



Privatisation of Air Vanuatu



Preliminary Information Memorandum



Preliminary information

Important notice This Preliminary Information Memorandum (hereinafter referred to as the “Memorandum”) is being issued on behalf of the Government of the Republic of Vanuatu (“GoV”) to the recipient to obtain the recipient’s preliminary assessment and feedback on the proposed transaction, and an initial indication of the recipient’s level of interest in participating in the same.

This Memorandum has been prepared by the International Finance Corporation (“IFC”) from information supplied to it by Air Vanuatu Ltd (“Air Vanuatu”) and other related agencies of the GoV.

This Memorandum does not contain all of the information that a prospective airline investor may need. It has been prepared to assist interested parties in making their own evaluation.

In all cases, interested parties should conduct their own investigation and analysis of the information set forth in the data room to be established by Air Vanuatu in its headquarters.

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1 Executive Summary

The opportunity

Privatisation of national airline

The Government of the Republic of Vanuatu (“GoV”) is in the process of reforming its parastatal (or government controlled) sector with the objective of promoting increased economic growth and improving the competitiveness of the economy. In this context, GoV is currently undertaking a legal, technical and economic due diligence of Air Vanuatu, with a view to introducing private sector equity ownership into the company.

The International Finance Corporation (“IFC”), the private sector arm of the World Bank Group, was retained by the GoV in August 2007 as the Lead Transaction Advisor to implement the privatisation of Air Vanuatu, a strong signal of intent from GoV. IFC has substantial experience in implementing successful airline privatizations in the Pacific Islands region, having advised the Government of Samoa on setting up the landmark Polynesian Blue Joint Venture in 2005.

Aviation in Vanuatu

“The happiest place on Earth”

Vanuatu is an island archipelago nation of approximately 220,000 people, located one third of the way from Sydney to Hawaii. According to the 2006 Happy Planet Index, Vanuatu is the “happiest country on Earth”. Three air routes dominate the market: Port Vila to Sydney, Auckland and Brisbane. The Sydney route accounts for approximately 30% of traffic and is operated exclusively by Air Vanuatu, with a codeshare agreement with Qantas. The Brisbane route is approximately the same size and is operated by Air Vanuatu and Pacific Blue, with approximately equal market shares.

In the 9 months to September 2007, approximately 69,000 people visited Vanuatu, with the full year total expected to reach 100,000. GoV is aiming to grow tourist arrivals to 200,000 by 2012.

Forecast annual tourism revenue growth of 6.8%

Vanuatu is currently experiencing a sustained burst of strong GDP growth. This is largely being driven by increased tourist visitor numbers, attracted by the emergence of a strong global tourist brand. WTTC, a travel and tourism industry association, forecasts annual tourism revenue growth of 6.8% for the 10 years from 2006. This places Vanuatu as the 12th fastest growing tourist market globally. Supporting these forecasts, considerable investment is being made by hotel operators. The number of hotel beds in and around Port Vila has increased by 50% in the last 18 months, with occupancy rates remaining consistent at between 60 and 70 percent.

Air Vanuatu

2006 profits of approximately US\$2m

Air Vanuatu is the national carrier of Vanuatu. The airline offers international services to from Port Vila to Sydney, Brisbane, Auckland, Noumea and Nadi and from Santo to Brisbane. Since acquiring VanAir in September 2004, domestic services are also operated by Air Vanuatu.

Currently the airline has a fleet of 6 aircraft. A Boeing 737-300 is leased from ILFC, and runs the international routes. An ATR-300 is owned by Air Vanuatu and operates the main domestic trunk routes of Port Vila to

Santos and Tanna, as well as international routes to Nadi and Noumea. Two Twin Otters and two Islanders are also owned. These operate the other domestic routes to outlying islands.

Despite an extremely challenging internal and external operating environment, Air Vanuatu is currently generating a positive net income, a substantial turnaround over historic performance. In 2004, when the current management team was appointed, the airline had an inappropriate fleet (including two leased Boeing 737s). In addition, the company was merged with the loss making domestic carrier VanAir, presenting significant integration challenge. A net loss of US\$4.19m in 2004 was translated into net profit of US\$0.89m and US\$1.42m in 2005 and 2006 respectively. In this context, Air Vanuatu's operations are currently a notable success.

