

THE STATES OF DELIBERATION
of the
ISLAND OF GUERNSEY

POLICY & RESOURCES COMMITTEE AND STATES' TRADING SUPERVISORY BOARD

THE AURIGNY GROUP – FINANCIAL SUSTAINABILITY

The States are asked to decide:-

Whether, after consideration of the policy letter 'The Aurigny Group – Financial Sustainability' dated 3rd September, 2021, they are of the opinion:-

1. To note the Air Policy Framework which includes the Shareholder Objectives for Aurigny;
2. To approve the recapitalisation of the Aurigny Group in respect of its cumulative losses up to 31st December, 2020, in the sum of £46.8m in accordance with the provisions of section 6 of that policy letter and in accordance with such terms as the Policy & Resources Committee and the States' Trading Supervisory Board shall deem appropriate;
3. To approve the recapitalisation of the Aurigny Group in respect of its losses for the year-ending 31st December, 2021, in accordance with the provisions of section 6 of that policy letter and in accordance with such terms as the Policy & Resources Committee and the States' Trading Supervisory Board shall deem appropriate;
4. To authorise the Policy & Resources Committee to provide or guarantee overdraft facilities to the Aurigny Group in accordance with the provisions of sections 5 and 6 of that policy letter and on such terms as the Policy & Resources Committee shall deem appropriate.

The above Propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications in accordance with Rule 4(1) of the Rules of Procedure of the States of Deliberation and their Committees.

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THE AURIGNY GROUP – FINANCIAL SUSTAINABILITY

The Presiding Officer
States of Guernsey
Royal Court House
St Peter Port

3rd September, 2021

Dear Sir

1. Executive Summary

- 1.1 The Aurigny Group¹ maintains lifeline scheduled and medevac air services for the Bailiwick and at no time has that role proved to be more important than during the COVID pandemic. Nevertheless, it has accumulated substantial losses in the five years since it was last recapitalised by the States. This policy letter sets out proposals to recapitalise Aurigny in respect of its accumulated losses up to 2020, which will require an injection of £46.8m into the company, and in respect of its 2021 losses, which are projected to be £16.1m. The States have previously made provision in their Accounts for the prior-year losses made by Aurigny so the recapitalisation will be funded by drawing down this provision, as well as an additional allowance that has been made in the General Revenue Reserve in respect of the 2021 losses.
- 1.2 Aurigny has developed a new business plan which is based firmly on the presumption that it will become financially self-sustainable by 2023. However, it is acknowledged that there is no realistic prospect of the airline being able to cover from future revenues the losses which have accumulated. **A recapitalisation of the airline needs to be considered and, given that the States have made provision for the historic losses and its projected losses for 2021, doing so would have no net effect on the States' overall financial position.**

¹ The Aurigny Group (hereinafter referred to as Aurigny) is made up of three companies: Cabernet Ltd; Aurigny Air Services Ltd; and, Anglo Normandy Aero Engineering Ltd. The States of Guernsey owns all of the shares in Cabernet Ltd which acts as the holding company for the two other companies and is their sole shareholder.

- 1.3 In consultation with the Committee *for* Economic Development (CfED) and the States' Trading Supervisory Board (STSB), the Policy & Resources Committee (P&RC) has developed a new Air Policy Framework, which defines the strategic roles and responsibilities of key stakeholders, including Aurigny. It also includes new Shareholder Objectives for Aurigny that have been developed by the STSB in response to the role set out within the Framework for Aurigny.
- 1.4 Building on the restructuring that has taken place within the airline during the pandemic and the Public Service Obligation (PSO) contract that has now been put in place for its Alderney services, Aurigny has developed a new business plan that is consistent with its new Shareholder Objectives and which also takes into account the recommendations of previous fleet and efficiency reviews commissioned by the States. The plan sets out how Aurigny intends to be an economic and social enabler more efficiently and more sustainably. It is strongly focused on Aurigny becoming financially self-sufficient as it recovers from the pandemic and indicates that it will start returning modest profits from 2023 onwards.

2. Background – Aurigny Historic and Current Funding Arrangements

- 2.1 Following consideration of a policy letter from the former Treasury & Resources Department (T&RD) in 2015, the States agreed², *inter alia*, to recapitalise Aurigny in respect of its accumulated losses of £19.9m up to 31st December 2014 and its forecast losses of £5.3m for the years 2015 to 2017.
- 2.2 The policy letter assumed that, by 2018, a new PSO contract for the operation of Aurigny's Alderney services would have been introduced and, from that point, the losses on those services would no longer fall to Aurigny to absorb. The financial projections provided by Aurigny at the time indicated that, from 2018 onwards, it would reach a breakeven position if a PSO contract was in place. That contract was not established until 2021, but in any event, it would not have offset all of Aurigny's losses, which exceeded those projections in the following years. The policy letter did also acknowledge the volatility of the commercial environment within which Aurigny operated. Accordingly, the States also agreed³ to authorise the T&RD to provide short-term borrowing facilities to Aurigny to ensure its ongoing operation, provided that it reported the details of and reasons for such facilities to the States within 6 months.
- 2.3 Aurigny's accumulated losses between 2015 and 2020 are set out in Table 1 below:

² Resolution 1 of Article XII of Billet d'Etat XX of 2015: Cabernet Ltd - Recapitalisation

³ Resolutions 2 and 3 of Article XII of Billet d'Etat XX of 2015: Cabernet Ltd - Recapitalisation

Table 1: Aurigny Losses (£m)

2015	2016	2017	2018	2019	2020	2015-2020	2021 (forecast)	TOTAL
3.2	5.2	5.2	4.9	9.7	28.3	56.5	16.1 ⁴	72.6

Accumulated losses are forecast to be £72.6m by the end of 2021. Those losses can be broken down as follows: £30.6m are attributable to the impact of the COVID pandemic in 2020/21; £16.3m are attributable to the operation of its services to Alderney between 2015 and 2020; £5.3m relate to impairment in aircraft values (the majority of which occurred during the pandemic). The balance relates to “general” operational losses. Aurigny’s financial performance has been reported to the States each year in their annual Budget Reports, which have on occasion flagged the likely requirement to consider a further recapitalisation in future.

- 2.4 The net asset position in the balance sheet, which takes into account the balance of the agreed recapitalisation funds, was (£48.1m) at the end of 2020 and is expected to be (£64.2m) at the end of 2021. This includes a net £1.3m of non-cash temporary timing differences that will ‘reverse out’ in future years which are accounting adjustments arising from the application of Accounting Standard FRS102. These are in respect of the year-end valuation of financial instruments used to fix interest rates for external loan finance to purchase aircraft and forward contracts (commodity and currency) for the purchase of fuel. Therefore, in respect of the losses up to the end of 2020, the recapitalisation required is £46.8m.
- 2.5 It is acknowledged that the States have previously agreed to provide funding and financing to Aurigny through various other mechanisms, including long-term loans and loan guarantees for aircraft acquisitions and temporary overdraft facilities for operational purposes. The following loans and loan guarantees for aircraft acquisitions have been agreed previously by the States:
- A guarantee of up to £51m for a long-term loan with Royal Bank Scotland International Ltd (RBSI) for the acquisition of the three ATR 72-600 aircraft. Aurigny drew down £48.8m against this facility and the balance now stands at £42.5m following scheduled repayments; and,
 - Long term loans totalling £37.5m with the States (using proceeds from the States of Guernsey Bond Issue) for the acquisition of an Embraer 195 and

⁴ Projected losses for 2021 are net of payments from the States to Aurigny under the PSO contract for the operation of Alderney air services.

Dornier 228 aircraft. These facilities have been fully drawn as at 31st December, 2020, but the outstanding balance currently stands at £27.6m through scheduled repayments.

It should be stressed that the proposals set out in this policy letter do not relate to the above loans, which will continue to be serviced by the airline's normal trading activities.

2.6 The following overdraft and overdraft guarantees have been agreed previously by the States:

- A temporary overdraft facility with the States to support Aurigny's trading activities. The States have previously authorised⁵ the P&RC to provide an overdraft of up to £53m until 31st December, 2021; and,
- A guarantee for an operational loan with RBSI comprising an overdraft facility up to a maximum of £1.25m. The balance drawn against this facility as at 31st December 2020 was £nil;

The proposals set out in this policy letter will effectively enable Aurigny to repay its overdraft facility with the States. The overdraft facility with RBSI would be maintained in order to efficiently manage day-to-day operational cash flow.

3. 2021 – Aurigny Funding Update

3.1 In preparing the financial forecasts for Aurigny for inclusion within the States' 2021 Budget Report, the following assumptions were agreed with the airline:

- By the start of 2021, a testing on arrival scheme would still be in place, but there would be no requirement to self-isolate upon receipt of a negative test result;
- There would be no further lockdowns during 2021;
- A fuller flying programme would be introduced with effect from 1st January, with services and frequencies being built up over the course of the year, but with passenger numbers likely to be 30%-40% lower than 2019.

The 2021 Budget Report acknowledged that there was a considerable risk to Aurigny's forecasts, as there was significant uncertainty around many of the underlying assumptions that were outside of its control. Self-evidently, the assumptions proved to be invalid, with additional lockdowns in both the Bailiwick and the UK during 2021, together with ongoing restrictions on travel.

