George

2019 – a year of challenges and changing market conditions

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I am pleased to be able to present the 2019 Annual Report for the Aurigny Group.

This is my first report as Chairman of the Group, having been appointed as Chairman on 1 October 2020, and I look forward to engaging with as many of our stakeholders as possible over the coming months.

### **Performance, changing Market Conditions and the Covid-19 pandemic**

2019 was a challenging year for the airline sector, although this pales by comparison with the unprecedented conditions that the sector has faced in 2020 during the Covid-19 pandemic. Our shareholder, The States of Guernsey, took early action to secure the airline's future and to ensure that we had the financing in place to remain as an "airline in waiting" for when conditions allow Guernsey to remove border restrictions and for us to resume normal airline operations. The safety, technical, training and licensing conditions of an airline mean that once operations are mothballed and staff released, it can take many months to recover the ability for operations to recommence and would have left Guernsey and Alderney with the prospect of insufficient air links for an extended period of time once the crisis caused by the pandemic is finally over. In the meantime, we have continued to do what we do best as a community airline, continuing to play a key connectivity role, being the only airline currently serving the Guernsey and Alderney markets and providing the essential lifeline link to Southampton for health and other essential travel.

Whilst we published our financial statements earlier in the year, we have waited until the Autumn to provide our accompanying Annual Report given the huge uncertainty that the Covid-19 pandemic has brought to the airline sector and to the accompanying rules regarding travel to and from the Bailiwick. With the ever-changing position in the UK and the greater restrictions being placed once again on travel to and from the Bailiwick, the prospects for a further period of very low levels of travel now look extremely likely through the remainder of 2020.

In 2019, Aurigny's turnover reduced by £0.5m to £45.0m (2018 - £45.5m) and generated negative EBITDA of £1.6m (2018 was a positive £2.3m). This deterioration in operating performance must be considered alongside changes in the external environment with the introduction of "Open Skies" in the Bailiwick and launch of services to the wider London market. The resultant additional capacity and customer choice brought competition for our main 'lifeline' route to Gatwick. Despite management focus on cost and productivity improvements, and our own route expansion, the financial impact could not fully be offset. Further details of the external market conditions and financial performance of the Group are contained in the Chief Executive's and Finance Director's reports in this Annual Report.

### **Continued focus on innovation and customer service**

October and December 2019 saw the arrival of our three new ATR72-600 aircraft, two of which did not enter service until early in 2020. These innovative new aircraft make our fleet one of the youngest in the commercial marketplace. As detailed in last year's Annual Report, the correlation between the age of fleet and reliability

in performance is clear and the new aircraft will equip us to deliver improved reliability and better access in low visibility. Reliability and regularity of service has continually been highlighted as one of the most important components of the provision of our lifeline services by both our leisure and business customers.

One of our main focuses in the year was once again on continuing to improve our customer experience. Our “we get you back” approach to handling disruption, in contrast to our major competitors, is an important part of our customer service and everybody in the company was delighted when in December 2019 we were voted “Best Short Haul Airline of the Year” in the global Which Magazine Awards, with a market-leading 80% customer satisfaction overall score. We entered the Guernsey-Southampton market at the beginning of 2019 to operate alongside our Alderney-Southampton route. During 2019 we were delighted to be awarded the “Airline of the Year” Award by Southampton Airport, underscoring a relationship with that airport which has continued to be a vital part of Guernsey’s lifeline service to Southampton during the coronavirus pandemic and at a time when our competitors on the route have chosen not to fly.

During 2019 we also received a platinum award for our customer website and a gold award for our in-flight customer magazine, *En Voyage*, at the global Hermes Creative Awards, reflecting our all-encompassing commitment to the customer experience.

### **Community Role**

As a States owned airline, Aurigny is embedded in the community and understands its objectives to serve the people of Guernsey, where in normal times connections between the islands, London and other key UK hubs are an essential part of life. Our staff are our biggest asset, and work as a team to achieve our objectives, many of them fully invested in our business and community as local residents.

We all value this role, and in times of disruption will always endeavor, where possible, to get our customers to their required destination rather than cancel flights, which is a key differentiator in the airline industry.

Since the start of the Covid-19 pandemic and imposition of travel restrictions, we have been the only airline which has chosen to continue to operate from Guernsey to the UK, flying lifeline services to Southampton, supplementing these with special services to Manchester and Gatwick during school holiday and university travel periods and developing the innovative air bridge to the Isle of Man, together with maintaining our lifeline inter-island service between Alderney and Guernsey.

My Board and I look forward to supporting the new States of Guernsey as they develop an holistic airlinks framework to support the post Covid-19 recovery and future economic growth.

### **Our People**

As an airline, we continue to invest in our workforce and recognise their importance to us and our customers.

