



MORRISON & CO

Airport Group

Value Based Airlines

***Commerce Commission Conference
- QF/Air NZ Alliance***

August 2003

Objectives / Scope

Objective

- Critique Airlines' assertions on VBA entry and impact

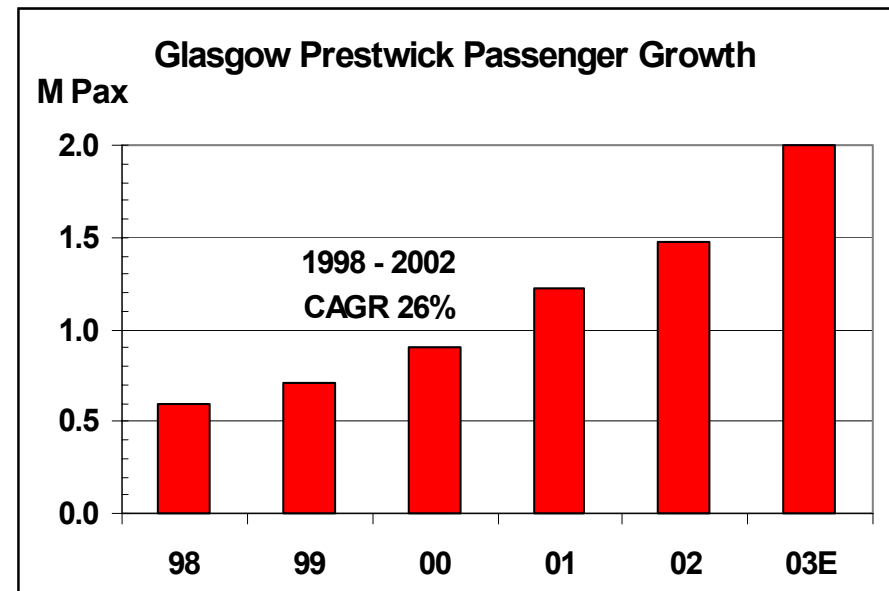
Scope

- Overview of Morrison & Co/Infratil aviation activities and experience
- Discuss characteristics of:
 - VBAs
 - NZ aviation market
- Overview of European Aviation Market
 - impact of Low Cost Carriers
- Implications for Network Carriers
 - including Air NZ



Morrison & Co airport activities

- Purchase & management of Perth, Darwin, Alice Springs airports
- Purchase of Wellington Airport
- Seven year involvement in Europe. Numerous projects investigated.
- Acquisition of Glasgow Prestwick in January 2001
 - 2 million pax p.a.
30% growth for last 3 yrs
 - Ryanair major customer
 - 44,000 tonnes airfreight p.a.
 - Active airline development



Applicants' VBA Proposition

■ VBA will enter NZ market

- domestic and Tasman routes
- Virgin Blue most likely candidate
- barriers not material or manageable

■ VBA will be successful

- set prices
- erode Air NZ market, yield and profitability
- contribute to Air NZ demise

■ Alliance will provide superior result

- benefits exceed anti-competitive effects
- VBA to constrain Alliance across all customer types
- Alliance not to impede entry, extent of constraint or continuing presence

QF vs Air NZ proposition not addressed in this submission



VBAAs – not all the same

■ Low, Low Cost – Ryanair/Southwest

- all the usual + secondary airports, high direct sell, high prod./low labour cost, strict point to point, av. sector length 800km, no in-flight entertainment, strong commission revenue, etc

■ Low Cost

- **easyJet** - primary airports -targets business, UK labour, integrating Go
- **AirTran** – business class, loyalty progr, major a/ps, thru check-in, complementary alcohol/snacks
- **jetBlue** – av. sector length 1840 km, pre-assigned leather seats, 24 channel satellite TV, 50% agent sale, primary and secondary a/ps., loyalty progr., complimentary snacks
- **Virgin Blue** – primary a/ps, 15% agent sales, interline agree., new lounges/AN terminals, considering loyalty progr.