Transaction: Structuring and timetable

Structuring phase The first phase of work in the proposed transaction is a legal, technical and economic due diligence of Air Vanuatu, which is currently being undertaken. This phase also includes preliminary market testing to gauge potential investor interest, an analysis of Vanuatu's aviation market, and the identification of strategic options for both the sector and the company.

This will take approximately 3 months, to be completed by January 2008.

Implementation phase Once GoV has finalised the transaction structure, the implementation phase will commence. This will likely include opening a data room; pre-bid negotiation of the transaction documents; a transparent bidding and award process; financial closing and handover. The indicative timetable is given in Section 5 below.

Purpose of this memorandum

Soliciting feedback on structuring The purpose of this Preliminary Information Memorandum is to provide information on the Air Vanuatu transaction to aviation investors who may be potentially interested in the opportunity, and to solicit expressions of interest, along with comments and feedback on issues that may be of concern to airline operators. Considerable scope remains for finalising the details of the Structuring Phase based on investor feedback, and hence investor feedback is actively encouraged. In particular, GoV is keen to hear investor's thoughts in the following 5 areas:

- (i) Anticipated vision for the future of Air Vanuatu, including proposed business model;
- (ii) Risks and other concerns associated with the transaction;
- (iii) Nature of investment – i.e. size of equity stake to be acquired, preferred shareholding structure;
- (iv) Appetite and interest in equity ownership and management control of domestic routes; and
- (v) Benefits to be provided to Air Vanuatu and the Republic of Vanuatu post-privatisation.

2 The Republic of Vanuatu

Background

Archipelago in Melanesia The Republic of Vanuatu, formerly known as the New Hebrides, is an island nation in the South Pacific, located at the centre of Fiji, New Caledonia and the Solomon Islands. The country gained independence in 1980 after being governed since 1906 as an Anglo-French “condominium”.

Vanuatu is an archipelago of islands. In total, these number 83, most of which are inhabited. There are four principle centres of population: Efate, where the capital Port Vila is located, Santo, site of the 2nd city of Luganville, Tanna and Malekula.

Despite the country’s small size (the estimated population in 2006 was 220,000), strong progress has been made since independence in numerous areas:

1. The country is a functioning democracy under the Westminster parliamentary system. Since the last elections in 2004 the coalition Government of Prime Minister Ham Lini has been in power, with elections due again in 2008.
2. Good relations are maintained with its neighbours in the Pacific Islands community as well as the larger regional nations such as Australia, New Zealand, the USA and China.
3. Economic activity is developing robustly and Vanuatu is noticeably outperforming its peers as a destination in the international tourist market.

The currency of Vanuatu is the Vatu (Vt). In recent years this has shadowed the Australian Dollar, appreciating significantly against the US Dollar. Rates per US\$ were 111 and 104 in 2006 and 2007 respectively.

Economy

Main Sectors: Travel & Tourism, Agriculture Vanuatu’s GDP per capita was US\$1,680 at market exchange rates or US\$3,800 at PPP in 2005 (source: World Bank). As such, the country is classified as lower-middle income, slightly behind Samoa and Fiji but ahead of the Solomon Islands and Papua New Guinea. Economic activity is primarily based around 2 sectors: travel & tourism and agriculture.

Travel and tourism revenue has been growing strongly in recent years. This has been helped by the emergence of a Vanuatu brand. In 2005 wide publicity was generated when the New Economics Foundation and Friends of the Earth reported that Vanuatu is the “happiest country on Earth”, based on responses to public survey questionnaires. In addition, numerous versions of the international TV show Survivor have been filmed in the country. Concerted international publicity campaigns have also been held, led in large part by Air Vanuatu. This, and the robust economic environment of the main source markets of Australia and New Zealand, has seen tourist arrivals reach 68,200 in 2006 – a record number of arrivals.

Travel and tourism is now the largest sector in the economy, directly

contributing around 20% of economic activity. When indirect or knock-on economic activity is included, this figure increases to nearly 50% (Source: World Travel and Tourism Council – “WTTC”). More information on the travel market in Vanuatu is given in Section 3 below.

The agricultural sector accounts for just under 20% of GDP and more than 75% of tangible exports. The main cash crops are coconut, cocoa and vegetables. Recent years have witnessed some startling growth. For example the volume of coconut oil exports has surged from 1,812 tonnes in 2000 to 17,110 tonnes in 2004. Beef and timber exports have also recently begun: beef was certified for export to New Zealand and Australia in 2002 and 2003 respectively; and having joined the International Tropical Timber Organisation in May 2000 Vanuatu is currently awaiting sustainable forest certification.

