

Air NZ, Virgin tipped to get even closer

by Owen Hembry

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Transtasman alliance will see both airlines 'working as one' analysts say

Air New Zealand and Australia-based airline Virgin Blue will work as one airline within two years, says an aviation analyst.

The two airlines last month were given regulatory approval for a transtasman alliance and this week Air New Zealand took a 14.9 per cent stake in Virgin Blue.

The investment was a sensible and logical progression in the process of getting the airlines to operate together, said Peter Harbison, executive chairman of the Centre for Asia Pacific Aviation.

"There's an awful lot which is still to be discussed between them but my assumption is, with Virgin Blue and Air New Zealand, within two years they'll be effectively operating as a common airline," he said.

"That's the sensible way to go."



The investment took the airlines' partnership a step further, he said.

"Progressively I think it's making this partnership irreversible."

Both carriers were anxious to target the 90 per cent of the Australian corporate market held by Qantas, he said.

"If you don't have full access to both Australia and New Zealand . . . it's much harder to attract that corporate market."

Air New Zealand chief executive Rob Fyfe said the NZX-listed airline had been considering an investment in Virgin Blue for some time.

The purchase

- Air New Zealand has bought a 14.9 per cent stake in Virgin Blue.
- Cost of investment is A\$145m.
- No intention to extend ownership beyond 14.99pc.

The alliance

- Air New Zealand and Australia-based Virgin Blue have agreed a transtasman alliance.
- Agreements on a code-share for the Tasman and domestic travel as part of a connecting journey, revenue allocation, frequent flyer and lounge access.

Both carriers are keen to target the Australian corporate market.

"We've determined that we don't want to operate in our own right in Australia, we've also determined that we don't want to take over an airline but we would like to have a stake and a position in that market and so we've chosen to do that by taking a 14.9 per cent stake in Virgin Blue," Fyfe said.

The cost of the investment was A\$145 million (\$189 million) or A44c a share and there was no intention of launching a full takeover, he said.

Air New Zealand had obtained approval from the Australian Foreign Investment Review Board to buy up to 14.99 per cent of Virgin Blue, which it said would keep the total foreign ownership within the statutory limit of 49 per cent.

Air New Zealand would fund the investment out of free cash flow.

"When we look at the value of the investment we believe that the upside potential for Virgin in the medium-term is strong enough to justify that cost of funds and we've clearly done the sums to figure out how that return looks to us and we are more than satisfied with the upside potential."

Shares in ASX-listed Virgin Blue closed down 1c at A43c yesterday.

The airlines will code-share on Tasman routes and connecting domestic flights and offer reciprocal frequent flyer and lounge access agreements.

"We think there are opportunities for us to extend our relationship with

Virgin and we'll be looking at those opportunities in coming months subject obviously to any approvals required from competitions authorities," Fyfe said.

Return on investment could come from gains in share price, partnership opportunities or dividends.

"We know we'll get value out of the transtasman alliance within 12 months but certainly in the 12-24 month time-line we see some valuable upside."

Shares in Air New Zealand, which is 74.7 per cent government owned, closed down 2c at \$1.42 on the NZX yesterday.

Forsyth Barr head of research Rob Mercer said the alliance on the Tasman strengthened both businesses.

"I think it's going to be very successful in terms of what it can achieve in market share from the Australian domestic and the combined share on the Tasman," Mercer said.

"Alliances are fragile from time to time, so I think Air New Zealand going to 15 per cent signals this is really about a long-term strategic alliance," Mercer said.

"Makes sense to put some investment in because you can't just get the benefits from the alliance without some skin in the game as well."

The alliance would provide a better product and service at a competitive price, he said.

Air New Zealand had a strong balance sheet, was capable of making the investment and would deliver a strong interim result in February, Mercer said.

"I think they'll get a reasonable return on their investment from this price level."

NZ Funds Management chief investment officer Michael Lang said "the global airline industry was in the early stages of a long cyclical rebound following the global financial crisis.

"A shareholding in Virgin Blue gives Air New Zealand access to a much larger population in a way that does not require a large capital outlay," Lang said.

"I expect as a result of this purchase to see a number of changes to Virgin Blue which will result in the new Alliance taking market share from Qantas, which is a good thing for Air New Zealand shareholders."