NZ Market – Numerous elements

■ International – longhaul

- value (more than price), onboard service/comfort (food/ent.), choice of class, connectivity, loyalty progr, lounges, priority queues, alliance (Star) benefits,

■ International - Tasman

- price, frequency, connectivity (where on-carriage), lesser extent -lounge, loyalty, etc

■ Domestic - trunk

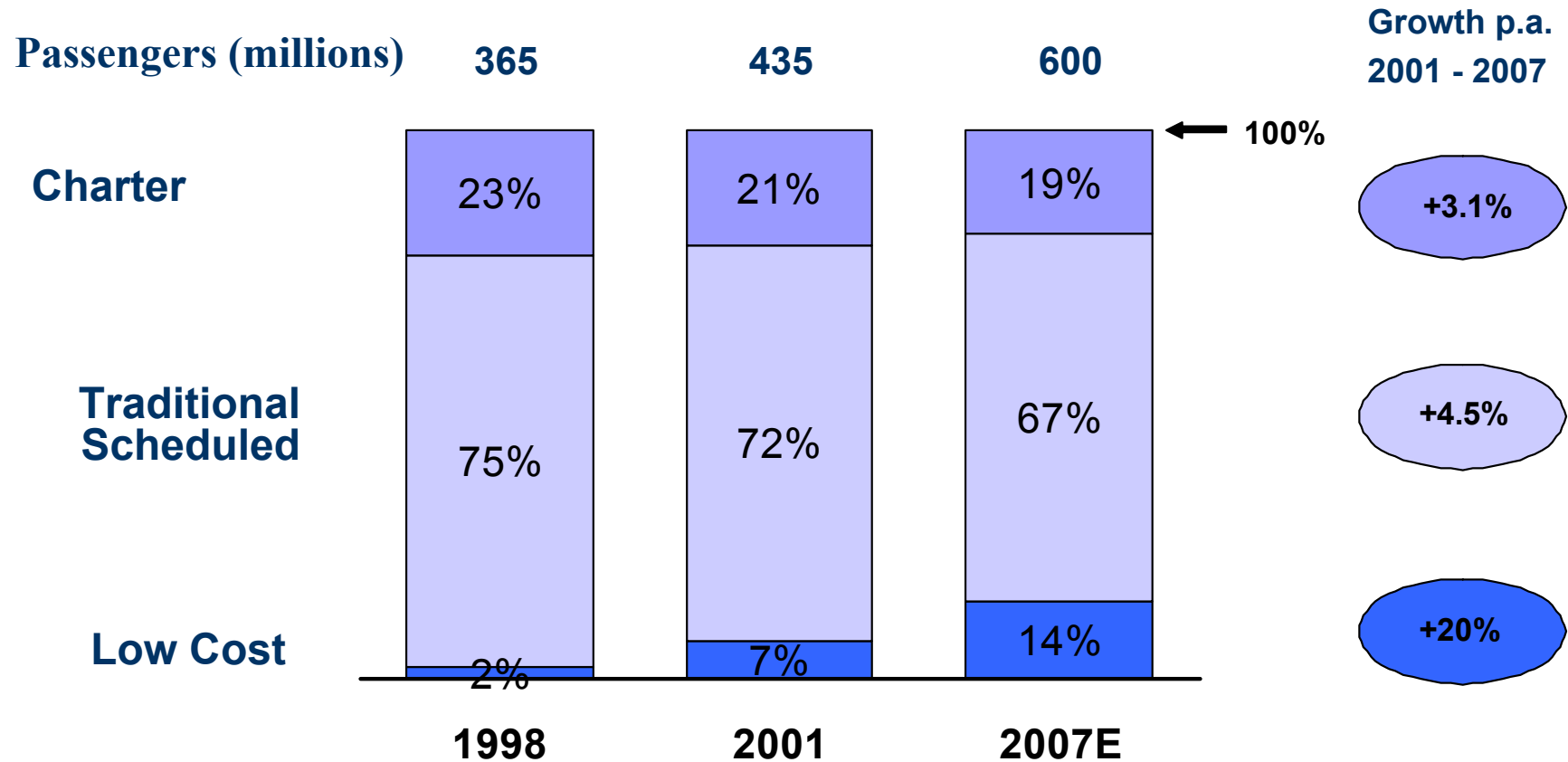
- price, frequency, connectivity (where on-carriage), lesser extent -lounge, loyalty, etc