We appreciate the dedication and pride they have in their important roles at Aurigny, and their continued commitment in helping to get passengers where they need to be, each and every day. We are also incredibly proud as an employer of the length of service given to us by so many of our staff. This shows just how much they value working for Aurigny and how dedicated they are to their roles. Daily airline operations are incredibly complex and rarely without their challenges, so it is vital that we have a committed team of staff who can make everything work.

This has particularly been the case during the 2020 Covid-19 pandemic and I would like to thank all our staff, across all our locations, for helping us to achieve and deliver to our customers and stakeholders throughout 2019 and during the unprecedented challenges that we have faced in 2020.



# Chief Executive's Report

## Mark Darby

Although the current challenges of operating an airline during the Covid-19 pandemic in 2020 put the difficulties of normal airline operations into context, it would be fair to say that 2019 was a challenging year for the airline, with a rapidly changing external environment in which we were operating.

Overall, in 2018 we had generated a positive cash flow of £2.5m. In that year our UK routes had delivered an EBITDA contribution of £3.9m, and loss of £0.4m, on a pre-FRS102 and pre-States financing costs basis. This had moved us closer to achieving the overall break-even financial target set for us by the States of Guernsey.

In the first quarter of 2019 we were operating at a level that was ahead of budget and ahead of 2018 numbers but the remainder of the year was impacted by several market changes.

### Market Changes

In our 2018 Annual Report we flagged the significant changes to the competitive landscape and regulatory environment that were happening in 2019 and which would have a considerable impact on our operations and financial performance. The main ones were as follows:

- 1) the adoption of an "Open Skies" policy by the States of Guernsey for all UK routes except LGW
- 2) the provision of financial support for new routes, both directly as route subsidies and indirectly through waivers on Guernsey airport charges
- 3) increasing financial fragility of the smaller regional airline market in the face of competition from the major players such as Easyjet
- 4) the potential of a "no deal" Brexit and with it a period of airline disruption on the UK mainland which will inevitably impact service levels to and from Gatwick for a period of time.

Whilst the potential disruption of a "no deal" Brexit in 2019 was delayed by the transition agreement that is due to finish on 31 December 2020, the threat remains for the beginning of 2021, albeit this is likely to be somewhat mitigated by the relatively low levels of demand for travel that are probable in the early part of 2021 due to the ongoing Covid-19 pandemic.

The other factors did prove to have a marked effect on the marketplace and on our operations in 2019.

Open Skies presented both the threat of increased competition from new entrants and also the opportunity for Aurigny to compete in other markets.

Our main "lifeline" London Gatwick service was impacted by competition from new routes to the wider London area that received financial support, when Flybe commenced a London Heathrow flight and Blue Islands introduced service to London Southend. Our Manchester route also saw competition from a new service to Liverpool. All the new destinations from Guernsey attracted route support unlike Aurigny's established network.

Aurigny identified both Jersey and Southampton as route opportunities where there appeared to be customer demand for improved service quality and value. The Jersey service did not gain traction and was curtailed in early 2020. The Southampton route has grown favorably and we were proud to have gained recognition as Southampton Airport's Airline of the Year. Our increased presence at Southampton has served Aurigny and Guernsey well during the current Covid-19 challenges.

Overall, the financial performance in the UK market in 2019 substantially underperformed recent years, leading to a loss on UK operations. As the operator of the 6 pairs of slots owned by the States of Guernsey on the lifeline London Gatwick route, we were unable to reduce capacity in the marketplace, even if we had wished to do so, by reducing our daily rotations to London Gatwick, as it is a requirement of the EU imposed slots rules that, if not utilized for more than 80% of the year, they become forfeit.

It is clear from our experience in 2019 that there are issues to be resolved in terms of an airlinks strategy and we look forward to supporting the States of Guernsey work on this.

**Subsequent market changes:** Since the end of 2019, the continuing uncertainty in the UK regional market has led to the demise of Flybe with the cessation of all their Guernsey routes including the short lived Heathrow route, and the cancellation of Blue Islands' London Southend and Liverpool routes.

Aurigny moved to ensure that the former Flybe routes to Birmingham and Exeter would continue to be served, however the arrival of the Covid-19 restrictions did not allow significant operations on these new routes.

During the Covid-19 pandemic, we are currently the only airline serving the Guernsey to UK market, providing an essential lifeline link for health and emergency travel. As a community-owned airline, we have also agreed with the States of Guernsey as our shareholder that during the extended period of travel restrictions this lifeline service will be provided to customers at the lowest reasonable price to cover our marginal costs of flying only.

## **Operational Review**

By the end of 2019 we were the proud owners of three new ATR72-600 aircraft which we brought into operation in early 2020, delivering improved reliability and better access in low visibility. 2019 was also the first full year when we have operated both of the new Dornier 228NGs on our Alderney routes. This substantial investment in new aircraft will stand the airline in good stead to provide a more reliable service, at a more predictable cost, with less unplanned maintenance.