⁵ Resolution 19 of Billet d'Etat XXVI of 2020

- 3.2 As a result, Aurigny has updated its forecasts for 2021. Its original forecast was for a loss of £14m on its UK services, with an accumulated cash (overdraft) requirement of £53m. As a result of the delay in returning to a fuller flying programme, it is now forecasting a loss of £16.1m and anticipates that it will fully utilise its current overdraft facilities during October.
- 3.3 Aurigny took the following steps during the pandemic to reduce losses:
- A reduction of 18% in its employee headcount through contract terminations, redundancies and natural attrition;
 - A reduction⁶ in the size of the fleet;
 - The operation of an internal furlough scheme in Guernsey, where all staff have been subject to reductions in their salaries;
 - The furloughing of its UK based staff under the UK Government's scheme;
 - The pursuit of other flying activity that could contribute positively to fixed overheads, including the Isle of Man airbridge (in 2020) and the Formula 1 charter programme.
- 3.4 At the request of the States, the airline has been kept in a state of operational readiness to enable it: firstly, to maintain lifeline services to Southampton and Alderney; and, secondly, to ensure it has been able to scale up its operations as quickly as possible and without delay as and when conditions have allowed. As a result, since July, it has supported the Bailiwick's exit from lockdown by quickly and progressively restoring services on all but one⁷ of its pre-pandemic routes, including the reinstatement of routes formerly provided by Flybe to Birmingham and Exeter.
- 3.5 The P&RC has now put in place a PSO contract with Aurigny that secures the operation of Alderney's air services to and from Guernsey and Southampton. The contract sets out the levels of services to be provided and establishes clear limits on the amount that will be paid in return. In consultation with the States of Alderney and, supplemented by comprehensive reporting, the contract provides for a range of control mechanisms to be applied by the parties to achieve a target contract payment of no greater than £2m, with a provision for a

⁶ During the course of 2021, Aurigny is returning one ATR72-500 to its lessor and is proceeding with the planned disposal of two Dornier 228 (Classic).

⁷ Services to London Stansted remain suspended.

maximum sum of £2.5m⁸. It should be noted that Aurigny's projected losses for 2021 (Table 1 above) take account of payments to Aurigny under this contract.

4. Air Policy Framework

4.1 The Government Work Plan's Priority 3 (delivering the recovery actions) identifies the need to secure transport connectivity and infrastructure as a key area of focus and includes the development of an air links policy in 2021 and support for air route connectivity over the remainder of this political term.

4.2 In tandem with the above, the P&RC has established an Air Policy Framework for the period 2021-26. This has been developed in consultation with the Committee for Economic Development (CfED) and the STSB and identifies the roles and responsibilities of key stakeholders to ensure that the Framework can be developed and implemented in a coordinated and cohesive manner. The Framework reviews the air policy challenges facing the Bailiwick. It reviews and updates the States' objectives for air connectivity and sets out a number of policies and initiatives in response to those, including the recapitalisation of Aurigny in 2021. A copy of the Framework is attached as Appendix 1.

4.3 The Framework identifies the strategic role of Aurigny as follows:

"Aurigny is to maintain reliable air transportation services, in the first instance to protect designated economic, medical, and social lifeline air routes to and from the Bailiwick, and thereafter more broadly to grow air connectivity, directly and through partnership, in a financially sustainable manner. It is expected that Aurigny, as a carrier substantially based within Guernsey, will support the developmental objectives of the States by supporting local employment where practical and financially viable, will forsake a profit motive beyond that needed to be financially self-sufficient in favour of affordable air travel and, where called on by the States but not to the financial detriment of Aurigny, cooperate with the States in terms of route development initiatives."

In support of this role, the Framework sets out in priority order three core shareholder objectives for Aurigny that have been established by the STSB, which can be summarised as follows:

- Objective 1 - Provide security of essential routes (Guernsey-Gatwick; Guernsey-Southampton; and, Guernsey-Alderney);
- Objective 2 – Achieve a financial breakeven result during the next 5 years; and,
- Objective 3 - Support the core strategic objectives of the States of Guernsey.

⁸ The contract excludes 2021 from being subject to the maximum deficit sum, in recognition of the impact of COVID-19 on the operation of the services.

The full detail around these objectives is set out in the Framework.

- 4.4 Aurigny has developed a new business plan in response to the Framework and the shareholder objectives set out therein. Details of that plan, which sets out how Aurigny will move to a sustainable financial position, are set out below.

5. Aurigny – Sustainable Business Plan - 2022 Onwards

- 5.1 In response to the new Air Policy Framework, Aurigny has developed a new business plan that is financially sustainable and demonstrates that it can operate without ongoing taxpayer support unless otherwise expressly agreed by the States through, for example, PSO arrangements akin to those agreed for the Alderney services or support for the development of new routes in accordance with strategies agreed by the States for the Island's economic development. The business plan also takes account of a number of previous reviews and, in particular, the Fleet Review⁹ commissioned by the STSB in 2018 and the Efficiency and Benchmarking Review¹⁰ of Aurigny that was commissioned jointly by the STSB and the Scrutiny Management Committee in 2019. An Executive Summary of the business plan is attached as Appendix 2 (given that Aurigny operates in a competitive marketplace, the full business plan is not being published for reasons of commercial confidentiality).

- 5.2 In moving towards a sustainable financial position, this plan directly confronts the challenges that arise from Aurigny's small scale and size. It analyses and benchmarks the increases in the airline's cost base since the 2015 recapitalisation and, building on the restructuring that has started during the pandemic, identifies steps to further redress those. It is focused on delivering passenger growth and improving the Bailiwick's connectivity by both increasing its own productivity and developing partnerships with other airlines.

- 5.3 Key elements of the new business plan include:

- Identifying further opportunities to reduce costs and improve efficiency by reducing the size and/or complexity of the current fleet. The measures already taken in this area are now generating recurring combined savings of £1.4m per annum in reduced aircraft lease and salary costs.

Whilst the structural changes in the aviation market arising from the pandemic will have profound implications for the aviation industry, they may also present opportunities, notably in terms of the fleet structure. The fleet will remain under review to ensure that it is aligned with the prevailing

⁹ Article 17 of Billet d'Etat XXVII of 2018: STSB – Aurigny Aircraft Acquisitions (Section 2 – Fleet Review)

¹⁰ [Aurigny - Efficiency & Benchmarking Review - States of Guernsey \(gov.gg\)](https://www.gov.gg/Aurigny-Efficiency-Benchmarking-Review-States-of-Guernsey)

commercial environment and levels of passenger demand as the Island emerges from the pandemic.

Significant opportunities to standardise more of Aurigny's operations around its ATR turboprop aircraft would arise in the event that a decision is made in due course to extend the runway at Alderney Airport. Alternatively, if additional slots can be acquired at Gatwick to enable higher frequency ATR services on the route sufficient to meet post-pandemic demand, the requirement to retain the Embraer jet reduces.

Aurigny will also be reviewing ownership structures for the fleet. With the support and assistance of both the P&RC and STSB, it will be investigating the pros and cons of a fleet that achieves a balance between owned and leased aircraft assets, acknowledging that one advantage of leasing is that the airline would no longer bear the risk associated with fluctuations in aircraft values;

- Improving productivity by increasing utilisation of the now smaller fleet without compromising essential connectivity for the Island. This has included the reinstatement of the former Flybe services to Birmingham and Exeter and, looking forward, will include more pursuit of marginal flying activity that can make a positive contribution to fixed overheads, such as the new direct service being introduced to Dublin. These new routes, together with the ongoing operation of the Southampton service in conjunction with Blue Islands, are expected to increase revenues by circa £1.2m per annum;
- A review of the efficiency of the maintenance function, including working practices and support functions. Maintenance currently represents 19½% of Aurigny's total costs, more than double the average for other IATA¹¹ carriers, so there are opportunities for improvements here both generally and in line with the ongoing simplification of the fleet;
- Improving connectivity for both Guernsey and Alderney and extending the airline's "reach" without adding to net costs by agreeing interline and codeshare arrangements with other carriers. For example, Aurigny is developing an agreement with British Airways that will enable customers to connect with British Airways' flights at Gatwick, Heathrow and Southampton with a single ticket bookable through either carrier. Customers will benefit from reduced Air Passenger Duty charges and Guernsey will benefit from being marketed and visible through British Airways' sales and marketing channels. Aurigny is currently also finalising agreements with one other major international airline and two regional carriers and expects to announce details of those shortly;

¹¹ IATA – International Air Transport Association

- Reducing overheads by cooperating with other carriers on procurement and to share fixed costs in areas such as ground handling and maintenance. In addition, the interest charges incurred by Aurigny will reduce by circa £400,000 per annum in the event that the proposals set out in this policy letter for the recapitalisation of the airline are approved; and,
- Undertaking more joint work with the local visitor and hospitality sectors, including Visit Guernsey, to promote the Bailiwick and offer flight-inclusive packages, with a particular focus on making use of spare capacity available during the shoulder months.

Aurigny has already identified £3m in increased revenues / reduced costs that can be delivered from the above initiatives, with others still in the pipeline. If account is also taken of the new PSO contract for the Alderney services, then its financial performance can be expected to improve by circa £5m per annum.