■ Domestic – regional/provincial

- value (more than price), frequency, connectivity, (lesser extent –lounges, loyalty, etc)



Intra European Aviation Market



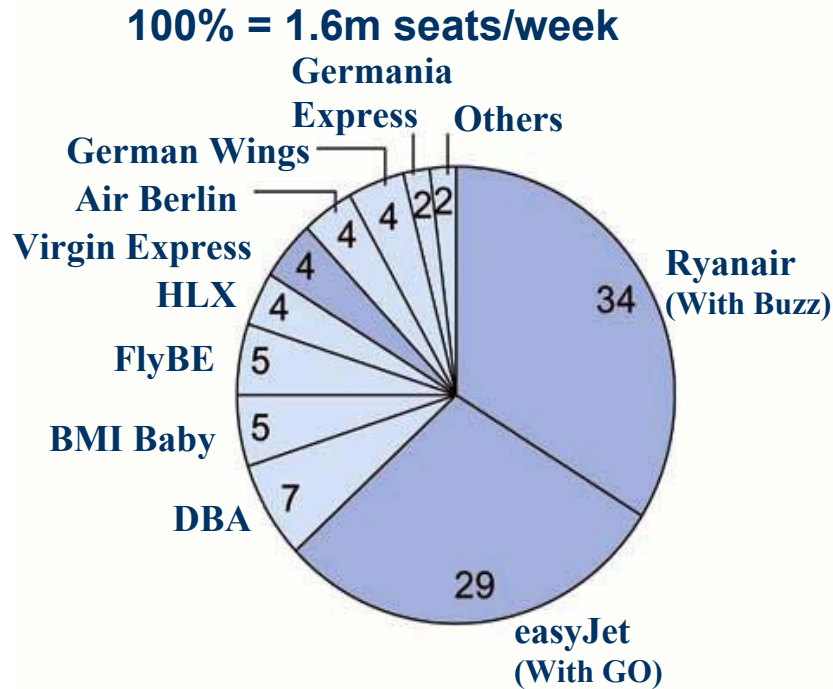
Source: AEA, ERA, IATA, Airline Business, Annual Reports, Air Transport World



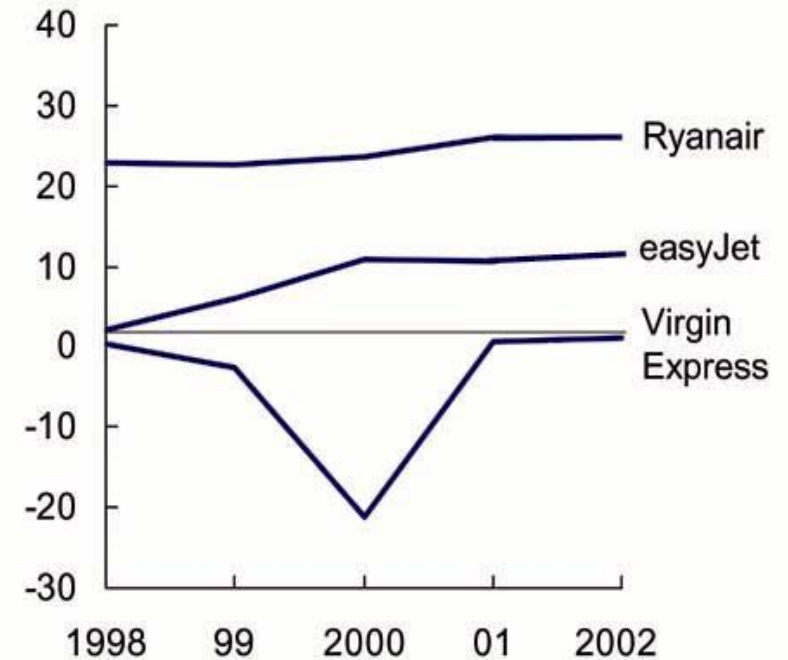
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Low Cost Carrier Market Share & Operating Margins

