

# AURIGNY GROUP ANNUAL REPORT

2018



## 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 engineering

Cabernet Ltd owns 100% of the shares in Aurigny Air Services Ltd and Anglo Normandy Aero Engineering Ltd. Collectively, they are referred to in this report as 'Aurigny' or 'Aurigny Group'.

Cabernet Ltd is owned 100% by the States of Guernsey, its ultimate controlling party.

### The Board of Directors of:

#### Cabernet Ltd

- Andrew Haining (Chairman)
- Mark Darby
- Malcolm Coupar
- Chris Simpson

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

- Andrew Haining (Chairman)
- Mark Darby (CEO)
- Malcolm Coupar (Commercial Director)
- Chris Simpson (Finance Director)
- John-Paul Williams (Technical Director) (appointed 6.6.18)
- 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,  
La Planque Lane,  
Forest,  
Guernsey, GY8 0DT  
Channel Islands,



# Chairman's Statement

## Andrew Haining

2018 – a year of Performance, Achievements and Continuing Innovation.

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I am pleased to be able to present the 2018 Annual Report for the Aurigny Group.

### **Performance, Achievements and Continuing Innovation**

In 2018, Aurigny's turnover was £45.5m (2017 - £44.7m) generating positive EBITDA<sup>1</sup> of £2.3m (2017 - £0.8m). This substantial improvement in operating performance reflected continuing management focus on cost and productivity improvements. The numbers reflect a full year improvement in the contribution from our UK routes following the closure of the London City route. These routes generated a positive EBITDA of £3.9m (2017 - £3.1m). I am very pleased to report that on its UK routes Aurigny has reduced the overall loss to £0.4m on a pre-FRS102, pre-States financing costs basis. Achieving breakeven on these routes is a key performance target set us by the States and we are pleased to continue to improve our financial performance.

Further details of the financial performance of the company are contained in the Chief Executive's and Finance Director's Reports in this Annual Report.

Aside from an improvement in financial performance, one of the main focusses in the year was on continuing to improve our customer experience. Our new website, incorporating many of the features which our customers have been asking for, launched in April. This paved the way for us to launch our new fares structure in May offering customers more choice and flexibility with their travel plans. Both have been well-received. Our "we get you back" approach to handling disruption, in contrast to our major competitors, is an important part of our customer service and I was delighted that for overall service we were voted "Short-haul Airline of the Year 2018" by the respected consumer and travel magazine Which?

We are always looking for ways to improve our service through innovation and we were extremely grateful to the States for its approval of our new ATR72-600 aircraft purchases. This will make our fleet one of the youngest of regional airlines in Europe. The correlation between the age of fleet and reliability in performance is clear and I hope these new aircraft, arriving later in 2019, will equip us to deliver improved reliability and better access in low visibility. Reliability and regularity of service is continually highlighted as one of the most important components of the provision of our lifeline services by both our leisure and business customers.

### **Market Changes**

2018 was a relatively stable year in terms of both the competitive landscape and regulatory environment. However, during the course of the year, a number of policies, issues and trends emerged which will have a significant impact on our operating environment in 2019. The main ones are as follows:

- 1) the adoption of an "Open Skies" policy by the States of Guernsey.

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<sup>1</sup> EBITDA 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.

- 2) the provision of significant financial subsidy to our competitors, both directly by the States and indirectly through Guernsey airport's waiver of certain charges to our competitors.
- 3) increasing financial fragility of the smaller regional airline market in the face of competition from the major players such as Easyjet which has led to several insolvencies and rescues of companies such as Flybe.
- 4) the potential of a "no deal" Brexit and with it a possible period of airline disruption on the UK mainland which will inevitably impact service levels to and from Gatwick for a period of time.

All the above contrive to generate greater uncertainty in terms of our ability to deliver the level of service our customers rightly expect at the best possible price, whilst still achieving our overall financial target of breakeven.

The provision of cost-effective airline services is a function of a number of factors but scale is a key ingredient. I would like to see Aurigny grow and be a stronger, more cost-effective provider of island lifeline services long into the future. This is why, in 2019, we have taken advantage of the Open Skies policy to launch new routes to Jersey and Southampton that will provide attractive additional services for our customers and valuable additional activity to the business that enables us to utilise our aircraft fleet more efficiently.

Early in 2018 'slots' at London Heathrow became available to us, on a temporary basis, that would have given us the opportunity to operate services to Heathrow. Unfortunately, this did not progress. We would have preferred that our offer had been adopted, as opposed to the one that has recently been launched by Flybe/Connect Airways and hope that we will have another opportunity to compete for the subsidy if that route continues.