Excellent bilateral relations Vanuatu maintains extremely good relations with the major trading partners. For example, New Zealand piloted a Recognised Seasonal Employer (RSE) programme in 2006, which will expand in 2007 from 150 to potentially over 1,000 workers. The workers will spend about seven months in New Zealand during the fruit and vegetable harvest, and each is expected to be able to repatriate savings of around Vt700,000 (US\$6,295) to Vanuatu. Under the terms of the scheme, workers will only have to pay half the cost of their airfares to New Zealand.

In addition, New Zealand’s development assistance to Vanuatu reached US\$7.5m in 2006/07, and is targeted to increase by 43% to US\$10.7m in 2007/08. Australia, Vanuatu’s largest donor partner, has also announced a 28% increase in its aid programme to Vanuatu, with the total rising to US\$33m.

Vanuatu is the only Pacific Island country thus far to qualify for funding by the USA’s Millennium Challenge Corporation (MCC). MCC will provide nearly US\$66m over five years. The programme is implementing key transport infrastructure investments which will significantly open up access and development opportunities. The MCC investments aim to increase average income per head by 15% within five years.

The United Nations also has active projects in Vanuatu and the country has been engaged in a dialogue aimed at joining the WTO. France is also a major bi-lateral donor, as is the EU.

Surge in economic activity The positive developments outlined above have contributed to an impressive record on economic growth – the strongest in the Pacific Islands region. Over the past five years the average GDP growth rate has been over 5% per annum. In recent years this has accelerated. According to the latest data from the National Statistics Office, real GDP growth reached 7.2% in 2006, surpassing the 6.5% growth achieved in 2005.

In terms of sub-sectors, activity in construction has been particularly high, with 2006 seeing growth of 15.7%. The wholesale and retail sector and real estate and business services also grew strongly, by 12.4% and 11.2% respectively. Tourism receipts accounted for 20% of GDP, boosted by a record total of 68,200 visitors in 2006.

Inflation GoVs fiscal position improved markedly in 2004 and 2005,

**moderate,
Government
finances stable**

recording surpluses of 1.2% and 2.2% of GDP respectively, according to the Asian Development Bank (ADB). The annual rate of inflation was 1.9% at the end of 2006 and has not exceeded 3% since 2002.

Main Economic Indicators, 2003-2006.
Source: EIU

	2003	2004	2005	2006
Population (k)	207	213	218	221
GDP (\$m, market rates)	280	330	366	387
GDP per capita (\$, market rates)	1,347	1,546	1,677	1,753
GDP (\$m, purchasing power parity)	669	726	803	861
GDP per capita (\$, PPP)	3,222	3,402	3,685	3,894
GDP real growth rate (%)	3.20%	5.50%	6.80%	7.20%
Govt consumption (% of GDP)	21.18%	19.73%	18.67%	na
Budget balance (% of GDP)	-2.93%	-1.59%	0.62%	na
Consumer prices (change pa; avg)	3.10%	1.60%	0.90%	2.60%
External debt (% of GDP)	35.90%	38.70%	na	na
Current acc balance (% of GDP)	-14.6%	-13.4%	-17.3%	-14.3%
Foreign exchange reserves (\$m)	44	62	68	105
Average exchange rate (vt:\$)	122	112	110	111

Government policy

**Increasingly
stable and pro-
private sector**

Vanuatu's constitution is based on the UK Parliamentary model with elections every 4 years. As support for political groups is relatively fragmented, recent years have witnessed a trend towards coalition governments. The last election, held in July 2004, resulted in the NUP / VP coalition which has remained in office.

As demonstrated by the increased engagement with the international community (see above), the current Government has embarked on a series of reforms in a number of sectors aimed at improving governance, encouraging private investment, and generating sustainable private sector led growth.

As part of these reforms, in late 2006 GoV announced a decision to sell a strategic stake in Air Vanuatu to private investors. On August 10th 2007, IFC was appointed as lead transaction advisor to advise on the implementation of this restructuring.