Low Cost Capacity (%)



Operating Margin (%)

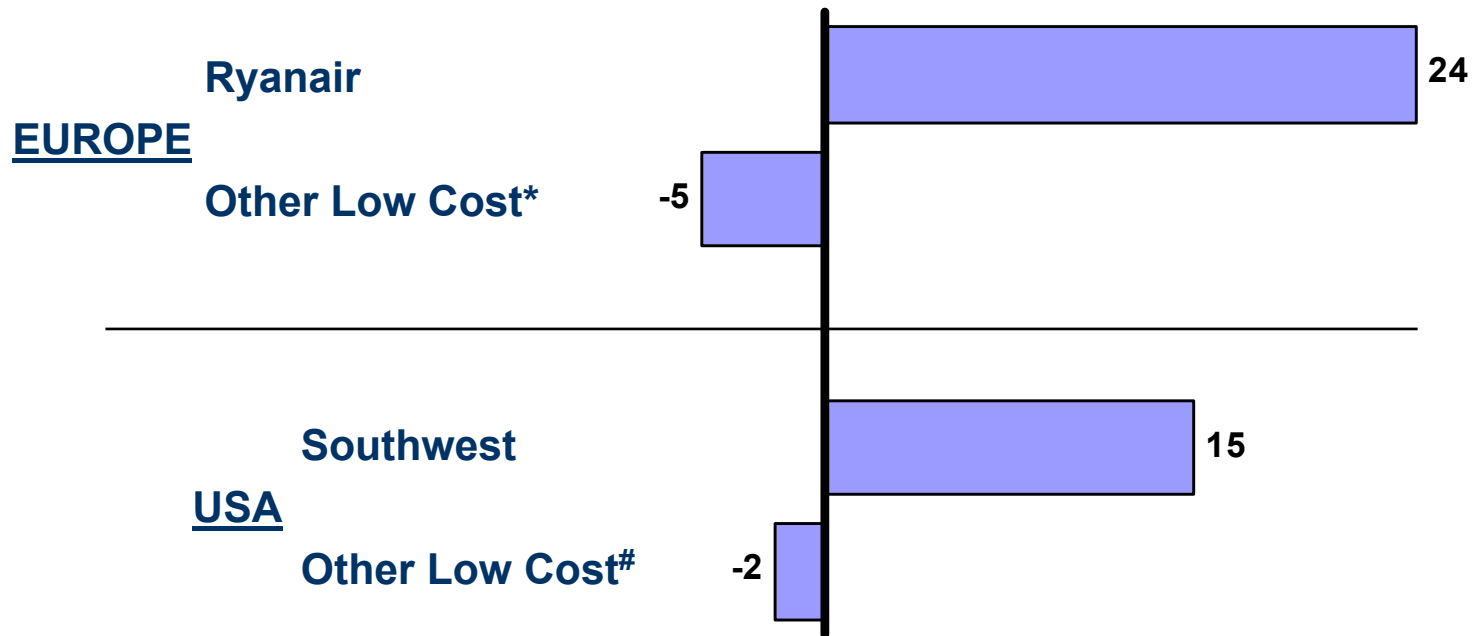


Source: OAG April 2003, Annual Reports, Airline Business



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Operating Margin % (1997 – 2001)