### **Community Role**

As a States' owned airline, Aurigny is embedded in the community and understands its objectives to serve the people of Guernsey, where connections between the islands, Gatwick 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 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. This dedication and ability to adapt was demonstrated in December 2018, when a drone sighting at Gatwick closed the airport for over 24 hours. Our team were quick to adapt and re-routed our lifeline Gatwick service in and out of Southampton airport for an entire day, rather than cancel flights. Aurigny were the only airline to continue operating the services it had planned for Gatwick during this time. It was greatly appreciated by the local community and those of our customers based off island. We received an award from Southampton Airport for this operation, recognising our efforts and community commitment, which was especially notable as it was in the run-up to Christmas.

The Committee for Economic Development's launch of a Public Service Obligations (PSO) tender process for the provision of scheduled air services on the Alderney-Guernsey and Alderney-Southampton routes is a welcome step. In 2018 Aurigny marked its 50<sup>th</sup> year of service on Alderney routes and we look forward to continuing to serve the Island as the PSO provider in the future.

### **Our People**

As an airline, we continue to invest in our team and recognise their importance to us and our customers. We appreciate the dedication and pride our team 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 very 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, particularly at times of disruption.

It is testament to our staff and the customer experience we enable that we were able to achieve the Which? award competing alongside the likes of Easyjet, British Airways and Flybe. We would like to thank all our staff, across all our locations, for helping us to achieve and deliver to our customers throughout 2018.



# Chief Executive's Report

## Mark Darby

2018 proved to be a year of considerable progress for the company with the business delivering improvements in both its financial and operational performance as well as taking steps to further improve the business in years to come.

2018 saw our 50<sup>th</sup> anniversary – a remarkable achievement in the world of regional aviation. Since Aurigny was founded in 1968 operating 8-seater Britten-Norman Islanders, the airline has carried over 16 million customers. We celebrated our 'Golden Anniversary' with a number of events including a 'Vin d'honneur' hosted by the Lieutenant-Governor and his wife, Sir Ian and Lady Corder, at Government House.

The Chairman has, above, set out a number of key themes which I would like to develop. We see Aurigny's role as being part of the Islands' essential infrastructure and as such expend considerable resources on seeking ways to improve our dependability and reliability. This was exemplified by our purchase of the Embraer E195 jet aircraft, the replacement of the Trislanders by the Dorniers (the second new 'NG' aircraft arrived in August 2018) and now the order for the 3 new ATR 72-600 which will be delivered in 2019.

The \$60+ million investment in the new ATR 72-600 aircraft was supported and approved by the States in December 2018, for which we were very grateful. Apart from the improved reliability that we should secure with the new aircraft and the improved passenger cabin, this acquisition is made more exciting by the addition of new technology, known as 'Enhanced Vision Systems', that will help our crews to land in reduced visibility. While Aurigny will be the first operator to deploy such technology in scheduled air services, the 'ClearVision' technology has been widely used on military



and business jet aircraft for many years. The picture here was taken during an approach into Guernsey and illustrates the difference that the technology can make. The captain will be able to see through the fog/low cloud and safely land in circumstances that are not possible today. It will be a big step forward for commercial aviation in Guernsey as it will offer similar performance to a 'Category 2 ILS'<sup>2</sup>. It will take us a while to fully train our crews on the new technology, but we expect the system to be fully operational in 2020. We have approached Embraer, the manufacturer of our Jet aircraft, to see whether a similar system could be fitted to this type.



<sup>2</sup> Guernsey Airport currently has a Category 1 ILS – which has a RVR visibility limit of 550m and decision height of 200', whereas Category 2 ILS permits approaches in visibility down to 350m. ClearVision should allow approaches to be made in visibility of greater than 350m and a decision height of 100'. While these differences may appear small, we anticipate that it will have a marked effect on our ability to land in Guernsey, reducing the number of cancellations and delays.

The following table shows the aircraft fleet that we operated during 2018 and the fleet we expect to have at the end of 2019:

Type	No. of Seats	Year of Manufacture	Owned / Leased	No in Fleet at 31.12.18	No. in Fleet at 31.12.19 (planned)
Embraer E195	122	2014	Owned	1	1
ATR 72-500	72	2009	Owned	2	-
ATR 72-500	72	2009	Leased	1	1
ATR 42-500	48	1999	Leased	1	1 (off-lease 4/20)
ATR 72-600	72	2019	Owned	-	3
Dornier 228 'NG'	19	2016 & 2019	Owned	2	2
Dornier 228 'Classic'	18	1988	Owned	2	1

As mentioned by the Chairman, by 2020 Aurigny will have one of the youngest fleets of any regional airline in Europe. This should enable us to provide a more reliable and comfortable customer experience.