3 The Aviation Market

International market

85% of passengers originate overseas

As mentioned above, the travel and tourism industries represent an ever increasing segment of the economy of Vanuatu, and not surprisingly tourists account for the overwhelming majority of demand for aviation services. Currently, approximately 85% of the passengers into and out of the country originate overseas.

In addition to the tourist market, there is rapidly growing demand from migrant ni-Vanuatu workers. As mentioned above, New Zealand piloted a Recognised Seasonal Employer (RSE) programme in 2006, which will allow over 1,000 workers to spend about seven months in New Zealand for the fruit harvest. Typically they fly out in Sept-Oct and back in Apr-May.

There is also a small but extremely robust business segment, which is growing considerably. The size of the various routes, as well as their markets shares, is given below.

International Passenger Movements, 2007 Jan-Sept
Source: Airports Vanuatu

Route	Air Vanuatu passengers	Competitor passengers	Competitor	Air Vanuatu share*
Brisbane	22,562	22,692	Pacific Blue	50%
Sydney	40,404	-	-	100%
Noumea	7,308	11,960	Air Calin	38%
Nadi	2,982	5,568	Air Pacific	35%
Honiara	-	2,703	Solomon Air; Air Pacific	-
Auckland	14,492	7,278	Air New Zealand	67%
Total	87,748	50,201		64%

Codesharing arrangements on individual routes are given in Section 4 below.

Future growth

Vanuatu brand driving growth in aviation

Prospects for demand for aviation services will be largely determined by Vanuatu's status as a tourist destination. The strong growth in passenger arrivals during the last 5 years has been driven by the emergence of a Vanuatu brand. As mentioned above, several factors underlie this development. The Happy Planet Index ranking, the TV show Survivor being filmed in the country, the robust economic environment of the main source markets of Australia and New Zealand and the publicity campaigns, led in large part by Air Vanuatu, have all contributed. Finally, Vanuatu's main competitor in the tourist market is Fiji, which has experienced political instability over this period.

WTTC, an industry group, calculates that on an absolute size measure, Vanuatu's tourism industry's total spend of US\$162.0m ranks the country 166th out of 174 countries worldwide. However, relative to the

size of the national economy Vanuatu is the 14th largest globally.

Annual tourism revenue growth of 6.8% 2006-2016 estimated

WTTC also views Vanuatu's medium term prospects extremely aggressively. With continued political instability in neighbouring Fiji, and high levels of price inflation in Australia's Gold Coast, WTTC estimates that Vanuatu will record an annual increase in revenues of 6.8% in the 10 years from 2006. This rate of growth would make Vanuatu the 12th fastest growing tourist market globally.

Based on the preceding, the travel and tourism sector in Vanuatu can be described as small, highly intensive and fast growing.

Relative size of Regional Travel and Tourism market
Source: WTTC

	Travel and Tourism Total Spend 2006 (US\$m)	Global Rank (out of 176)	10yr growth forecast (annual%)
Mauritius	2,424.5	100	3.7
Fiji	977.6	130	5.5
Maldives	730.7	138	5.5
Seychelles	471.5	147	3.1
Vanuatu	162.0	166	6.8
Tonga	45.2	173	4.3
Solomon Islands	45.0	174	4.9
Kiribati	19.2	176	5.9

Domestic Market

3 paved runways on 3 islands

Up until 2004, domestic routes were served by VanAir, a separate parastatal company, with Air Vanuatu concentrating exclusively on international routes. However, due to various operational difficulties Air Vanuatu took over VanAir in September 2004. These routes are now run exclusively by Air Vanuatu.

The domestic market is served by two main trunk routes: Port Vila to Santo and Port Vila to Tanna. There are the three paved airports in Vanuatu which are currently served by the ATR and 737. The demand for these services comes both from domestic and international travellers. An estimated 30% of passengers on domestic routes are from the international market.

Institutional agencies

The airline is regulated by the Civil Aviation Authority. This agency issues an Aircraft Operating Certificate which is needed by any airline registered in Vanuatu.

As the national carrier, Air Vanuatu, is 100% Government owned. Responsibility for policy in the sector is with the Ministry of Infrastructure and Public Utilities (MIPU).

4 Air Vanuatu: The Company

Air Vanuatu is the national carrier of Vanuatu and is 100% owned by GoV through three shareholders: the Minister of Public Utilities, the Minister of Finance, and the Prime Minister. Each owns an equal 33% stake, with the Minister of Public Utilities holding the chair. The airline has recently completed an IATA Operational Safety Audit (IOSA), the results of which should be available in the coming months.