- 5.4 One of the most tangible examples of the new business plan is the co-operation agreement between Blue Islands and Aurigny, which will include the following initiatives: the harmonisation of their schedules between Guernsey, Jersey, Exeter and Birmingham to offer same-day return services; working together to rebuild sustainable flight frequencies between Guernsey and Southampton; and, the establishment of a connecting service between Alderney and Jersey via Guernsey. The agreement will provide more certainty and choice to both Islanders and passengers from the UK, noting that pricing and customer care will continue to be managed by each airline independently to ensure competition remains. Under the agreement, both carriers will share some ground handling and maintenance facilities to reduce costs.
- 5.5 Table 2 below summarises Aurigny's expected revenue and profit evolution between 2022-25. The forecast has been provided against a backdrop of unprecedented uncertainty around the longer-term effects which the COVID pandemic may have on demand for air travel to and from the Bailiwick, especially within the business sector. It is sensitive to changes in the underlying assumptions around the commercial environment in which Aurigny operates and some of these are also identified below.
- 5.6 Whilst conservative in its approach, the forecast assumes that testing and self-isolation requirements will gradually reduce and that traffic will continue to recover during 2022. Within that context, the forecast indicates Aurigny will start returning modest profits from 2023 onwards:

Table 2: Aurigny – Forecast Revenue and (Loss)/Profit (£m)¹

£000s	2022	2023	2024	2025
Revenue	44.6	46.8	47.6	47.6
PSO Income	2.0	2.1	2.2	2.1
Total Revenues	46.6	48.9	49.8	49.7
Operating costs	(40.7)	(41.4)	(42.1)	(41.6)
EBITDA²	5.9	7.5	7.7	8.1
Depreciation	(5.5)	(5.5)	(5.6)	(6.4)
Interest	(1.8)	(1.7)	(1.5)	(1.4)
(Loss)/Profit	(1.4)	0.3	0.6	0.3

Cumulative Projected Loss – 2022-2025: (£200,000)**Notes:**

1. Figures do not include allowance for inflation
2. EBITDA – Earnings before Interest, Taxes, Depreciation & Amortisation

5.7 Aurigny's projections are based on a number of modelling assumptions in areas outside of the airline's control which are very difficult to predict in the pandemic environment, including:

- COVID related travel restrictions and self-isolation requirements in Guernsey, the UK and further afield;
- The speed of recovery in passenger demand, notably in the business sector, and the load factors and revenue yields that will be achievable;
- The prevailing competitive environment in both the air and sea markets, together with the associated air route licensing and quasi-open skies arrangements; and
- Jet fuel prices and foreign exchange rates (noting that fuel is purchased in US dollars).

5.8 Aurigny has undertaken sensitivity analyses of a range of different factors that could impact its financial performance over the 4-year forecast period (2022-25) and examples of some of these include:

- A 1% variance in its projected passenger numbers could impact performance by £1.4m;

- A 1% variance in its projected load factors could impact performance by £2m;
- A 1% variance in its projected yields (the average ticket price achieved) could impact performance by £1.9m;
- A movement in the projected fuel price of \$10 per metric tonne could impact performance by £236,000; and,
- A movement in the projected US\$ exchange rate of 5 cents could impact performance by £500,000.

- 5.9 It should be noted that, in 2025, Aurigny is forecasting significant planned maintenance expenditure of £9.2m on the Embraer jet. Options for the financing of this expenditure remain under review, noting that this would be a capital expense spread over the remaining anticipated life of the aircraft. In any event, this will be subject to a review of whether the Embraer should be retained within the fleet, which is expected to be completed well before this point.
- 5.10 The forecast indicates that Aurigny's losses will reduce substantially to £1.4m in 2022 as the airline continues its recovery from the pandemic and that, from 2023, it anticipates returning modest profits. Over the forecast period, those profits will almost offset the loss anticipated in 2022.
- 5.11 Acknowledging the unpredictable environment within which Aurigny operates and its susceptibility to external forces, the P&RC is proposing that it should have delegated authority to provide Aurigny with (or to guarantee) overdraft facilities to manage its cash-flow and ensure it has sufficient liquidity to address such challenges in the short-term and adjust its business plan accordingly.
- 5.12 In consultation with the CfED and the STSB, the P&RC will be reviewing annually the air connectivity and investment objectives set out in the Air Policy Framework. This process will provide an opportunity to review any variances in Aurigny's forecast financial performance and any policy interventions that may be required from the States as a result.

6. Aurigny – Recapitalisation

- 6.1 The States have previously made provision in their Accounts for the prior-year losses made by Aurigny so the recapitalisation will be funded by drawing down this provision, as well as an additional allowance that has been made in the General Revenue Reserve in respect of the 2021 losses.
- 6.2 Whilst Aurigny's new business plan is based firmly on the presumption that it will become financially self-sustainable by 2023, it is acknowledged that there is no realistic prospect of the airline being able to repay from future revenues the losses which have accumulated. **A recapitalisation of the airline needs to be considered and, given that the States have made provision for the historic**

losses and its projected losses for 2021, doing so would have no net effect on the States' overall financial position.

6.3 A recapitalisation has been anticipated in previous Budget Reports and is identified as an initiative in the Air Policy Framework. Therefore, the P&RC and the STSB are proposing that the States adopts a phased approach to the recapitalisation of the airline as follows:

- Firstly, a recapitalisation in respect of £46.8m in respect of its accumulated losses to 31 December 2020, after excluding net £1.3m of non-cash temporary timing differences that will 'reverse out' in future years which are accounting adjustments arising from the application of Accounting Standard FRS102; and
- Secondly, in respect of its projected losses for the year-ending 31st December, 2021, a recapitalisation in the sum of its loss (currently projected to be £16.1m), again net of any adjustments in respect of Accounting Standard FRS102, which can only be determined at the end of the financial year. Given that this element of the recapitalisation is based on a projection, it is proposed that the States delegates authority to the P&RC to determine the recapitalisation required for this period upon the finalisation of Aurigny's accounts for 2021.

The recapitalisation will be implemented through a share issue and share subscription arrangement, with the States - acting through the STSB in its role as shareholder - undertaking to purchase additional shares in Aurigny equivalent in value to the recapitalisation sum. Whilst it is anticipated that the first phase of the recapitalisation should be completed by the end of 2021, the P&RC will need to continue to provide short-term overdraft facilities to Aurigny in Q4, given that the airline is currently projecting that it will be fully utilising its current facilities in October of this year and the recapitalisation in respect of the 2021 losses will not take place until mid-2022.

6.4 During the course of this process, it is intended that the companies within the Group will be re-organised. The current holding company structure reflects a historic focus of Anglo Normandy Engineering (ANE) as an independent entity generating revenues from engineering and maintenance services to third parties. However, ANE has for some years now had a focus dedicated almost entirely on providing services to Aurigny, essentially operating as a division of the airline. It no longer needs to be held and maintained as an independent maintenance and repair organisation. Therefore, the three existing entities (Cabernet Ltd, ANE Ltd and Aurigny Ltd) will be combined into one under the Aurigny name in order to reduce the associated administrative overheads. It is anticipated that this process will be complete by early 2022 and the precise detail of the recapitalisation will take account of this proposed Group restructure.

7. Compliance with Rule 4

7.1 Rule 4 of the Rules of Procedure of the States of Deliberation and their Committees sets out the information which must be included in, or appended to, motions laid before the States.

7.2 In accordance with Rule 4(1):

- a) The Propositions contribute to Priority 3 of the Government Work Plan (delivering recovery actions), which identifies the need to secure transport connectivity and infrastructure as a key area of focus and includes the development of an air links policy in 2021 and support for air route connectivity over the remainder of this political term;
- b) The Policy & Resources Committee has consulted with the Committee *for* Economic Development and the States' Trading Supervisory Board on the development of the Air Policy Framework that provides the basis for the Propositions. It also received representations from external stakeholders in developing the Framework. The States' Trading Supervisory Board has consulted with Aurigny in the development of the airline's shareholder objectives and the Propositions for the recapitalisation of the airline;
- c) The Propositions have been submitted to Her Majesty's Procureur for advice on any legal or constitutional implications; and,
- d) The financial implications to the States of Guernsey of carrying out the Propositions are set out in sections 5 and 6 of this policy letter.

7.3 In accordance with Rule 4(2):

- a) The Propositions relate to:
 - firstly, the duties of the Policy & Resources Committee to advise the States on fiscal policy, economic affairs and the financial and other resources of the States;
 - and, secondly, the States' Trading Supervisory Board's duties to carry out the States' role as shareholder in Aurigny; and,

- b) It is confirmed that the Propositions accompanying this policy letter are supported unanimously by the Policy & Resources Committee and the States' Trading Supervisory Board.

Yours faithfully

Policy & Resources Committee:

P T R Ferbrache
President

H J R Soulsby MBE
Vice-President

M A J Helyar
J P Le Tocq
D J Mahoney

States' Trading Supervisory Board:

P J Roffey
President

C N K Parkinson
Vice-President

N G Moakes
S J Falla CBE
J Hollis

APPENDIX 1

Guernsey's Air Policy Framework 2021-26

The air policy challenge for Guernsey and the Bailiwick

1. In December 2018 the States agreed Guernsey's air and sea connectivity and investment objectives, including the role of Aurigny as a strategic asset. Since then, the world has changed – and, during 2020-21 in particular, Guernsey's air policy challenges have shifted. This policy framework provides a clarification and in places an update on how those objectives will be met in the context of those changes. The Policy & Resources Committee has consulted with the Committee for Economic Development and the States' Trading Supervisory Board and it has received representations from stakeholders outside of the States.