Listening to our customers, we know that they value being able to travel at convenient times to airports which fit their travel plans so we have designed our timetable to offer the best possible balance of frequency of service to the most popular destinations.



London is the lifeline destination for Guernsey. We serve the London market up to 7 times daily – 6 flight rotations to Gatwick and 1 to Stansted – with departures spread across the day so whether your journey is on business and you need a day return, or for more leisurely purposes, you will find a departure that meets your needs.

The link between Alderney and Guernsey is another lifeline: we fly at least 4 times daily and we ensure that we have the capacity to put on additional services at peak times. We provide 'medevac' flights on behalf of the hospital in Alderney when it is necessary to transfer residents to Guernsey for medical treatment; in 2018 we flew over 50 of these services, which we provide to Guernsey's HSC at marginal cost. Alongside this lifeline service, we also connect Alderney with Southampton 3 times daily. At the end of 2018 we took the decision to cease our Dornier-operated service to Dinard as demand for the service had steadily declined. This should help provide additional capacity for and greater operational resilience on the Alderney routes.

As mentioned above we have recently launched two new services to Southampton and Jersey in response to frequent requests from all sections of our customer base to provide them with a competitive and reliable service. Reliability is key on these services and to help achieve this the aircraft serving the early morning Jersey service will originate in Guernsey. We are serving both routes on a 'double-daily' basis mid-week with convenient timings for both business and leisure customers as well as daily services to Southampton on weekends. Aurigny is now the only airline that regularly serves Guernsey that offers a 'frequent flyer scheme'. This valuable benefit rewards the loyalty of our customers and gives us a competitive advantage in an increasingly crowded market.

As shown in the above route map, we serve a range of important cities in the UK but are continually seeking new route opportunities that we can explore in the UK or Europe.

Operationally, 2018 saw improvements to our reliability and punctuality. This has been the result of concerted efforts by our flight operations, ground operations and engineering teams who have worked tirelessly to seek opportunities to improve our performance.

Overall, we improved the punctuality of our operation during the year with, excluding weather-related delays; 86% of our flights departing on-time<sup>3</sup> in 2018 as compared to 81% in 2017.

2018 was the first full year of the operation of our own ground handling team at London Gatwick. This lifeline route deserves the best service and we had found it impossible to secure a reliable ground handling service from the handling agencies at Gatwick. Since establishing our own handling team in 2017 our on-time-performance at Gatwick (excluding delays due to weather) has improved from 79% to 83% - an excellent performance during a period when many other Gatwick operators have seen a deterioration in their punctuality.

At the end of December 2018, the Aurigny Group of companies employed 312 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.

	Guernsey		Alderney		United Kingdom		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
Pilots	51	53	4	5			55	58
Cabin Crew	37	39					37	39
Engineers & Strores	26	26					26	26
Ground staff	92	91	15	16	36	33	143	140
Management & Administration	43	42	2	2	6	6	51	50
<b>Total</b>	<b>249</b>	<b>251</b>	<b>21</b>	<b>23</b>	<b>42</b>	<b>39</b>	<b>312</b>	<b>313</b>

Management and administration includes executive management, flight operations management and administration, engineering management and administration, HR, IR, safety office, compliance office, finance and accounts.

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

<sup>3</sup> Measured as departing within 15 minutes of the scheduled departure time



# Finance Director's Report

## Chris Simpson

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### Our financial performance

Our reported loss for 2018 improved to £4.4m, down from £5.2m in 2017. Excluding FRS102<sup>4</sup> adjustments, our loss this year improved to £3.6m (£6.3m in 2017). Of this loss, £2.8m was attributable to our Alderney routes and £0.4m to overdraft interest (an overdraft provided by the States of Guernsey) leaving a loss of £0.4m attributable to our Guernsey – UK routes and other activities.

### Investment in our business

We continue to invest in our aircraft fleets and support systems. A second Dornier 228NG aircraft was delivered in September bringing the investment in this fleet to more than £15m. The decision to replace the 10-year old ATR72-500s with three new ATR72-600s will deliver cost-savings and operational benefits, expected to be more than £6m over the next 10 years. Following a competitive tender, we were able to secure attractive funding for the acquisition. We have entered into hedging arrangements to mitigate the risk of interest rate rises and currency fluctuations.

