



Air NZ boosts stake in Virgin Blue

HAMISH RUTHERFORD AND ROELAND VAN DEN BERGH Last updated 10:45 21/01/2011

Air New Zealand has paid \$188.9m for a 14.9 per cent stake in Australian-based airline Virgin Blue.

Air New Zealand, which announced last night had acquired a stake of at least 5 per cent of Virgin Blue, said this morning that it had bought more shares off-market overnight, raising its stake to 14.9 per cent. Virgin Blue operates as Pacific Blue on the Tasman.

Air New Zealand chief financial officer Rob McDonald said the cost of the Virgin Blue stake was A\$145 million (NZ\$189m) or A44 cents a share. The stake was funded through the airline's existing cash reserves.

The airline has no plans to raise its stake beyond 14.99 per cent. Its chief executive, Rob Fyfe, phoned Virgin Blue's chief executive, John Borghetti, to reassure him that there were no plans for a takeover.

Reaction

NZ Funds chief investment officer Michael Lang said Air New Zealand decision to take a cornerstone shareholding in Virgin Blue would cement the airline as the dominant partner in their recently approved trans-Tasman alliance.

"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," Mr 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."

Fyfe had found a way to continue the airline's expansion plans in a way that did not require a full takeover of another carrier and would not require additional capital from shareholders, Lang said.

Air New Zealand shares fell 4 cent to \$1.40 this morning. But NZ Funds valued Air New Zealand's shares at over \$2 a share.

Strategic growth

Fyfe said the investment "reinforces Air New Zealand's strategy to grow its business in Australasia which is continually evolving as a single aviation market," adding that the stake gave it exposure to the Australian domestic market, but that it had no intention of entering that market directly.

Last year Air New Zealand and Virgin Blue won approval from Transport Minister Steven Joyce to operate on routes across the Tasman Sea. The decision followed approval from Australia's antitrust regulator, which reversed its preliminary view, after the two airlines gave guarantees on growth in capacity.

It would not seek a position on the Virgin Blue board for at least six months.

The stake allows Virgin to keep within the statutory limits on foreign ownership of 49 per cent.

- **BusinessDay.co.nz**



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Tim Hunter and Roeland van den Bergh

Developing more long haul routes and bringing more visitors to this country are among the opportunities for Air New Zealand in owning a substantial stake in Australia's Virgin Blue, says its chief executive Rob Fyfe.

Discussing the airline's A\$145 million (\$188.9 million) purchase of 14.9 per cent of Virgin Blue at a press conference this morning, Fyfe said it was a long-term investment.

"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 to any approvals required from competition authorities," he said.

Last year the two airlines won regulatory approval to work together on trans-Tasman routes and Fyfe said there was scope to extend their relationship.

He was coy on specifics, citing commercial sensitivity, but indicated long haul routes would be a focus.

"Just as there are routes which will be difficult to make work unless we have more than one airline working together, we also think there are long haul markets that may be developed more quickly if we could work in co-operation with an airline from Australia. Assuming we can get competition approval it may allow us to accelerate development of some long haul routes."

Working together could also bring more tourists from Australia, he said.

"In terms of inbound tourism I think New Zealand performs relatively poorly out of Australia.

"It's as easy to fly to New Zealand from Australia as it is to fly to other states, yet when you look at percentage of Australians we're able to attract over here I think it's relatively disappointing. Part of the reason for that is if you want to fly from anywhere other than the eastern seaboard ports that we fly from, there's only one operator that can offer you a seamless journey, which is the Qantas group. I think if we can bring much more competition to that market we can attract a lot more tourists to New Zealand from Australia, so that's very exciting for us."

Tourists taking in both Australia and New Zealand would be a key target, said Fyfe, as a deeper alliance would allow more seamless travel to customers.

Virgin Blue chief executive John Borghetti had been informed last night of Air New Zealand's move and was supportive, said Fyfe.

"It's a strong endorsement of Virgin Blue and their strategy and he likewise sees Air New Zealand as a potentially very valuable partner for Virgin Blue."

Borghetti's arrival as CEO last May was instrumental in Air NZ's decision, Fyfe told BusinessDay.

"We certainly have become increasingly comfortable and confident in Virgin's strategy since John Borghetti has arrived as CEO.

"His decision to address the underperforming parts of the business, to develop the higher value parts of the business, we think are exactly the right strategies for Virgin Blue.

"It's seeing those strategies executed, or the formative stages of that execution occur, is what has

given us the confidence to back the current direction of the business and the current management of the business," he said.

In particular, Virgin Blue's decision to shut down its loss-making New Zealand operation had made it easier to buy into the company, he said.

