

Cabernet Ltd

Annual Report and Financial Statement 2016



Corporate Details

The Board:

Andrew Haining (Chairman)

Mark Darby (CEO)

Malcolm Coupar (Commercial Director)

Chris Simpson (Finance Director)

John-Paul Williams (Group Technical Director)

Chris Holliday (Non-Executive Director)

Meriel Lenfestey (Non-Executive Director)

John Le Poidevin (No-Executive Director)

Registered Office:

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Chairman's Statement

Looking Back at the Past Year

I am delighted to present this annual report for 2016, in what is my first year as chairman of Aurigny.

It was a challenging year for the airline in many ways, but equally a year we can be proud of and one that we can build in the years ahead. One major decision of 2016 was to end the Code-Share agreement with Blue Islands on the inter-island Guernsey-Jersey route, but instead we have looked to develop and expand our network elsewhere. This saw us continuing our approach for testing new routes. We added a year-round service to Leeds/Bradford, a seasonal summer service to Norwich and experimented with a summer service to Barcelona, all proving incredibly successful and popular from the outset.

Overall, the Company recorded stable passenger numbers in somewhat difficult market conditions, with unusually poor weather in the summer impacting on the Guernsey-UK and inter-island figures.

As an airline, we continued to be Guernsey Airport's number one customer, contributing around £6m. to its revenue over the course of the year. Looking at our overall contribution to the States' income, Aurigny contributes an estimated £9m. when also taking into account the taxes paid by our 250+

Guernsey based staff. On top of this, there is of course the economic value generated from the hundreds of thousands of business and leisure visitors the airline brought to Guernsey during the year.

Looking at our assets and capital spending, there has also been considerable investment in the fleet in 2016, including the introduction of a new ATR 72-500 and the continued transition to the Dornier fleet.

In addition, the Recapitalisation of the Group was completed earlier in the year, in what was a vital move for the airline's ongoing financial sustainability, and we continue to work hard to improve the financial position of the Company all the time.

Looking ahead, we welcome next year's publication of the Strategic Review and incorporating its recommendations into our business plan moving forward. We will also look to improve the services we provide to our customers, and continue to develop and improve the lifeline links we provide to the islands. I would like to take this opportunity to thank each and every one of our staff for their hard work and dedication throughout the year, without which none of this would be possible. It is very much appreciated by the entire Aurigny board.

Background

Cabernet Limited is the holding company for the Aurigny Group, consisting of Aurigny Air Services Limited (“Aurigny”), the airline and provider of Ground Handling services in Guernsey, Alderney, Southampton, and Anglo Normandy Aero Engineering Services Limited (“Anglo Normandy”), which provides aircraft maintenance and engineering services to the airline and a small number of other companies.

This report relates to the activities of the Group.

Highlights

- During the year the ‘Code-Share’ with Blue Islands on the Guernsey-Jersey inter-island route ended after Blue Islands decided to become a Franchisee of Flybe.
- Menzies Ground Handling decided to close their handling operation in Guernsey. Aurigny took over their customers, the main one being Flybe.
- Sale of our ATR 72-200 ‘DB’.
- Outsourced heavy maintenance.
- Engine overhauls.
- Operating Lease of G-LERE.
- Board changes.
- New routes: Leeds Bradford and Norwich (seasonal), as well as short season service to Barcelona.

Trading conditions

The group’s fortunes are closely linked to the economy of Guernsey and the resulting demand on air transportation. The overall Guernsey air transport market amounted to 841,912 passengers, a drop of 18,211 from the 860,123 in 2015.

Breaking the market down into inter island travel (between Guernsey and Jersey and Alderney) and UK travel and “international” travel, the inter-island market accounted for the majority of the reduction in the overall passenger numbers.

2016 market changes (as compared to 2015)

Guernsey UK	681,876, down 3,759 (-1%)
Guernsey Inter-island	148,625, down 15,114 (-9%)
Guernsey “Europe”	11,411, up 662 (13%)
Total	841,192, down 18,211 (-2%)

The Guernsey-UK Market

The unusually poor weather condition in the summer months (primarily fog) prevented flying on a number of days. This caused a reduction in the overall numbers of passengers carried. Had the weather been “normal” the market would likely have been flat rather than the recorded 2% decline.

The London market Gatwick was down 7,441 passengers (-2%), whereas London City grew by 4,114 (18%) and London Stanstead was flat meaning the reduction in this market was 3,312 (-0.9%).

New services were introduced to Leeds Bradford (7,860 passengers) but it could be argued that these passengers were drawn from existing services to Manchester and East Midlands where passenger volumes were down by 2,591 (-4%) and 4,338 (-14%).

The only other significant statistic was the Southampton market (the second largest UK market) was down 4,554 (-3%). This was a result of significantly less capacity being offered in the winter of 2016/17 following the withdrawal of Flybe's competing services.