*7 European airlines, including: Buzz, easyJet, Go, Virgin Expr, Debonair

20 US airlines, including: AirTran, Frontier, jetBlue, Spirit

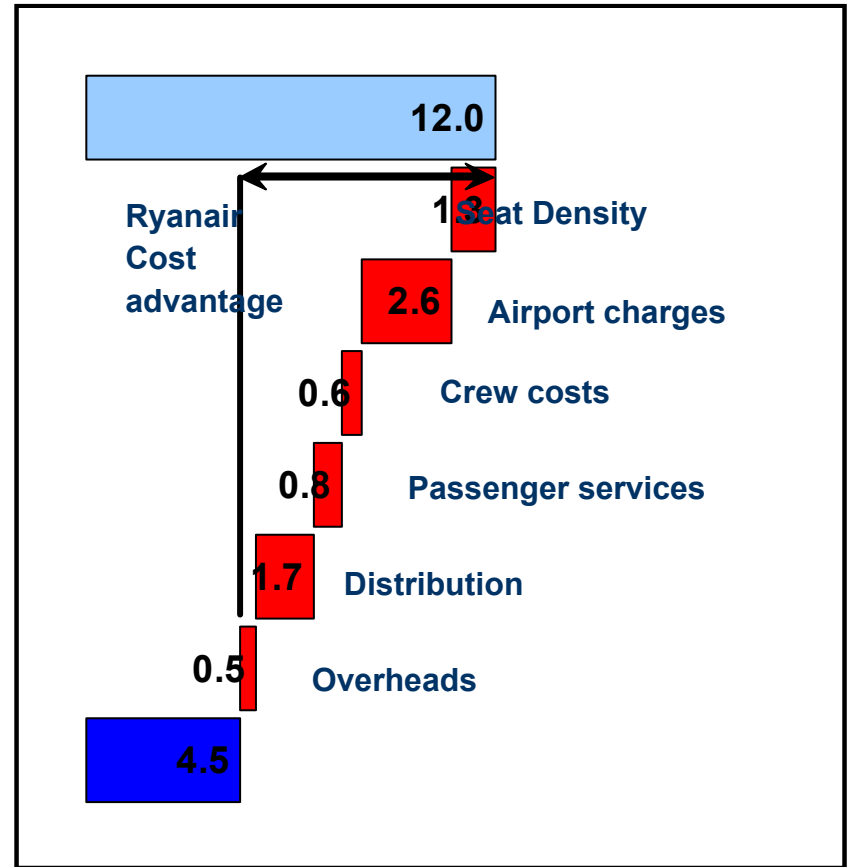
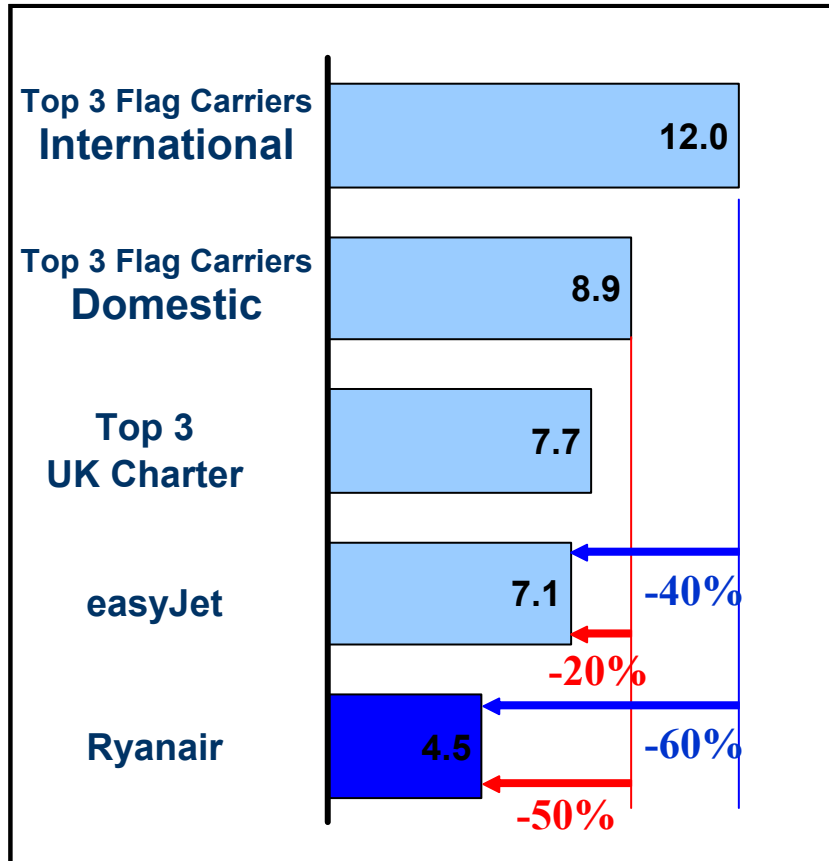
Source: McKinsey Qtrly, 2002 No. 4, US Dept of Trans., Annual Reports