"As the market has evolved over the last four or five years, Qantas has created Jetstar, they've become the dominant player in the region, and to some degree if you're only operating in one of the markets - either Australia or New Zealand you get marginalised by the carrier that's operating across the region as a whole. So both Air New Zealand and Virgin have suffered as a result of Qantas's dominance in terms of constraining their growth opportunities.

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A spokesman for Deputy Prime Minister Bill English said it was good to see Air New Zealand building positively on its strategic position.

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Benefits from Air NZ's stake in Virgin

By *Dene Mackenzie*

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A shareholding in Virgin Blue gave Air New Zealand access to a much larger population in a way that did not require a large capital outlay, New Zealand Funds Management chief investment officer Michael Lang said yesterday.

New Zealand's national carrier yesterday lifted its stake in Virgin Blue to 14.99%, with chief executive Rob Fyfe saying there was no intention to go above that holding.

Air New Zealand spent \$145 million, or 44c a share, to buy into the Australian-listed airline.

The airline had no intention of entering the Australian domestic market in its own right, he said.

Mr Lang said the cornerstone shareholding in Virgin Blue by Air New Zealand cemented the airline's position as the dominant partner in the recently announced Air New Zealand-Virgin alliance.

"Airlines are a lot about brand, consumer perception and vision, and Fyfe and the broader team have this in spades. The problem is they have such a small population to capitalise on."

The result of the purchase was expected to bring changes to Virgin Blue, resulting in the new alliance taking market share from Qantas - a good thing for Air New Zealand shareholders, Mr Lang said.

Mr Fyfe had found a way to continue to expand his "Air New Zealand vision" in a way that did not require a full takeover.

That was positive for shareholders as they would not need to provide additional capital for the next stage of the airline's growth.

Air New Zealand had rejuvenated itself from a dowdy government-owned entity which bankrupted itself over the Ansett deal, turning itself into an industry leader, with shareholders having seen their shares rise 22% in the past year alone, he said.

The airline's reputation and stock price would both continue to appreciate, with NZ Funds Management valuing the company's share price at more than \$2, Mr Lang said.

Mr Fyfe said the investment in Virgin Blue reinforced the airline's strategy to expand its business in Australia-New Zealand, which was continually evolving as a single aviation market.

The alliance with Virgin Blue was a key step in that strategy.

The investment provided Air New Zealand with an interest in the No 2 airline in Australia and, through that, access to the opportunities in the growing Australian domestic market, he said.

Air New Zealand would not seek representation on the Virgin Blue board for at least six months and any representation would be a decision for the Virgin board and shareholders, Mr Fyfe said.

NZ Funds Management expected Air New Zealand to announce on February 24 an "extremely strong" first-half result for the six months ended December, Mr Lang said.

"Conditions are ideal for airlines and I think you'll find Air New Zealand management are capitalising on this very well."

The global airline industry was in the early stages of a long cyclical rebound after the global financial crisis, which led to a "nuclear winter" in demand.

A recent increase in the oil price had slowed the industry's rate of growth, but there was enough customer demand - and limited new capacity - so that airline profits would continue to rise despite the oil price. Airlines would increase prices.

Qantas announced on Thursday it planned increasing prices, Mr Lang said.

Forsyth Barr broker Peter Young said the alliance with Virgin Blue was valuable for both companies, but Virgin Blue probably had the most to gain through benefits that should strengthen its Australian domestic business.

"For most strategic alliances, it makes perfect sense to also back that up by an equity investment. Realistically, the alliance is an obvious long-term partnership that should strengthen both companies."

Business Air New Zealand Virgin Blue

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John Borghetti of Virgin Blue.

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Discussing the airline's A\$145 million (T\$290 million) purchase of 14.9 per cent of Virgin Blue, Fyfe said it was a long-term investment. "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 to any approvals required from competition authorities," he said.

Last year the two airlines won regulatory approval to work together on trans-Tasman routes and Fyfe said there was scope to extend their relationship.

He was coy on specifics, citing commercial sensitivity, but indicated long haul routes would be a focus.

"Just as there are routes which will be difficult to make work unless we have more than one airline working together, we also think there are long haul markets that may be developed more quickly if we could work in co-operation with an airline from Australia. Assuming we can get competition approval it may allow us to accelerate development of some long haul routes."

Working together could also bring more tourists from Australia, he said.

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"It's as easy to fly to New Zealand from Australia as it is to fly to other states, yet when you look at percentage of Australians we're able to attract over here I think it's relatively disappointing.

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Both Air New Zealand and Virgin Blue fly to Samoa.

Polynesian Blue is a joint venture between the Government, Virgin Blue and Aggie Grey's Hotel and Resort.

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