

AIR NEW ZEALAND – QANTAS ALLIANCE PROPOSALS

THE COUNTERFACTUALS

A PRESENTATION TO THE NEW ZEALAND COMMERCE COMMISSION

BY

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THE APPLICANTS COUNTERFACTUAL

The “war of attrition”

The Applicants’ counterfactual is flawed because:

- **It is irrational for a major listed company to embark on a course which it has insistentlly predicted beforehand would lead to its destruction.**
- **Over-capacity has been a major cause for the financial crisis that has befallen many full service airlines elsewhere.**

THE BIG SQUEEZE ?

The Applicants claim that Air NZ would be squeezed between a larger full service airline - Qantas – and a value based airline – Virgin Blue

BUT the circumstances suggest that Qantas would be more vulnerable than Air NZ to the impact of Virgin Blue's entry because:

- **Qantas' costs are higher**
- **Virgin Blue would siphon off Australian domestic feed to the Tasman and New Zealand previously monopolised by Qantas**

THE BIG SQUEEZE

It is therefore fallacious to argue that competition between the two airlines would be determined by which of them had the “deepest pockets”

A Macquarie Equities analyst has recently cast doubt on Qantas’ ability to finance both the proposed equity in Air NZ and the needed upgrading of its short-haul fleet.

THE EXTENT OF COMPETITION FROM FIFTH FREEDOM AIRLINES HAS BEEN OVERSTATED :

- **all so far operate only to and from Auckland;**
- **they do not operate with the frequency of Air NZ nor, in some cases, at similarly convenient times;**
- **although they all carry through traffic, the Applicants have emphasised capacity share rather than market share on the Tasman, which is misleading**
- **due to costs differential, their impact would likely be felt more directly by Qantas**

The fifth freedom market on the Tasman has always been unstable, with airlines coming and going.

Withdrawing from international routes would be counter-productive because it would deprive Air NZ of international origin passengers on its domestic services.

**AIR NEW ZEALAND'S FINANCIAL POSITION HAS GREATLY IMPROVED AND
HAS BEEN STABILISED :**

There's no doubt that Air NZ's financial position is looking a lot better. We have got a significant pool of cash in the bank, we've paid off all of our unsecured bank debt and we have been strongly cash flow positive, and we're going to turn a profit.

**Ralph Norris on Channel Nine's "Business Sunday" programme, 3
August 2003**

**Air New Zealand's profit (before unusualls and tax)
for year ending June 2003 :**

"comfortably on the positive side of \$200 million".

Ralph Norris, statement to stock exchanges, 30 July 2003

FACTORS AFFECTING AIR NZ'S ONGOING OPERATIONAL PERFORMANCE AND FINANCIAL POSITION –

- **Exogenous condititons – but aren't they cyclical anyway, not a cause for special treatment?**
- **Express class - a VBA-plus**
- **benefits from the new A320 aircraft**
- **orientation of international network**
- **reputation as safe tourist destination**
- **increasing international arrivals**
- **retention of membership of Star – world's largest international alliance**

CONCLUSION

- **the Commission's counterfactual is more credible than the counterfactual submitted by the applicants**
- **developments since the release of its draft determination have added weight to the Commission's initial assessment.**