Customer satisfaction continued to be at the heart of everything we do. Being voted "Best Short Haul Airline of the Year" in the global Which Magazine Awards, is a reflection of the efforts of all of our staff in improving customer satisfaction. Our investment in our own ground staff at Gatwick continued to see a marked improvement in customer service and in our ability to load the aircraft quickly and to take off on time during 2019.

2019 also saw the publication of the States-commissioned independent review into the efficiency of Aurigny by the specialist air transport consultancy firm, PA Consulting/Nyras – the Efficiency and Benchmarking Review – which was reviewed by the Scrutiny Committee and published. I am proud of the entire Aurigny team for the recognition the airline received in the report. No significant areas for major improvement that were not already in hand were highlighted in the report which praised the overall efficiency of our operations and the way we were structured, while recognising we operated in a sub-scale market-place and were impacted by external market forces such as Open Skies and state-subsidised competition that were beyond our direct control. The report included an observation that Guernsey needs a realistic, holistic and optimised aviation strategy for the Island, and Aurigny endorses this.

## Our staff

At the end of December 2019, the Aurigny Group of companies employed 289 people (full-time equivalents) across 4 locations: Alderney, Guernsey, Gatwick/UK and Southampton, demonstrating our commitment as a significant employer within the islands and our investment in our Gatwick ground operations staff.

Full-time equivalents	Guernsey		Alderney		United Kingdom		Total	
	2019	2018	2019	2018	2019	2018	2019	2018
Pilots	55	53	2	5			57	58
Cabin Crew	35	39					35	39
Engineers & Stores	26	26					26	26
Ground operations	81	91	7	16	36	33	124	140
Management & Administration	37	42	4	2	6	6	47	50
<b>Total</b>	<b>234</b>	<b>251</b>	<b>13</b>	<b>23</b>	<b>42</b>	<b>39</b>	<b>289</b>	<b>313</b>

I would like to give my considerable appreciation and thanks to all of our staff who have helped put airline safety and customer service at the heart of our organisation throughout the year.

## Conclusion

2019 was a challenging year, but one in which many lessons can be learned for the development of future policy. It has been overshadowed in many respects by 2020 which has been a year like no other for the airline industry. Throughout, we have continued to do what we do best: operating as a community airline; delivering a lifeline service to the UK; facilitating inter-island travel and “staycations” between Alderney and Guernsey that have been so vital for both economies in the absence of UK tourists; and developing a highly successful innovative air-bridge between Guernsey and the Isle of Man. The reasons the States of Guernsey purchased Aurigny, and the Gatwick slots, many years ago remains the same, to provide a resilient lifeline link between London and Guernsey, to operate lifeline services for Alderney and to act as an economic enabler through the development of other routes to and from the Bailiwick. We are Guernsey’s economic asset and I remain convinced more than ever that Aurigny has a key role to play in the “Revive and Thrive” strategy as the islands emerge from the Covid-19 pandemic.

This is my last Annual Report as CEO and I look forward to welcoming my replacement, Mr. Nico Bezuidenhout, who joins us at the beginning of November. I will look back on my time at Aurigny with satisfaction and pride. Over the last 8 years the business has been transformed: the airline has replaced all of its aircraft and now has the youngest fleet of any regional airline in Europe, including for the first time in its 50 year history, a jet aircraft; everyone in the organisation is focussed on operational safety and reliability; we have invested in modern, “fit-for-purpose” systems and procedures; we have earned a reputation for, whenever possible, “getting people home”. But, while these are important achievements, I’m most proud of the team of management and staff that we have built. They are a credit to the company and to Guernsey – without them all of the other advances would count for very little!



# Finance Director's Report

Chris Simpson

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## Our financial performance

EBITDA was negative £1.6m, a deterioration of £3.9m from 2018's reported positive EBITDA of £2.3m, the major contributor being the new competition to our Gatwick and other UK services as detailed further in the CEO's Report. As a result, our reported loss for 2019 deteriorated to £9.7m (from £4.5m in 2018).

EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) is a specific, recognised profit measure that the Board uses to assess operational performance as it highlights the underlying performance of our business before charges for: non-cash depreciation on our aircraft fleet; interest on our loans to finance our aircraft fleet ; and overdraft interest which we are charged by the States of Guernsey and our bank.

Stripping out FRS102 adjustments, our loss this year was £8.5m (2018: £3.6m). Of this loss, £2.8m (2018: £2.8m) was attributable to our Alderney routes; £0.3m (2018: £0.4m) was incurred in overdraft interest leaving a loss of £5.4m (2018: £0.4m) attributable to our Guernsey-UK operations and other activities.