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European Airline Unit Costs

Cost in US Cents / ASK* for (yr 2001) average stage length (800km)



* Available Seat Kilometer

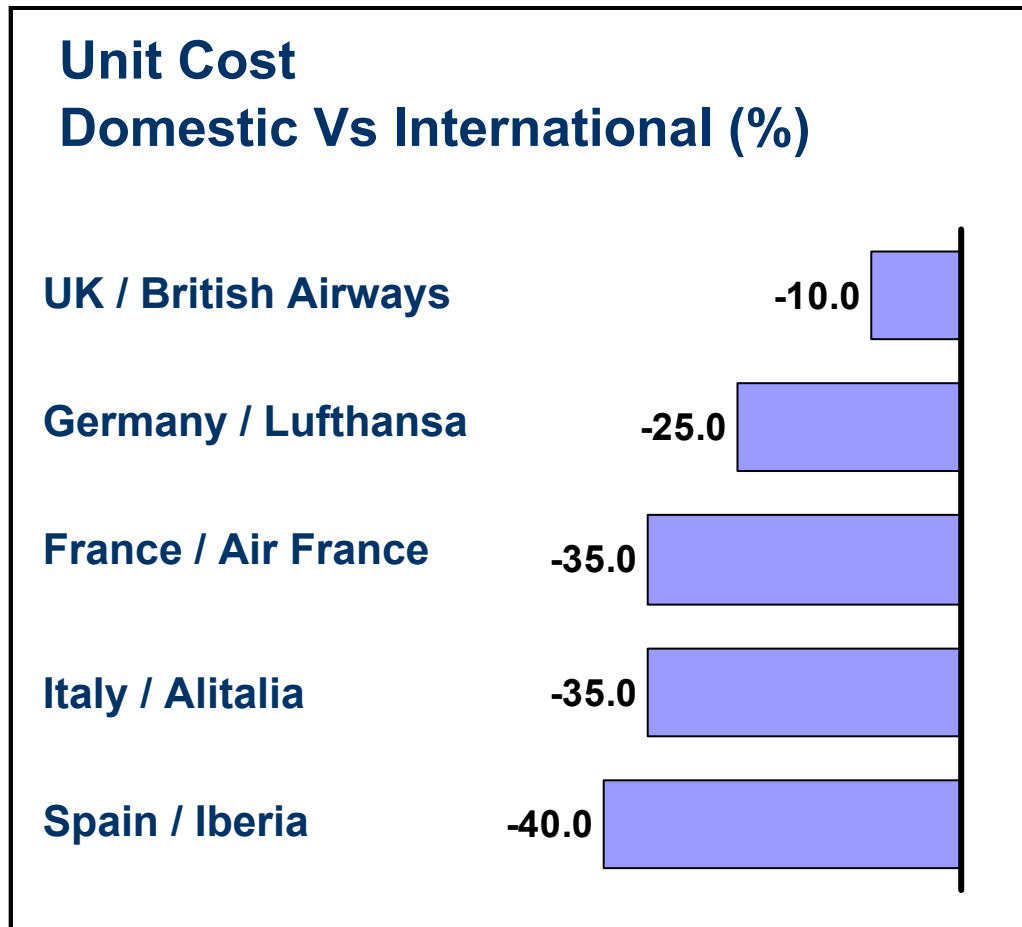
Source: McKinsey Qtrly, 2002 No. 4, AEA, ICAO, Annual Reports