The changing regional aviation and economic environment

2. The post-Brexit Trade and Co-Operation Agreement provides an economic context that will require an outward looking economy that has first-class resilient air connectivity. The economic and community recovery from the impact of Covid-19 means the States will need to invest in air connectivity given the changing landscape of the regional aviation sector, and it will need to set clear objectives for Aurigny to maximise its benefits as a strategic asset. Many regional airlines and airports have struggled in the aftermath of Covid-19 and its impact on air travel and the loss of Flybe in particular has had a significant impact on Bailiwick connectivity. Guernsey is fortunate that it has ownership of a regional airline and a regional airport.

Fair and proportionate competition

3. Fair and proportionate competition means realising that for a jurisdiction as small as Guernsey, there is an economy of scale: essential routes need security of operation through slot ownership (Gatwick), route licensing (Southampton) or a Public Service Obligation (Alderney). Open competition on other non-essential routes should continue to be allowed, with checks and balances in place to ensure that the operation of those routes does not damage the operation of essential routes, and by extension of Guernsey's overall objectives. The Airport's role in ensuring equality of treatment of carriers is important in this respect.

Stability and certainty

4. Guernsey's government needs to provide a stable approach to the post-2021 challenge, one that ensures as much certainty as possible for all stakeholders: the community, the finance sector, the visitor economy, the wider economy, health care providers, Aurigny, commercial airlines, Guernsey Airport, Alderney and its Airport. Certainty will enable investment; investment will improve service and choice. This policy framework is intended to provide that. This means that the air policy should only change to meet new challenges or

opportunities – but otherwise the framework set out here should be established for five years, through to Q4 2026, and be reviewed in Q1/Q2 2026.

5. It is important to emphasise that this is a framework. The States need to create an environment in which Aurigny, Blue Islands and other airlines can operate with a minimum of government intervention. In response to this framework, Aurigny will soon finalise its new business plan which will also cover the next five years, ie. the same period. The States should not seek to run Aurigny as a business, directly or by stealth. It needs to set clear objectives, as below, and then as the shareholder be assured that these objectives are being met.

Guernsey Airport

6. During this period the Airport will undertake and complete the development of a 'land use masterplan' in order to enhance its operational infrastructure, optimise the value of its estate, and maximise its non-aeronautical revenue. This latter point is vital, as it should enable the Airport in the future to have greater flexibility in respect of landing or other operational charges; this flexibility can then be applied in order to enable the Airport to attract more carriers on new routes, and increase passenger numbers to the Island. The Airport's role as a wider economic enabler needs to be understood and supported, including through the States' approach to route development support. It is clear that there will be tension between the Airport's current plan to increase landing fees in order to reach breakeven and the aim of the policy framework to hold or, where possible, reduce the level of landing fees. This tension will need to be managed between the Policy & Resources Committee and the States' Trading Supervisory Board until such time as a balanced budget can be achieved through non-aeronautical revenue.

Monitoring and review

7. The Policy & Resources Committee, the Committee *for* Economic Development and the States' Trading Supervisory Board have agreed the air policy framework. They will work to support it through annual monitoring meetings.

Air policy framework – 2021-26

Growth, wellbeing and resilience

8. The States will pursue an air connectivity policy that enables the reliable, efficient and sustainable movement of people, goods and services between the Bailiwick and destinations within the UK, Europe and further afield with whom it shares important trade, tourism, health and community connections. The purpose of this is to support growth within the local economy, the enhanced wellbeing of the residents of the Bailiwick, and the overall effective resilience of our community.

Retention of 'quasi-open skies'

9. The States will continue to encourage fair and proportionate competition (see paragraph 3) through the 'quasi-open skies' regime established in 2018, but will do so without undermining the Bailiwick's overall policy and interests.

Essential air links

10. One way of protecting the overall Bailiwick interest will be through the designation of essential routes to support and protect the Bailiwick's strategic interests, as with the Guernsey-Southampton link in Q3 2021. The decision to designate Southampton as an essential link was made in 2021 on the basis of the environment and factors set out in paragraphs 2-4 above.

11. The basis of the designation of a route as an essential link is set out in the review of air transport licensing agreed by the States in July 2018. These criteria remain fit-for-purpose, but as a next step the **Committee for Economic Development is asked to monitor routes to ascertain if other routes in the future should be designated as essential.**

12. In addition to this, the development of the air policy framework has demonstrated the ongoing importance of the slots at London Gatwick while the aviation sector is going through a period of significant change and retrenchment. On that basis, Guernsey-Gatwick will remain an essential link until Q3 2026, with a review in Q1 2026 if circumstances do not change significantly in the interim.

13. In Q1 2021 a Public Service Obligation (PSO) agreement was put in place on the essential Alderney-Guernsey service for a period of up to five years.

Route development

14. Notwithstanding Guernsey's move to open skies in 2018 on all but two essential routes at that time (now three essential routes), route development support may still be required to open up new routes to increase passenger numbers and enhance connectivity.

15. Any government or Airport financial support in the development of new routes must meet the following criteria which are compatible with the air policy framework:

- a) A new route with no operator on it;
- b) A route which increases overall passenger numbers;
- c) In achieving (b), a route or service that does not directly cannibalise passengers from other routes currently in operation, in particular essential routes, and does not have a demonstrable and significant detrimental impact on the operation of that other route;
- d) A route where there is agreed potential with the operator for the route to be operated for the same period annually for a minimum of three years if the route is successful; and
- e) Onward connectivity to routes of economic interest to Guernsey.

16. The States need to remain watchful that routes that are near a licensed essential route or feed from the same catchment area, but that are not designated as essential routes themselves, serve as inter-route competition and thereby impact the viability of the lifeline route itself and risks prejudicing the States' objectives for the lifeline routes. Any issues in this respect should be considered as part of the annual review of the effectiveness of the policy framework (see paragraph 7).

17. As a next step, the **Committee for Economic Development will be asked to work with the Airport to ensure that these route development criteria are the basis for route development support.**

18. The Airport, Aurigny and all airlines also have shared objectives, such as increasing passenger numbers to Guernsey, and they will be able to explore joint initiatives for meeting these objectives. A direct initiative may be to taper landing charges so that the fee is reduced as passenger numbers increase. An indirect initiative may be to focus landing charge discounts on new routes which do not cannibalise existing essential routes. On that basis – as a next step – **the Airport will be asked to review the potential for a landing charge discount scheme to support passenger number growth which reflects the criteria set out in paragraph 15.**

19. In addition **the Policy & Resources Committee will explore the potential connectivity benefits of providing airlines serving the Bailiwick with Bailiwick 'base carrier' status,** which is in line with airports in other jurisdictions.

The States' objectives for air connectivity

20. In December 2018 the States of Guernsey agreed their objectives for air connectivity. These have been updated in the context of the changes set out in paragraph 1, and given the current economic, financial and community context for Guernsey. The updated objectives are set out in the table below:

Core Strategic Objectives	
<i>What are our key requirements for air links?</i>	<ul style="list-style-type: none">• Provide stability on current essential routes• Provide flexibility to meet the future requirements of the residents of the Bailiwick, for example destinations that support health care (currently London and Southampton)• Stimulate economic growth through the routes that are operated, such as UK regions and non-UK destinations• Focus any financial stimulus on new routes which do not cannibalise existing routes being operated, particularly essential routes• Increase visitor numbers back to 2015 levels

Critical Success Factors	
<i>What needs to be done well in order to achieve the Core Strategic Objectives?</i>	<ul style="list-style-type: none"> • Be affordable to the community • Be sustainable – seasonal operations on new routes are welcome to support the visitor economy or business travellers, but should look to be year-on-year where possible • Optimise choice and flexibility of connections • Provide reliability and security of essential services
<p style="text-align: center;"><i>Affordability</i></p> <ul style="list-style-type: none"> • Reduce Aurigny's costs and losses in order to enable it to sustainably offer market competitive fares • Enable the Airport to work with other carriers to encourage competitive fares without negatively impacting the interests of other commercial carriers on existing routes 	
<p style="text-align: center;"><i>Connectivity</i></p> <ul style="list-style-type: none"> • Encourage development of regional (UK and Europe) connectivity in partnership with Aurigny and other commercial carriers following the stabilisation of the operation of essential routes • Security of connection to London Gatwick • Explore with Aurigny and other commercial carriers the potential connection to an additional UK or a non-UK international hub following the stabilisation of the operation of essential routes • Take into account the impact of additional routes on the essential services to London Gatwick and Southampton • Security of connectivity to Alderney through the operation of the PSO • Broaden UK and European connectivity (scheduled and Charter services) • Access for Bailiwick residents to specialist healthcare and emergency evacuation services 	
<p style="text-align: center;"><i>Reliability</i></p> <ul style="list-style-type: none"> • Investment in airport infrastructure, with private investment encouraged • Aurigny fleet review and reconfiguration 	

21. Given the opportunities for Aurigny to provide connections to non-UK hubs and into France and Europe generally, it is important to note that Aurigny does not at this stage have automatic traffic rights into the European Union under the Trade and Co-Operation Agreement. In the case of scheduled services, this will be reliant on our agreeing (via the UK) authority for Aurigny to fly into Europe on a country by country basis. Any evaluation of

options for connecting into Europe will therefore need to take account of the issues on traffic rights.