Aurigny's share of the UK market was 72%, as it was in 2015.

Guernsey Inter-Island Market 2016

The poor weather had an impact in this market to a greater extent than it did on the UK markets

Aurigny withdrew from the Guernsey - Jersey market midway through March 2016 leaving Blue Islands competing with Flybe's triangulated double daily services. In June 2016 Blue Islands became a Flybe franchisee effectively leaving the market services by a single (Flybe) brand. The market reduced by 13,372 (11%) the vast majority of these losses being from June onwards. The Guernsey – Alderney market also suffered a reduction, 1,592 (-4%).

Guernsey "Europe" Market 2016

This is a very small market, with only 11,411 passengers in the year, the majority of which are charter services in the summer months to Germany and the Netherlands. The market grew by 955 (13%), unfortunately the available statistics are not detailed enough to provide a breakdown of this growth, however Aurigny operated a short season services to Barcelona which generated 624 passengers which was part of the growth.

Aurigny's share of the "Europe" market grew from 3,514 (33%) in 2015 to 4,373 (38%) in 2016.

Route Network

Our portfolio of routes continues to be developed around the need to serve lifeline routes, including the London Gatwick and Alderney services.

On the London Gatwick route, we added an extra flight to the winter season in 2016 and made some important improvements to the schedules.

2016 also saw us launch three new routes on the network. A year-round Leeds Bradford service was launched in May, carrying nearly 8,000 passengers by the end of the year (representing around 75% of available seats). A seasonal Norwich service was also launched at around the same time and did equally well in its inaugural year. In addition to this, we operated direct flights to Barcelona onboard the Embraer for the 2016 summer, with well over 70% of the seats filled.

The London City route completed its second full year in 2016, and achieved significant growth, although it is likely to have taken passengers from the Gatwick market.

Safety and compliance

The company places a great deal of emphasis on the safety of its operations. It has a well-developed 'Safety Management System' that encourages all members of staff to report any safety related incidents and actively look for deficiencies in our operation that may cause safety problems.

The group's operations are regulated by the UK's Civil Aviation Authority ("CAA") who apply the standards set by EASA, the European Aviation Safety Agency. The group's companies are regularly audited by the CAA who check our compliance with the regulations. In addition, our internal compliance team perform regular internal audits as well as auditing our key suppliers such as Ground Handlers and maintenance organisations.

Operations

In 2016, Aurigny carried just over 550,000 passengers on its network, on 15,000 flights to 14 different airports. The airline remains Guernsey Airport's number one customer, providing an estimated £6m. towards its revenue. Overall in 2016, Aurigny directly contribute £9m. a year to the States' income in the form of airport landing fees and taxes paid by our employees. In addition to this is the economic value generated by over 100,000 business and leisure visitors the airline brought to Guernsey.

Fleet

The Group has continued to make substantial capital investments to support the transport links between the mainland and the Bailiwick.

Towards the end of 2016, the airline introduced a new ATR 72-500 into the fleet, leased from Nordic Aviation Capital. This aircraft replaces the old ATR 72-200 (DB) which has been sold.

The new ATR 72-500 G-LERE arrived at Aurigny fully refurbished and fitted with 72 new, all forward facing seats that give additional legroom.

The company continues to operate a mixed fleet of aircraft, led by its flagship Jet aircraft, an Embraer 195, which in 2016 operated the Barcelona route as well as the Gatwick service.

2016 also saw the continued and phased transition from the Trislander to Dornier aircraft, which operate on the Alderney and Dinard services.

Ground Handling

During the year, Aurigny's ground services division became the only Ground Handling service provider at Guernsey Airport following the withdrawal of Menzies Aviation services. This has seen our Ground Handling team take over the handling of Flybe locally. We also have Handling teams in Alderney, where we are the sole lifeline operator, and in Southampton.

Punctuality and reliability

Aurigny's punctuality for 2016 was to a large extent hampered by the poor weather in the Bailiwick over the summer period. Despite this setback, 80% of all flights, across the network, departed on time (within 15 minutes) and 93% within an hour. During the year we managed to operate 96% of all scheduled services. These figures are just a few percentage points down on the previous year when 83% of flights operated on-time and 94% within the hour.

As it has already been stated, the summer months had a significant impact on our performance. June featured a number of grounded days due to the fog and this is reflected in the punctuality figures for that month, with only 64% of flights departing on time (within 15 minutes). July and August did not fare much better, with 74% of flights departing on time, but punctuality improved later in the year. October and November achieved some of the best punctuality figures for 2016, with 88% of flights operating on time in these months.

Employment

In 2016 the Group employed nearly 280 full-time staff, of which a large majority were based in Guernsey (see the table on the next page for a full breakdown).

Our next biggest employee base remains in Alderney where our Ground Operations Team is located. We also have our own Ground Handling team based on the island.