### Revenues

On our UK routes passenger carryings declined 2% to 477,700, (2017 – 489,100) partly due to the closure of the London City route in October 2017. On our Alderney routes passengers also declined by 2% to 53,700 (2017 – 54,900). Total revenues increased 2% to £45.5m (2017 - £44.7m). Within that number, passenger revenues increased 0.7% to £41.9m (2017 - £41.6m) and revenues from other activities (ground handling services performed for other airlines; snacks and duty free goods sold on board our aircraft; cargo and mail carried; aircraft charters and medevac flights) improved from £3.1m to £3.8m.

### Controlling our costs

Our operating costs, before interest and finance charges, were 1.5% lower at £47.4m (2017 - £48.1m). We paid £1.53m interest to the States of Guernsey - £1.13m for aircraft loans and £0.45m for our overdraft facility.

With hedging in place, many of our operating costs are relatively stable and predictable. Hedging is integral to an airline's business risks mitigation strategy because it eliminates uncertainty around cash flows and enables management to plan more effectively. The Board has put in place a Hedging policy covering jet fuel procurement and US dollar exposures which currently extend towards the middle of 2020 and will continue to roll forward. The credit-worthiness of Hedging counter-parties is assessed and monitored.

The most significant financial and operational risk that we cannot control, which can lead to volatility in our numbers, is unplanned fleet maintenance. As our aircraft continued to age, we would have expected to see expensive scheduled maintenance checks at certain key lifetime dates and an increased risk of unplanned fleet maintenance issues resulting in increased costs and operational disruption for our customers.

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<sup>4</sup> In the Aurigny accounts for the purposes of complying with FRS102 adjustments are made for unrealised gains and losses on derivative financial instruments and an historic fair value adjustment on certain States of Guernsey loans. Derivative financial instruments are in respect of hedges for fuel costs, US\$ exchange rates and interest rates.

Management has mitigated the risk through careful, independently reviewed, analysis of its fleet requirements leading to decisions to replace our older ATR72-500s and Dornier 228 Classics with new ATR72-600s and Dornier 228NGs.

## Our business segments

	Passenger Numbers			Passenger Revenue			EBITDA Profit/(Loss)		
	2018	2017	Variance	2018	2017	Variance	2018	2017	Variance
				£'000	£'000	£'000	£'000	£'000	£'000
Guernsey - UK routes	477,687	489,115	(11,428)	37,883	37,800	83	3,874	3,107	767
Alderney routes	53,667	54,918	(1,251)	3,977	3,794	183	(1,599)	(2,283)	684
All routes	531,354	544,033	(12,679)	41,860	41,594	266	2,276	824	1,452

*Table showing 2018 results in our key business segments – Alderney and Guernsey networks*

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

90% (2017 – 90%) of our passengers flew on our Guernsey – UK operations, representing 90% (2017 - 91%) of our passenger revenues and generating a positive EBITDA contribution of £3.9m in 2018 (2017 - £3.1m).

Our commitment to the provision of the lifeline Alderney services continues as it has for 50 years: this is underscored by the fact that in 2018 approximately 38% of our flights were flown on the Alderney network whereas these routes represent only 10% of our overall passengers and passenger revenue. Approximately 25% of the cost of our fixed assets is utilised in our Alderney operations. The negative EBITDA contribution from our Alderney operations narrowed from (£2.3m) in 2017 to (£1.6m) in 2018.

## Cash flows

We generated a positive cash flow of £2.5m (2017 - £0.6m) from our operating activities and invested a further £12.1m in the purchase of tangible fixed assets in the year (2017 - £2.1m). The tangible assets are predominantly aircraft – deposits on 3 new ATR72-600s due to be delivered in 2019 and the balance payable on the Dornier 228NG delivered in 2018. In support of the investment we drew down £7.6m of bank loans.

Our year end net cash position was £0.5m compared to a net cash of £1.7m at the end of 2017.

## 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. The Safety Management System is in place to mitigate and navigate these risks, supported by our ‘Just Culture’ in all areas of our business.

**Operational** – reflecting the high level of service provision we aim for against a background of variable weather conditions, including the prevalence of fog in the islands, and the risks associated with aircraft non-availability, which we mitigate through the provision of back-up aircraft, stand-by flight crews and, most recently, the order for enhanced-vision equipped ATR72-600s.

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

**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 are in place to ensure that we can deliver on that commitment.