Clarification of roles and responsibilities

22. The current structure of the States, and the various mandates relating to air policy within that structure, was implemented in 2016 following the review of the States Review Committee. There are areas of cross-over and duplication which need to be removed. These areas can be considered as part of the review of the machinery of the States during this term, but in the meantime the following roles should be adhered to:

23. Role of government - co-ordinated by the Policy & Resources Committee

- In consultation with the Committee *for* Economic Development and the States' Trading Supervisory Board, review on an annual basis the air connectivity and investment objectives for the Bailiwick and ensure wider government policies are aligned to support these objectives and the wider air policy framework;
- In consultation with the Airport, explore the potential benefits for designating Bailiwick base carriers;
- Re-capitalise Aurigny on the basis of the airline working to meet clear objectives – enabling a clean slate post-Covid; and
- Ensure that the government's ownership of Aurigny is compliant with relevant rules such as the World Trade Organisation and the Trade and Co-Operation Agreement/Air Transport Agreement.

24. Role of the Committee *for* Economic Development

- Ensure that route development support and marketing is aligned with the air policy framework;
- Engage with the airline industry on the development of new routes which are in line with the route development criteria;
- Maintain a watching brief on the requirement for designating any routes as essential links; and
- Ensure a close alignment with Aurigny on the tourism strategy and the work of Visit Guernsey.

25. Role of the States' Trading Supervisory Board

- Carry out the shareholder function to ensure that Aurigny's objectives set by government are met, reviewing and updating these as necessary;
- Management and operation of the Airport and agreement of its business plan and strategic objectives, working with the Policy & Resources Committee and the Committee *for* Economic Development, in order to ensure alignment with wider government policies; and
- Work with the Policy & Resources Committee to ensure the Airport continues to achieve a breakeven position while supporting the objectives set out in the air policy framework.

26. Role of the Airport

- Undertake, complete and implement a programme to maximise non-aeronautical income during 2021-26;
- Explore initiatives with carriers to meet objectives in respect of increased passenger number targets;
- Assess schemes to reduce landing charges in line with passenger number increases to enable financial balancing, and in due course to potentially lower fares on essential routes and deliver increased load factors; and
- Support the further development of general and commercial aviation through private investment into infrastructure and reduced landing charges.

27. Role of the Aurigny board

- The development and implementation of a business plan to deliver the shareholder objectives, including:
 - Ensure safety standards are met;
 - Ensure international regulatory standards are being adhered to;
 - Explore how the airline can meet international ESG standards;
 - Support strategic relationships with other operators;
 - Ensure effectiveness and efficiency are benchmarked; and
 - Provide performance data to government.

28. The role of Aurigny

- Aurigny is to maintain reliable air transportation services, in the first instance to protect designated economic, medical, and social lifeline air routes to and from the Bailiwick, and thereafter more broadly to grow air connectivity, directly and through partnership, in a financially sustainable manner. It is expected that Aurigny, as a carrier substantially based within Guernsey, will: support the developmental objectives of the States by supporting local employment where practical and financially viable; forsake a profit motive beyond that needed to be financially self-sufficient in favour of affordable air travel; and, where called on by the States but not to the financial detriment of Aurigny, cooperate with the States in terms of route development initiatives. To do this it will support the objectives set out in paragraph 20 above; and,
- Aurigny will have shareholder objectives in order to support the States in pursuing and delivering their air policy objectives. These will be to:
 1. Provide security of essential routes;
 2. Achieve a financial breakeven result during the next five years; and
 3. Support the core strategic objectives of the States of Guernsey

Aurigny's shareholder objectives

Objective 1

29. The overarching strategic need is for Aurigny to retain its AOC in order to provide security of essential routes. The specific routes of relevance that are or will be designated as essential routes for a minimum period of five years, include: Guernsey-Gatwick; Guernsey-Southampton; Guernsey-Alderney; and Alderney-Southampton. Where essential services are economically non-viable, such service(s) shall be provided under fully funded PSO construct(s). Aurigny shall ensure that it maintains its current number of landing and take-off slots at Gatwick Airport.

Objective 2

30. The need for Aurigny to be cost-efficient by benchmarked standards and financially sustainable, following an appropriate level of recapitalisation of the business. In this regard, the States of Guernsey require Aurigny to present a strategy that achieves a financial breakeven result during the next five years and profits beyond breakeven may be compromised in facilitating greater passenger volumes to the Bailiwick. Aurigny should investigate the desirability of a fleet strategy that achieves a balance between owned and leased aircraft assets.

Objective 3

31. Aurigny to support the core strategic objectives of the States of Guernsey through:

- Where financially feasible, operating air services between Guernsey and other destinations in accordance with consumer demand (both Islanders and visitors) and thereby supporting the key economic sectors of the Bailiwick's economy;
- Developing and maintaining relationships with other airlines such that the overall air connectivity to and from Guernsey is enhanced, for the benefit of the States of Guernsey and individual travellers;
- Supporting the States in route-development initiatives, potentially including a non-UK hub, under the understanding that such route development initiatives will be funded through PSO constructs if not financially self-sustainable; and
- Directly contributing to the Bailiwick fiscus, including where possible through the creation of on-island employment within Aurigny, and the consequent taxation flows to the States of Guernsey.

Progress made in 2021

32. The development of the air policy framework was originally planned for April 2020 but has been delayed for a number of reasons:

- The change of executive at Aurigny;
- Changes to the regional aviation market further to the impact of Covid-19;

- Moving to a post-lockdown set of circumstances where Aurigny and Blue Islands are able to operate with less restrictions;
- The requirement to develop a new tourism strategy;
- An assessment of the impact of the ‘quasi-open skies’ regime and the designation of the Guernsey-Southampton route as an essential route; and
- Finalising the Alderney-Guernsey PSO.

33. Since November 2020, the following steps and actions have been taken in order to support the development of the air policy framework:

- The discussion and agreement of the shareholder objectives set out in the framework;
- The development of a five-year Aurigny business plan by the new Chief Executive and Chairman, supported by the executive and Board;
- Work on the Aurigny re-capitalisation policy letter, which will be submitted for the States to consider in October 2021;
- The designation of the Guernsey-Southampton route as an essential route in Q3 2021;
- Finalising the Alderney-Guernsey PSO in Q2 2021;
- Establishment – with regulatory oversight – of a commercial co-operation agreement between Aurigny and Blue Islands;
- The launch of a tourism marketing plan for Q3/Q4 2021 and the ongoing development of a new tourism strategy for 2022 onwards; and
- The start of the Guernsey Airport masterplan process with a clear timeline for completion, and the publication of an updated Guernsey Airport business plan.

Ownership

34. A question that emerges from time-to-time is whether Aurigny should remain a States-owned commercially-operated business, or become a commercially-owned and operated business. The view of the Policy & Resources Committee and many stakeholders internal and external to the States is that for the foreseeable future (and certainly the period of 2021-26) there is no benefit in considering a different ownership model. This is based on the need for investment, the current financial position, and the draft Aurigny business plan that has a path to breakeven post-recapitalisation. Whilst the States do not operate Aurigny, the relationship of alignment of Aurigny’s operations with the Bailiwick’s connectivity objectives is an important consideration at this stage of economic and community recovery, and a relationship that is unlikely to be replicated in a different ownership model.

Runway infrastructure

35. This framework is set out prior to any future debate on the potential for extending the Guernsey Airport runway. In due course the Committee *for* Economic Development will return to the States of Deliberation with a business case for the extension of the runway. Subject to the decision of the States of Deliberation, aspects of this air policy framework will then be reviewed as required.

Next steps

36. The Policy & Resources Committee, the Committee for Economic Development and the States' Trading Supervisory Board have agreed the air policy framework. They will work to support it, along with Aurigny and Guernsey Airport, through twice-yearly monitoring meetings.

Summary - Guernsey's air policy framework principles

1. *Meet our core strategic objectives for air connectivity (paragraph 20):*
 - *Stability on current essential lifeline routes to ensure resilience and encourage investment in service;*
 - *Flexibility to meet the future requirements of the residents of the Bailiwick, for example destinations that support health care (currently London and Southampton);*
 - *Stimulate economic growth through the routes that are operated, such as UK regions and non-UK destinations;*
 - *Focus any financial stimulus on new routes which do not cannibalise existing routes being operated, particularly essential routes; and,*
 - *Increase visitor numbers back to 2018 levels;*
2. *Maintain fair and proportionate competition balanced with licensing on essential, strategic routes (paragraphs 3, 9-13);*
3. *Ensure stability in the air policy framework to allow for planning and investment and to minimise government intervention (paragraphs 4-5);*
4. *Ensure route development support is deployed to support the overall objectives of the air policy framework (paragraphs 14-18) and that landing fee charges are competitive (paragraph 6);*
5. *Ensure that government and other stakeholders act in line with their roles within the air policy framework (paragraphs 22-28);*
6. *Measure Aurigny's performance against three clear overall shareholder objectives (paragraphs 29-31):*
 - *Provide security of essential routes (objective 1)*
 - *A financial breakeven result during the next five years (objective 2)*
 - *Support the core strategic objectives of the States of Guernsey (objective 3); and,*
7. *Explore the potential connectivity benefits of designating carriers as the Bailiwick's base carrier(s) (paragraph 19).*