Air Vanuatu has a board of directors which oversees the company's operations. Historically, the board has been excessively large which made governance difficult. However, in July 2007 the board was restructured and currently, there are 5 members: the CEO of the company plus 4 external appointments made by the shareholders.

Fleet

Fleet modernisation to bring significant improvement

At present Air Vanuatu has a fleet of 6 aircraft, as follows:

A Boeing 737-300 is leased from the International Leasing Financing Company (ILFC) and operates all international routes with the exception of Port Vila to Noumea. This lease is due to expire in January 2008, when the aircraft is to be replaced with a Boeing 737-800. This aircraft will offer both a larger capacity (approximately 170, an increase of 44) as well as significant fuel efficiency savings.

An ATR-300 is owned by Air Vanuatu and operates the main domestic trunk routes of Port Vila to Santos and Tanna, as well as the route to Noumea in New Caledonia. This aircraft is also currently scheduled for replacement within 36 months.

Two Twin Otters and two Islanders are also owned by the airline. These operate the other domestic routes to outlying islands. The company has 3 Chinese Harbin Y-12s on order. Details of the fleet are given below.

Air Vanuatu Fleet as of September 2007

Aircraft	Year of Manufacture	Seat Capacity	Avg Hours per month	Ownership
B737-300	1998	126	318	Leased
ATR42-300	1980	46	78	Owned
Twin Otter	1980	19	141	Owned
Twin Otter	1980	19	146	Owned
Islander	1969	9	67	Owned
Islander	1970	9	70	Owned

Maintenance is performed on the Boeing by Qantas under a long standing contractual arrangement.

Routes

Currently Air Vanuatu offers international services to from Port Vila to Sydney,

limited direct competition Brisbane, Auckland, Noumea and Nadi and from Santo to Brisbane. Since acquiring VanAir in September 2004, domestic services have also been operated. There are daily services on the trunk routes of Port Vila to Santo (two daily) and Port Vila to Tanna (one daily) as well as a network of island hopping services to all corners of the Vanuatu archipelago. Market sizes and shares for the main international routes are given in section 3 above.

On the international routes, Air Vanuatu has several codeshare agreements with other regional airlines. On the Sydney route an agreement is in operation with Qantas whereby Air Vanuatu operates all services between Australia and Vanuatu, with Qantas able to sell seats on each flight. Air Vanuatu is also a member of the Qantas frequent flyer programme, enabling customers to earn and spend Qantas air miles on all Air Vanuatu flights.

A codeshare agreement also exists with Air New Zealand whereby Air Vanuatu operates 2 weekly flights to Auckland and Air New Zealand 1. Each airline is then able to sell a number of seats per week on the other's services. Currently there are no codeshare arrangements between Air Vanuatu and Air Pacific or Air Calédonie, although there have been discussions on this topic in the past. There are no plans for codeshare arrangements with Pacific Blue.

International capacity expansion of 35% in 2008 In mid-2007 Air Vanuatu inaugurated a service between Santo and Brisbane. Although operational performance figures are not currently available, revenue on this route is already covering cost. In addition, Solomon Airlines is currently facing operational difficulties and discussions are in an advanced stage for Air Vanuatu to begin operating the Port Vila to Honiara sector.

In addition to expanding the route network, considerable new capacity will arrive in 2008 when the new Boeing 737-800 arrives, with 35% more seats. Driving this expansion is the fact that the tourism industry which, as discussed above in Section 4, is expected to average 6-7% annual growth over the next 10 years.

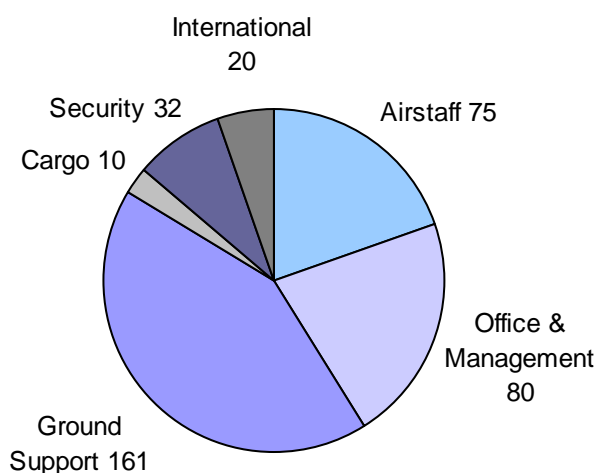
Staff

The staff complement at Air Vanuatu has fluctuated between 240 and 340 over the last 3 years. This has been driven by the integration of VanAir during this period. Recent numbers, as well as average cost per staff member, are given below.