We estimate this workforce contributes more than £3m. in taxes and social insurance to the locally economy.

Financial results

The financial results for 2016 are shown in full in the accounts (page reference). The Group's turnover has remained consistent year-on-year at £44.6m. The operating loss increased by £3.4m. to £2m. (2015: £1.4m. profit).

Financial risk management

The Group's operations expose it to a variety of financial risks which include fare risk, cost risk and foreign exchange/fuel price risk.

The Group continues to face cost risks through an increase in costs of aviation parts and consumables. The Group also has aircraft lease commitments and aviation fuel and aircraft parts are settled in dollars and Euros.

The devaluation of Sterling was identified as a business risk and the Group manages this currency risk through a combination of forward contracts and spot rate buys when the Board believed it was prudent.

Aviation fuel costs are exposed to both variations in market fuel costs and the variability in the US Dollar.

Corporate Governance

The Group is committed to high standards of corporate governance, business integrity and professionalism.

The Board of Directors, led by the Chairman, is the principal decision-making forum for the Group. It has overall responsibility for leading and controlling the Group and is accountable to the shareholder for financial and operational performance.

The Board approves Group strategy and monitors performance. The roles of the Chairman and Chief Executive are distinct and separate. The Chief Executive has responsibility for Aurigny Air Services Ltd and Anglo Normandy Aero Engineering Services Ltd. and acts in accordance with the authority delegated to him by the Board.

Twelve Board Meetings were held in the year. These meetings were structured to allow open discussion and all Directors participated in discussing the Group's strategic aims and performance as well as financial and risk management.

The Board is supplied with comprehensive and timely information in advance of each meeting, including financial and operational reports covering all the Group's business activities.

As at the date of approval of the Group accounts, the Board comprised 4 Non-Executive Directors (including the Chairman) and three Executive Directors. The Directors believe that the Board functions effectively and efficiently. The Directors provide a mix of skills, experience and expertise appropriate to the size of the business and its activities.

All Board appointments are made by the Board on recommendation of the Nominations Committee. The Chairman ensures that all Directors receive clear, accurate and timely information on all relevant matters. The Board has established a number of committees with specific responsibilities. The chairmanship and membership of these committees are refreshed at appropriate intervals.

Remuneration Committee

The Remuneration Committee comprises of Meriel Lenfestey as chairwoman, alongside Andrew Haining, Chris Holliday and John Le Poidevin. The committee's remit includes the review and recommendation to the Board of changes to the salary and benefits payable to the Executive Directors having regard to a wide range of comparables as well as the performance of the Company and that of the Executive.

The Committee was active throughout the year, meeting formally regularly as well as by email and telephone.

Nominations Committee

The Nominations Committee comprises of Andrew Haining as chairman, alongside Meriel Lenfestey, Chris Holliday and John Le Poidevin.

The committee has a wide remit which includes:

- Reviewing the Board's structure, size and composition.
- Identifying and nominating candidates to fill Board vacancies.
- Reviewing the time commitment required from non-executive directors to fulfil their responsibilities and to consider performance evaluation.
- Formulating succession plans for executive and non-executive directors recommending changes to the membership of the Audit, Nominations and Remuneration committees to the Board.

The Committee met formally on seven occasions during the year, to consider a number of issues, but primarily to identify candidates to enter the Company's Non-Executive Director selection process.

Audit Committee

The Audit Committee members are John Le Poidevin (chairman), sitting with Meriel Lenfestey and Chris Holliday. The Committee possesses a broad range of experience and diverse commercial knowledge assisting us to fulfil our responsibilities.

We constantly work to keep abreast of changing audit priorities, risks and changes to reporting in line with best practice and good governance.

Our principal role is to monitor the integrity of the financial statements of the Company and any formal announcement relating to the Company's performance, review the Company's internal financial controls and monitor and review the effectiveness of the Company's internal audit function. It also considers and recommends to the Board, the appointment of external auditors for approval by shareholders at the AGM. The Chairman and/or the Chief Executive are invited to attend audit meetings as and when appropriate.

The Audit Committee has formally met on two occasions during the financial year. On 15th April 2016 it met to review the previous year's draft accounts for year ending 31st December 2015 for recommendation to the Board and to review the audit management letter where there were no significant audit issues and few areas for follow up or for improvement.

The Risk Management Committee report to the Audit Committee identified business continuity risks and actions identified to mitigate these risks.

The adoption of the Financial Reporting Standard FRS 102 was a requirement for the Group's financial statements in the current reporting period. The Audit Committee can report that this matter has been discussed with the auditors and that this annual report includes the necessary disclosures and reporting format.

The influence of the Audit Committee continues throughout the year. The key role of the committee is to provide oversight and reassurance to the Board, Specifically, with regard to the integrity of the Company's financial reporting, audit arrangements and internal control processes.