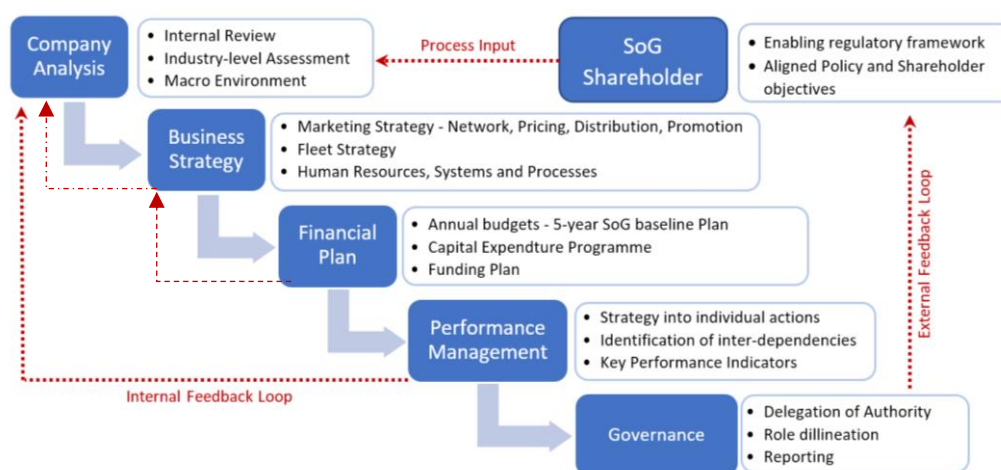


Introduction and Approach

Air links are essential to the Bailiwick of Guernsey. They maintain important connections for the Islands' population, supporting business and helping to attract inward investment, they help maintaining friends and family contacts, and they serve to enable access to social services such as medical facilities and treatments and access to training and education off-island. There are few, if any, sectors of our economy or sections of our society that are not directly, as a user or supplier, or indirectly, reliant on air transportation to/from the Bailiwick.

Airlines act as critical economic and social enablers, through the transport of people and goods and to the extent that their supply chains and the employment they create, directly stimulate economic activity. As it relates to the Bailiwick, no airline transports more passengers on more flights from or to more destinations, no airline employs more Guernsey residents or expends greater funds on local supply-chains and none has done it for longer than Aurigny. This 5-year Strategy (2021 – 2025) outlines how Aurigny intends being an economic and social enabler, owned by the States of Guernsey, into the future: more efficiently and more sustainably.

Figure A.: Strategy Development Process and Implementation Approach



Aurigny's strategy development is a process, depicted in Figure A above, that fundamentally relies on an in-depth and honest analysis and assessment of the Company's context, to accurately define the problems we are solving, and to present realistic potential strategic solutions which Stakeholders can consider and assess for optimal suitability. The process is iterative and consists of repeated cycles of (1) analysis, (2) problem framing and solution refinement, (3) evaluation and, if needed, further input, until a strategy is finally agreed for implementation. The process aims to ensure alignment – alignment in the collective understanding Stakeholders have of both the challenges at hand as well as the Organisation's capabilities to address those challenges, alignment of actions and activities

to a coherent strategy and plan, alignment of the Organization's internal resources to deliver effectively and efficiently on that plan, and alignment on what the end goal is, how attainment will be measured and reported on, and how it will be rewarded.

"Building a visionary company requires one percent vision and 99 percent alignment." — Jim Collins & Jerry Porras in their book Built to Last: Successful Habits of Visionary Companies

The strategy development process being followed employs the Expanded McKinsey 7-S analysis framework, which has at its core the alignment of Goals/Objectives, enabling organisational factors (including Strategy) and

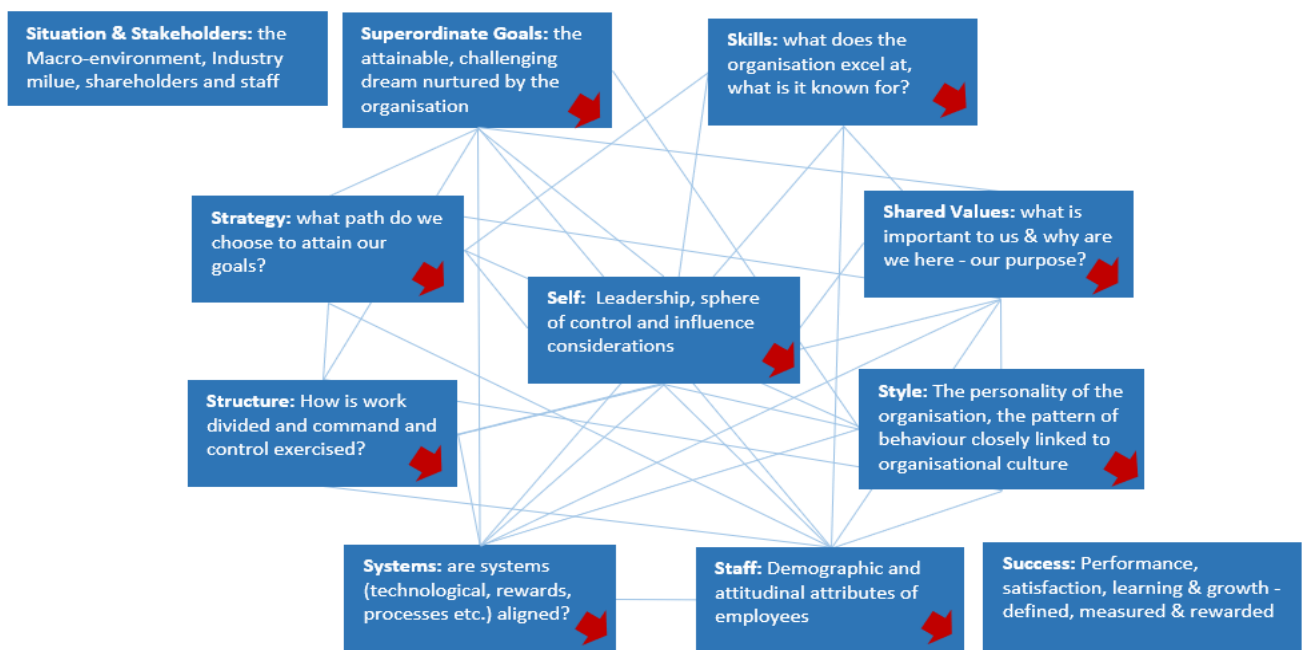
expected outcomes (Figure B below). The Business Overview and analysis that flows from the application of this framework is contained in **Section 1 - 3** of this document.

The 7-s framework postulates the point of departure in strategy formulation to be an in-depth understanding of the environment (both at macro and industry-levels) in which a company operates – its Situation, and, with reference to the company's stakeholders, to gain an understanding of what **the overall purpose** of the business is and what objectives the business are pursuing. Given previous public reports that Aurigny needs clarity in terms of its purpose and given the fact that Aurigny is owned by the States of Guernsey, with a dual commercial and developmental mandate, extensive effort has been applied to define/clarify, through a process of Stakeholder engagement, Aurigny's Purpose, and the Objectives that directly align thereto. **Understanding Shareholder, Customer and Regulatory (including Environmental) requirements** have been key to this process. You simply must know both the origin and destination before you can start a flight plan.

Continuing the aviation analogy, any flight plan has a clear reference to what weather conditions it will be operating in – much the same way as Aurigny needs to understand the **Market conditions** in which it operates. The analysis done includes an assessment of both air and sea transportation to and from the Bailiwick, the main transportation suppliers/competitors to Aurigny and how markets and competitors have evolved over time. Importantly, the analysis also includes an assessment of both Aurigny's revenue and cost **performance, over time**, within this competitive context and the effect thereof on its capital base and funding requirements.

A flight plan is cognisant of both the capabilities of the aircraft in use and how it is configured. In this regards the analysis reviews the extent to which Aurigny's corporate and organisational **structure** is aligned to its strategic direction, and how the **systems and processes** in use within the Business supports or impedes its strategy. Known factors such as Aurigny's complex fleet composition comes into stark focus, whilst flight controls, Aurigny's Governance Framework, including Risk Management, also receives attention.

Figure B: McKinsey's Expanded 7-s Analysis Framework



The interaction a passenger has with crew on a flight often leaves a lasting impression, possibly more-so than any other product dimensions. The analysis looks at Aurigny's **Human Capital**, and reviews aspects such as Employee demographics, organisation culture and skillsets, as well as the "attitude" or personality and service ethic displayed by Aurigny's people.

The analysis further looks at **Leadership** and considers the experience and skills composition of the Leadership Team, including the Board, whilst paying attention to succession planning.

Finally, the analysis considers the current **Strategy** and its suitability, in context of a fluid environment. Given Aurigny's internal strengths and weakness, and the opportunities and threats it is confronted with, what adjustments are needed to the strategy adopted by the Company? Importantly, the analysis also assesses the extent to which Aurigny has a system for aligning effort through an appropriate **Performance Management, Reporting and Reward** system, and how this is measured and reported on – what are our journey waypoints and how will we track progress?

As may be noted, the strategy development process adopted is analytically intense: 80% of the effort is in analysis (Sections 1 – 3 of this document). The analysis aims to arrive at a succinctly defined organisational purpose, along with four overriding objectives to be pursued, given the organisation's strengths and weaknesses, Stakeholder expectations and competitive and macro environments.