## Investment in our business

We continued to invest in our aircraft fleets and support systems, with the acquisition of the three new ATR72-600s, bringing investment in this fleet to more than \$60 million. The decision to replace the 10-year old ATR72-500s with three new ATR72-600s will deliver cost-savings and operational benefits estimated at more than £6m over the next 10 years. Following a competitive tender, we secured attractive funding, LIBOR plus 62 basis points, for the acquisition and entered into hedging arrangements to mitigate the risk of interest rate rises and currency fluctuations.

## Revenues

Passenger carryings declined 1,300 (0.2%) to 530,000 (2018 – 531,300) mainly due to the decline in both London and UK regional traffic to and from Guernsey, as a result of the competition on the Heathrow route, partially offset by new passengers on the Jersey and Southampton routes that were introduced in May. The loss of a contract to provide ground handling services to an airline at Guernsey airport had a negative impact on Revenue. Overall, total Revenue decreased 1.1% to £45.0m (2018 - £45.5m).

## Controlling our costs

The Efficiency and Benchmarking Review referred to in the Chief Executive's Report, which included benchmarking cost per seat and per trip, found Aurigny to be generally well-managed. The report highlighted areas for improvement which are being addressed by management, and concluded that most inefficiencies are either outside, or only partially within, the control of the Group.

Our fleet completed 13,500 flight sectors this year, up from 12,500 last year, an increase of 8%. 804,000 seats were offered for sale compared with 700,000 in 2018, an increase of 15%. Notwithstanding a 27% increase in fuel costs, our operating costs, before depreciation and interest, were 7.6% higher at £46.6m. Replacing the States of Guernsey temporary overdraft facility, which was in place at the beginning of the year, with an overdraft from a commercial bank mid-way through the year reduced the interest cost by £0.1m to £0.3m.

With hedging in place, many of our operating costs are relatively stable and predictable. Hedging is integral to an airline's risk mitigation because it eliminates uncertainty over cash flows and enables management to plan better. During 2019 The Board continued to operate a Hedging policy covering jet fuel procurement and US dollar exposures. Additionally, in consultation with our shareholder, it is the company's policy to enter into financial arrangements to fix the interest rate on its aircraft loans.

The most material financial and operational risk that we cannot control, and can lead to volatility in our numbers, is unplanned fleet maintenance. Although the average life of the fleet continued to age during 2019, because the new ATR72-600s did not enter service until the end of the year and early in 2020, our maintenance costs of £7.4m remained largely in line with the previous year (2018: £7.2m). During 2020 and beyond, the arrival of the three new ATRs and disposal of the oldest ATRs in the fleet should lead to a reduction in unplanned maintenance and will also avoid expensive scheduled maintenance checks at certain key lifetime dates for the old ATR aircraft being disposed of.

### **Our business segments**

We view our business in two operating segments: our Guernsey network operated by the Embraer jet and ATR72s and our Alderney network operated by Dornier 228s.

90% of our passengers flew on our core Guernsey operations, representing 90% of our passenger revenues and generating a breakeven EBITDA contribution (2018 – positive £3.9m).

Our commitment to the provision of the lifeline Alderney services continues as it has for more than 50 years: this is underscored by the fact that in 2019 approximately one in three of our flights were flown on the Alderney network whereas it represents only 10% of our overall passengers and 10% of our passenger revenue. Excluding FRS102 adjustments, Alderney routes generated a negative EBITDA of £1.6m and a loss of £2.8m in 2019 (2018 – negative EBITDA of £1.6m and a loss of £2.8m).

### **Cash flows**

Having generated a positive cash flow from operations in the previous year of £2.5m, the competition on key routes saw a £5.3m decline in operating cash flows to a net cash outflow of £2.8m. We also invested a further £40.7m in the purchase of tangible fixed assets in the year (2018 - £12.1m) with the arrival of the new ATR 72-600s, offset by cash received from new aircraft loans raised of £49.4m.

Our year end net cash position was a small overdraft of £76,000 compared to net cash of £500,000 at the end of 2018.

### **Strategic risks**

The Board groups our strategic risks into 4 headline areas:

**Safety** – encapsulating the fact that safety is core to our overall mission and reflecting on the risks associated with the occurrence of a safety related event and the Safety Management System we have in place to mitigate and navigate these risks.

**Operational** – reflecting the high level of service provision we aim for against a background of variable weather conditions and the prevalence of fog in the islands and the risks associated with aircraft unavailability and legal or governmental restrictions on our ability to operate, which we mitigate through keeping close relationships

with our shareholder and other key stakeholders and through the provision of back-up aircraft and stand-by flight crews.

**Financial** – representing the unpredictable movements in the price of Jet fuel and US dollar exchange rates, mitigated by an effective hedging strategy to manage the unpredictability.

**Reputational** – understanding that we are a state-owned airline servicing the islands' community and that we have an obligation to meet the needs of that community, our commitment to high levels of customer service and our risk mitigation plans that are put in place to ensure that we can deliver on that commitment.