Staff: Headcount & Cost
Source: Air Vanuatu

	2004	2005	2006
Total Staff Costs (vt m)	869	1016	966
Headcount	359	298	324
Cost per staff (vt 000)	2,421	3,409	2,981
Cost per staff (\$)	21,651	31,023	26,812

Current payroll (Sept 2007)
Source: Air Vanuatu



Financial Performance

Dramatic profitability turnaround in 2005 and 2006

Despite an extremely challenging internal and external operating environment, Air Vanuatu is currently generating profits, a substantial turnaround over its earlier historic performance. In 2004, when the current management team was appointed, the airline had an inappropriate fleet (including two leased Boeing 737s). In addition, the company was merged with the loss making domestic carrier VanAir, presenting significant integration challenge. A net loss of vt468m in 2004 was translated into net profit of vt98m and vt158m in 2005 and 2006 respectively. In this context, Air Vanuatu's financial performance is currently a notable success.

Audited Profit & Loss statements are given below. The accounts are audited by Hawkes Law, the local correspondent firm of KPMG. Note the corporate tax rate in Vanuatu is 0%.

Profit & Loss account, 2004-2006 (vt m)

	2004	2005	2006
Passenger Revenue	3293	3207	3177
Other revenue	674	1031	850
Total Revenue	3967	4238	4027
Aircraft leases	928	643	383
Airport charges	384	371	420
Commissions paid	257	233	244
Crewing	368	363	306
Depreciation (aircraft, spares)	31	36	60
Maintenance	500	484	236
Fuel	717	670	684
Insurance	90	32	54
Passenger charges	184	166	190
Overheads	950	1137	1239
Total Costs	4409	4135	3816
Profit from operations	-442	103	211
Financing income	-26	-5	-53
Profit	-468	98	158

This successful turnaround has been achieved despite numerous internal and external challenges. Clearly there are considerable difficulties for a parastatal entity competing with more agile private sector airlines. In addition, the airline occupies a niche position lacking significant economies of scale. Recent years have also seen very high fuel prices, putting strain on even the strongest airline business. Fuel is more expensive in Vanuatu than in the other major markets, once again due to economies of scale.

Balance Sheet, 2004-2006, as at Dec 31st (vt m)

	2004	2005	2006
Assets			
Cash & equivalents	121	117	17
Receivables	446	452	452
Inventories	89.3	123	162
Prepayments	18.3	10	18
Current assets	675	702	649
PPE	851	903	1137
Receivables	158	157	157
Non current assets	1009	1060	1294
Total Assets	1684	1762	1943
Liabilities			
Payables	584	476	397
Revenue in advance	365	279	362
Provisions	367	372	136
Current liabilities	1316	1127	895
Borrowings	120	100	322
Provisions	263	338	135
Non current liabilities	383	438	457
Equity	-15	197	591
Total Equity & Liabilities	1684	1762	1943

Operational performance

**Load factors
67% - 69%**

The principle airline performance indicators for Air Vanuatu are set out below. Note that these figures do not include passengers or revenue carried through code share arrangements, or tax or fuel surcharges revenue. In all three tables, figures for 2007 are for January to March only.

Revenue per passenger (2007 Jan-Mar only)

	2005	2006	2007
Passenger revenue (\$)	16,030,492	15,761,454	3,666,156
Passengers	87,417	85,110	20,713
Revenue per passenger (\$)	183	185	177

Does not include fuel surcharge

Load factors (2007 Jan-Mar only)

	2005	2006	2007
Revenue passenger km	178,651,883	179,496,120	41,978,993
Available seat km	260,078,312	264,645,269	62,402,612
Load factor	68.7%	67.8%	67.3%

Revenue per passenger km (2007 Jan-Mar only)

	2005	2006	2007
Passenger revenue (\$)	16,030,492	15,761,454	3,666,156
Revenue passenger km	178,651,883	179,496,120	41,978,993
Revenue per passenger km (cents)	9.0	8.8	8.7

Jul-Dec peak season load factors rise above 80%

Overall, these results are remarkable for their consistency. The Sydney route is by far the most important for Air Vanuatu, accounting for approximately half the airline's passenger numbers. Load factors on this route are consistently above 70%. Peak months are July to December, when load factors rise to 80-90%.