Sections 4, 5 and 6 of the document is markedly more succinct and employs the Objectives, Goals, Strategies and Measures (OGSM) framework to derive strategies that support the attainment of the Company's objectives, and ultimately, its purpose. The process of cascading objectives down to actionable strategies is done with reference to

a consistent aspirational theme – in the case of Aurigny Efficiency, doing more with less in the process of minimising revenue and optimising cost, has been adopted. This key theme flows throughout, and manifest in a drive towards simplification, standardisation and leverage of partnership and collaboration to achieve efficient, consistent, and reliable outcomes.

Each of the four objectives are supported by several quantifiable goals which the Company is pursuing – 19 goals in total have been identified. Goals are supported by strategies.

Strategies, or plans, are mapped to specific goals, and 39 strategies have been identified. Each strategy, in turn, has a defined measure that is used to track progress towards goals, objectives and ultimately the attainment of the Company's purpose. A practical example: Objective: Protect Lifeline Routes, Goal: Maintain AOC, Strategy: Maintain Safe Operations, Measure: Safety Management System outcomes.

The OGSM framework results in initiatives and actions that, in accordance with the Company's performance management system, are assigned to individual accountability. In this way performance management is directly linked to the attainment of Company objectives.

Sections 7 and 8 of the document outline the expected financial outcomes in the form of financial projections, and the key underlying assumptions, for the next 5-years. These sections also deal with sensitivity analysis pertaining to key input variables.

Sections 9 - 12 of the document transitions from planning to implementation, and aims to identify interdependencies, cascading of objectives into the organisation, specifically aiming to identify interdependencies and risks, as well as dealing with practicalities such as reporting format and frequency. Sections 9 – 12 are completed once the Strategy is settled and accepted.

Executive Summary

Background

Guernsey, according to studies conducted by PwC (2018) and York Aviation (2009), is well connected via air routes for its relatively small size, and indeed is better connected than other crown dependencies such as the Isle of Man or Jersey, on measures such as flights per capita, seats-per-workforce or seats-per-available-tourist bed-night. Whether it is for socio-economic lifeline purposes, high-frequency London connections as a competitive advantage to Guernsey's Finance sector or connecting to England's Regions to support tourism, Aviation is a key social and economic enabler to the Bailiwick of Guernsey.

Aurigny is a 53-year-old regional air carrier, the second-oldest Regional Airline Brand in the UK and is owned by the States of Guernsey (SoG). Aurigny is the primary provider of air transportation intra-Bailiwick and on services between the Bailiwick and mainly the United Kingdom, and is the only airline based in Guernsey. The SoG acquired the Carrier, and its maintenance division, Anglo Normandy Engineering in 2003, with the objective of protecting lifeline services to London Gatwick airport. In 2019 Aurigny transported c. 530,000 passengers, more than 50% of which were on the route between Gatwick and Guernsey, and c. 54,000 of which were on lifeline services between Alderney and Guernsey and between Alderney and Southampton.

The *lifeline services* which Aurigny operates are solely designated to Aurigny, albeit that an open-skies regime, implemented in 2019 by the SoG, allows **competition on routes with a shared source-market, notably in the Southeast of England**. Aurigny accordingly faces indirect competition on its largest Market, whilst it competes in unrestricted markets within the remainder of England. In 2019 Aurigny held a 66% share of air traffic between Guernsey and England, 5% lower than 2018. The Company generated its largest losses, up to that time, of c. £9.7 million during 2019.

The losses suffered by Aurigny in 2019 were not solely attributable to the change in market access regulations ('quasi-open skies') in that year, although it was a relevant factor. Aurigny has been generating losses since 2008, with those losses increasing as the level of fleet complexity within the Business increased. The Company was consequently recapitalised, to the extent of c. £25 million, in 2015, which consisted of c.£ 19.9 million in accrued losses up to 31 December 2014 (**equivalent to £3.58 per passenger**) and c. £5.3m million in then anticipated losses up to the end of 2017 (from when the Company was expected to break even with Alderney services being operated under a Public Service Obligation contract).

In practice Aurigny generated **£13.5m in losses between 2015 and 2017, of which c. £7.2m (53%) related to Alderney services**. The introduction of the Dornier fleet was associated with substantial unanticipated aircraft delivery delays, resulting in a protracted entry-into-service starting in 2015 and only being completed in 2019. During this period Aurigny had substantial fleet complexity in its small-gauge fleet, at some point operating a mixture of Dornier Classic aircraft (with different configurations from each other), Dornier NG and Trislander aircraft, all at the same time, for passenger volumes that constituted less than 12% of the Company's overall volumes. This, whilst being confronted with escalating maintenance cost with the ageing fleet operating beyond anticipated timeframes. In the absence of a PSO, a further loss of £5.6 million (pre-FRS102) was made on the Alderney services for the two financial years ending December 2019. **The implementation of the PSO contract for Alderney services with effect 1 January 2021 now protects Aurigny against these losses, whilst a potential extension of Alderney's runway would further reduce the PSO cost to taxpayers, deliver more seats and a more robust air service solution to the residents of Alderney.**

Fleet and Maintenance

Whilst challenges were being faced with the small gauge aircraft, Aurigny operated numerous types of ATR aircraft (ATR 42-500, ATR 72-200, ATR 72-500), with multiple of these types simultaneously in fleet, and also acquired the Embraer E195 jet in 2014 for the purpose of adequately servicing the Gatwick route with the slots available. After the exit of the ATR 42-500 aircraft in 2019 another variant overlap occurred, when the first ATR 72-600 was introduced. The introduction of the ATR 72-600 was, as with the D228 NG's, also occasioned by substantial aircraft delivery delays, in part caused by delays in the cutting-edge Clear Vision technology on these aircraft. ***The extent of fleet complexity, for a small carrier, was (and still is) exceptional (especially during the 2015 – 2019 period).***

The choice of aircraft or the fleet modernisation decisions, per se, are not what is in debate. ***There was a legitimate need to modernise Aurigny's ageing fleet and a requirement to move to two-pilot operations in the case of the Trislanders.*** What is however being highlighted is the cost that was associated with this process, especially considering material unanticipated delivery delays in both the D228 NG as well as the ATR 72-600 transitions. In each case, apart from the fleet being rather complex/diverse post the fleet renewal process, leading to crew and maintenance inefficiencies, the anticipated efficiencies from the transition processes were slower to materialise.

Beyond cost consequent to fleet transitioning, Aurigny suffered ***aircraft impairment charges*** in 2019 and again in 2020, with the latter charge in 2020 in part resulting from the ***global economic downturn in demand for air travel associated with the Covid-19 pandemic.*** Accordingly, the cost attached to Aurigny's aircraft fleet transition (including maintenance, crew, and impairments), which has now been absorbed, was the single biggest driver of cost increases between 2015 and 2019, resulting in cost-growth of 15% over this period. An efficiency review conducted by independent consultants, Nyra, on behalf of the SoG in 2019 indicated that, although Aurigny was efficiently managed, lack of scale and fleet complexity served as barriers to profitability. ***This Strategy aims to address these impediments to profitability, and this strategy, the assumptions on which it is based and expected financial outcomes, are again being submitted to Nyra for independent validation.***

The implications of the Company's current fleet to Aurigny's future Fleet Strategy are:

- The Company now has one of the most modern fleets in operation, with the ATR 72-600 serving as mainstay. During 2021 two aircraft types will be removed from Aurigny's fleet (The ATR 72-500 being returned to its lessor, one of the Dornier Classic's being sold for zero emission powertrain research and the other being retired and dismantled for spares), which will leave the airline with three aircraft types (ATR 72-600, Embraer EMB 195, and Dornier 228 NG). Subject to a runway extension in Alderney the Dornier 228 NG's could be removed, whilst potential slot-availability at Gatwick may allow the replacement of the EMB 195. Feasibility assessments of the jet operations are in progress, aiming to address both the operational risk and cost-implication of operating a single aircraft of a type within a fleet.
- The Company must aim to manage its future exposure to aircraft asset values and adopt a longer-term asset lifecycle management approach to the assets it has in its fleet and an appropriate balance between owned and leased assets that will meet the future strategic role of the airline.
- Aurigny requires a robust fleet plan for the future that adopts formalised project management methodologies to aircraft fleet entries and exits.

It is inescapable that the complexity of Aurigny's fleet leads to maintenance inefficiencies – in 2019 maintenance cost constituted 19.5% of Aurigny's total cost, more than double the average for IATA carriers (noting that IATA represents a mix of carriers). It has also previously been identified that the Cabernet Group structure, which holds Anglo Normandy Engineering as a separate legal entity to Aurigny, has outlived its usefulness and a case exists for collapsing the separate maintenance

organisation into Aurigny. The strategic focus for Aurigny's part-145 Maintenance function, apart from maintaining safe operations, dispatch reliability and fleet simplification, includes:

- Corporate integration of Anglo Normandy with Aurigny.
- As part of the corporate integration process, and in-line with a simplification of the fleet, a complete review of the efficiency of the function, including work practices and support systems.
- Ensuring cost-visibility for major maintenance events, in support of an overall lifecycle management approach to Aurigny's fleet.

Sales and Revenue

From a revenue perspective, between 2015 and 2019, the Company realised a very marginal revenue increase of 0.5%, on the back of declining passenger volumes and increasing average fares (necessitated by the increase in average cost of delivery). ***Whilst the Brand evidenced an ability to sustain a growth in income per passenger broadly equivalent to RPIX over the period,*** it does raise questions as to sustainability, and desirability, of such increases going forward. Ideally Aurigny wishes to reduce the average cost of air travel and make its services more accessible, and more affordable, to more travellers to and from the Bailiwick, thereby improving its own competitive position and being more effective as a social and economic enabler.

To address ***perceptions/reality of Aurigny's ticket prices becoming more expensive*** the Airline has, in 2020, adopted a pricing/revenue management approach that represents a narrower band of pricing options to the consumer (e.g., higher entry-level prices or fewer of them, and lower top-end prices). This approach appears to be more coherent with managing favourable perceptions pertaining to Aurigny's Brand, and effort in this regard is continuing. ***Independent studies, conducted by firms such as PwC, found Aurigny's fares to have been comparable to fares on routes out of Jersey in 2019,*** however, there was a fare differential of between c. £15 (peak season) and c. £30 (shoulder season) per flight when specifically comparing Aurigny's pricing between Guernsey and Gatwick with Low Cost Carrier (LCC) pricing between Jersey and Gatwick. This fare differential should be considered in the context of the basis of comparison (e.g., adding a single cabin bag on an LCC, which is included in Aurigny's pricing, would eliminate the peak season fare differential), as well as the high-frequency connectivity and schedules timed for the needs of Guernsey businesses travellers in contrast with seasonal/reduced frequency and flight timings suitable to leisure travellers.

Regardless of the above observation, Aurigny's fares may, firstly, be made sustainable through the cost benefit of a simplified fleet that is used more productively (an estimated 8% reduction in unit cost from 2019 to 2022, together with the implementation of the Alderney PSO, resulting in forecasted 2022 losses reducing to c. £1.4 million). Beyond the impact of cost reductions, fares may then be reduced consequent to increases in load factors, and in this regard ***Aurigny is looking to work with Industry stakeholders (Visit Guernsey, accommodation providers, tour operators, etc) to present value-based offerings, specifically in support of inbound tourism.*** A relatively smaller portion (c. 25%) of the overall cost incurred by a visitor to Guernsey relates to transportation cost, and whilst discounts in air travel could reduce the cost-delta to LCC pricing, an overall price-competitive offering for Guernsey as a destination will require cooperation throughout the value chain.

Brand and Service

Aurigny's Brand proposition, as encapsulated within its Customer Charter, is generally being delivered upon. From a reliability perspective, Aurigny was the only carrier to maintain uninterrupted lifeline services throughout the ongoing Covid-19 pandemic, albeit that this came at considerable expense during 2020 and 2021. Aurigny's on time performance (79% in 2019) is above the UK average as reported by the UK CAA, above that of LCC carriers and on-par with its direct Regional carrier

competitors. With Aurigny's fleet renewal now complete and looking towards the implementation of ClearVision technology on the ATR fleet in 2022, the Company will be aiming to reach its Customer Charter target of 85% on-time performance.

The Airline has started to make progress in forming *partnerships for purposes of codeshare and interline connectivity and enhanced network reach*, aligned to an objective set to the Company by its Shareholder and for purposes of increasing overall air connectivity to Guernsey. This partnership approach will complement Aurigny's own route development initiatives (Birmingham and Exeter routes commenced in 2021, Dublin to be introduced in 2022), as well as cooperation with the SoG in terms of ongoing hub (UK/EU) feasibility assessment.

To meet the Company's strategic objectives Aurigny's Commercial Strategy must:

- **Clearly define and consistently apply Aurigny's Brand and ensure that it is aligned to the key strategic objectives.** Thereafter ensuring that Aurigny's product, pricing/revenue management and service delivery fully reflects and is compliant with Aurigny's Brand and what it stands for.
- Manage and innovate product (including ancillaries)/schedule/network/pricing/distribution and service propositions to minimise cost, maximise revenue and enhance service, however, within context of the Company's affordance air travel objectives and Brand.
- Develop targeted and efficient marketing and communication capabilities, across all platforms (but favouring digital), to effectively communicate Aurigny's proposition and maintain top-of-mind awareness.
- Develop relationships with other carriers to increase network reach, leverage resources, improve buying power, and to innovate.

Aurigny has delivered *safe and reliable air services*, despite the challenges caused by the underlying fleet complexity. Apart from the foremost focus on safety, and pursuing efficiencies that flow from fleet simplification, the Flight and Ground Operations functions of the Business have the following strategic focus areas in support of the overall Company Strategy:

- Deliver an evolved level of service at Customer touchpoints, beyond delivering the basic functions correctly and consistently – personal and sincere interaction that reflects Aurigny's Brand essence.
- **Build on Aurigny's Customer focussed culture** and create an understanding throughout the Organisation of the significance of delays, cancellations, and good communication. Cultural enhancement, supported by technology such as ClearVision, would support a value-proposition based on reliability, and in that a point of differentiation.
- Improve cost-efficiency, through a clearer linkage of variable rewards to output (e.g., variable pay for flight crew) and value chain improvements (review in or outsource of certain functions, like the Operations Centre).
- Better leverage technology for internal process efficiencies and improved Customer service delivery.

Financial Management, Human Capital and ESG Responsibility

The Business has greatly improved the integrity of its financial planning and accounting processes between 2015 and 2019, whilst it has also improved its overall risk management maturity and maintained stability in the information technology environment which Aurigny needs to operate. Future work remains in this area to ensure that the Business continues to innovate and provide relevant solutions that best serves the Business and all its Stakeholders.

Aurigny, towards the latter part of the 2015 -2019 period, made significant progress in focussing on Cultural Values within the Business. Effort must now be applied to ensure alignment between internal cultural values and external Brand values. *The Company has a loyal and committed*

workforce, predominantly Guernsey-based and contributing to the Guernsey economy (Aurigny is responsible for c. 0.75% of total Employment in the Bailiwick, amounting to c. £10 million in annual salaries and wages). Whilst Employees are committed and no reason exists to believe that Aurigny does not get delivery from its investment in human capital, productivity is not overtly measured, and the Company's performance management system is immature. Strategic focus areas in this part of the Business accordingly include:

- Implementation of a performance management and reward approach directly linked to Company objectives, throughout the Business.
- Continued focus on employee engagement and organisational values.
- Development of succession planning for key roles.

Whilst the Business has been focussed on delivering to Stakeholder expectations, the Company has not made many inroads as it relates to its Environmental obligations. ***A near term strategic objective is accordingly to review Aurigny's Environmental, Social and Governance obligations, and to develop an appropriate ESG delivery plan.***

The Future

The effect of the Covid-19 pandemic on the Global Aviation Industry in 2020 and 2021 has been unparalleled throughout history. According to the International Civil Aviation Organisation, aviation industry losses in 2020 alone exceeded \$370 billion, funded by c. \$220 billion in State aid and c. \$130 billion in new debt and equity, along with drawing on pre-Covid cash resources. Despite taking various measures, including employee redundancies, supply-chain renegotiations, fleet reductions and curtailment of operations, Aurigny has not escaped this global pandemic impact, the Company's debt-burden doubled during the Pandemic, and liquidity has been under pressure. ***Accordingly, and whilst 2021 trading is progressing in line with expectations showing a marked improvement relative to 2020, the pandemic, along with the impact of Aurigny's performance during 2015 – 2019 on cash reserves and debt-levels, leaves Aurigny in need of capitalisation.*** A dialogue with Aurigny's Shareholder is currently in progress, aiming for resolution by September/October 2021. ***The envisaged capitalisation, which had been anticipated, would not require the injection of further cash into the Business, beyond that already provisioned by the SoG for Aurigny losses up to December 2021,*** and the proceeds from the capitalisation will be used to settle working capital loan facilities from the SoG that primarily arose during the period of support in the 2020/21 Covid-19 pandemic.

This retrospective analysis provides insight of what has contributed to Aurigny's historic performance and an understanding of the business that now exists, indicating what needs to be done to improve on the status quo. However, it is impossible to be 100% confident because the actions will take place in the uncertain environment in which Aurigny will operate in the future. Trading conditions within the Aviation Industry remain volatile and subject to the ongoing impact of Covid-19, which will endure for some time and may leave a permanent mark. ***The Company's projections, which forecast a break-even position from 2023/24 onwards, to the best extent possible takes into account the current market uncertainties and effort has been applied to model input sensitivities and to identify relevant risks. Input assumptions have been reviewed by the SoG and are being subjected to independent 3rd party review (Nyras).***

Despite the uncertainty that exists within aviation, it is believed that a succinct organisational purpose supported by clear objectives and well-defined goals, pursued through nimble strategies and plans, implemented in accordance with appropriate and relevant governance, risk management and monitoring processes, by a Company that is internally aligned and customer focused, is likely to yield success. This Strategy, the development of which entailed the alignment of Aurigny's purpose and

objectives with the draft SoG Air Policy Framework, together with a supporting Shareholder and a strengthening of relationships with all stakeholder groupings, will see Aurigny delivering more with less, and fulfil its purpose:

“To be the primary supplier of safe, reliable, and efficient air services, intra-Bailiwick and between the Bailiwick of Guernsey and such places with which the Islands share social, economic, cultural, or critical service links, in a sustainable manner, and thereby being an effective social and economic enabler”.