Air Vanuatu also operates a cargo business. The principal route is Auckland to Port Vila, accounting for approximately 40% of cargo revenue and is frequently full. Cargo revenues account for about 7.5% of the total revenue of the company.

5 Transaction Structuring & Timetable

Structuring phase IFC, assisted by airline specialists SH&E and the legal firm of Buddle Findlay, is currently undertaking a legal, technical and economic due diligence of Air Vanuatu with a view to introducing private sector equity ownership into the company. This phase of work also includes a preliminary market testing to gauge potential investor interest, an analysis of Vanuatu's aviation market, and the identification of strategic options for both the sector and the company.

This will take approximately 3 months and will be completed by January 2008.

At this early stage of the process the Government does not have any hard and fast rules regarding the structure of this transaction. The Government adopts a pragmatic stance on such issues as the percentage of shares to be sold, board and management arrangements, separation of domestic and international services, and aviation policy post-privatisation.

The Government has a well defined set of objectives for the transaction, including:

- (i) Secure a Strategic Partner with a strong market presence and a proven track record in airline operations;
- (ii) Enhance the economic competitiveness of the aviation sector in Vanuatu;
- (iii) Provide an adequate and efficient aircraft fleet; and
- (iv) Reduce the Government's financial commitments to the sector.

At the present time GoV has a preference for selling a minority block of shares to a Strategic Partner in a competitive international tender.

Government is also receptive to Vanuatu investors participation in the shareholding of the national airline. The exact mode and percentage of shares to be sold in this manner has not yet been decided.

This preliminary marketing of the transaction is designed to elicit investor response to the investment opportunity, and receive feedback on any potential issues that need to be addressed during the transaction structuring phase.

Implementation phase Once GoV has finalised the transaction structure, the implementation phase will commence. This will include opening of a data room (physical and/or virtual); pre-bid negotiation of the transaction documents; a transparent bidding and award process and financial closing. The indicative timetable below is given for planning purposes; milestones and dates are all subject to further refinement during the structuring phase.

Air Vanuatu transaction, indicative timeline

Milestones	Dates
Issuance of PIM	Oct 2007
Initial Discussions with aviation investors	Oct – Nov 2007
GoV due diligence completion	Jan 2008

Finalisation of transaction structure	Jan 2008
Investor due diligence	Feb – Apr 2008
Final transaction documents	May 2008
Bidding	May 2008
Closing	Jun 2008

GoV hiring of IFC as transaction advisor is a strong signal that GoV is committed to the privatisation of Air Vanuatu. IFC has substantial experience in implementing successful airline privatizations, including having advised the Government of Samoa on setting up the landmark Polynesian Blue Joint Venture in 2005. IFC will help ensure that the Air Vanuatu transaction process is conducted transparently and that a bankable transaction design is concluded.

6 Expression of Interest

Feedback cordially solicited

GoV and IFC are committed to the successful implementation of the restructuring of Air Vanuatu, and invite potential investors to express interest in the transaction. Interested bidders are invited to submit early feedback on issues that may be of concern, especially:

- (i) Anticipated vision for the future of the Air Vanuatu, including proposed business model;
- (ii) Risks and other concerns associated with the transaction;
- (iii) Nature of investment – e.g. percentage of equity stake required, preferred shareholding structure;
- (iv) Appetite and interest domestic routes; and
- (v) Benefits to be provided to Air Vanuatu and the Republic of Vanuatu post-privatisation.

Further to these responses, GoV, Air Vanuatu and IFC are planning to hold individual meetings with investors with a view to gaining further understanding of the issues.

Feedback from potential bidders will be taken into account when designing the overall transaction structure and the legal documents that underpin the transaction. The initial expression of interest stage will be followed by pre-qualification of bidders, opening of a data room to pre-qualified bidders that meet specified operational and financial criteria, and pre-bid negotiation of the transaction documents. An Information Memorandum and draft bidding documents will be issued concurrent with setting up the data room.

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