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Network Airlines

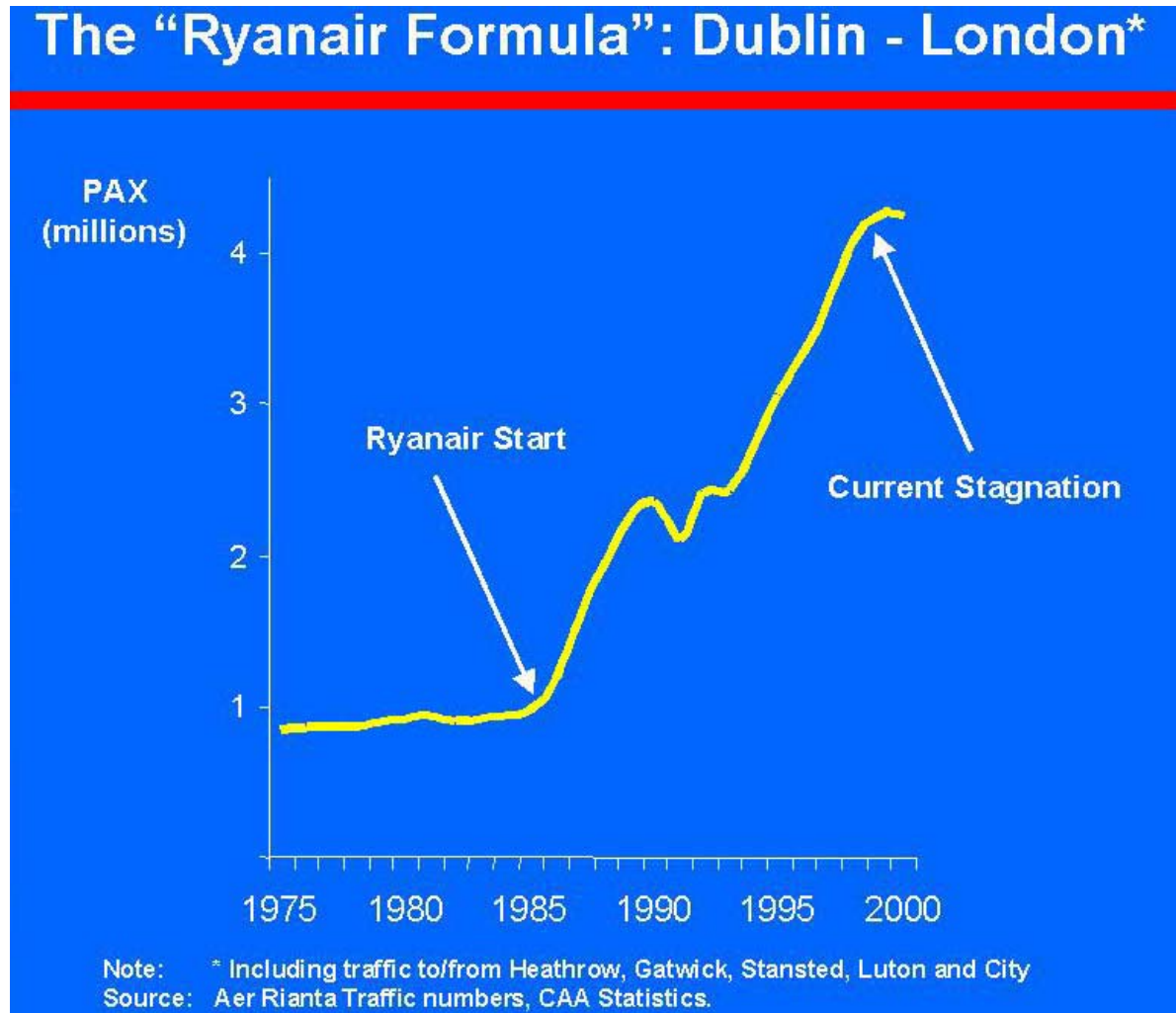
Domestic Operations typically more cost efficient



Source: McKinsey Presentation, Frankfurt Aviation Conf., 8.7.03, AEA, Annual Reports



Low Cost Impact



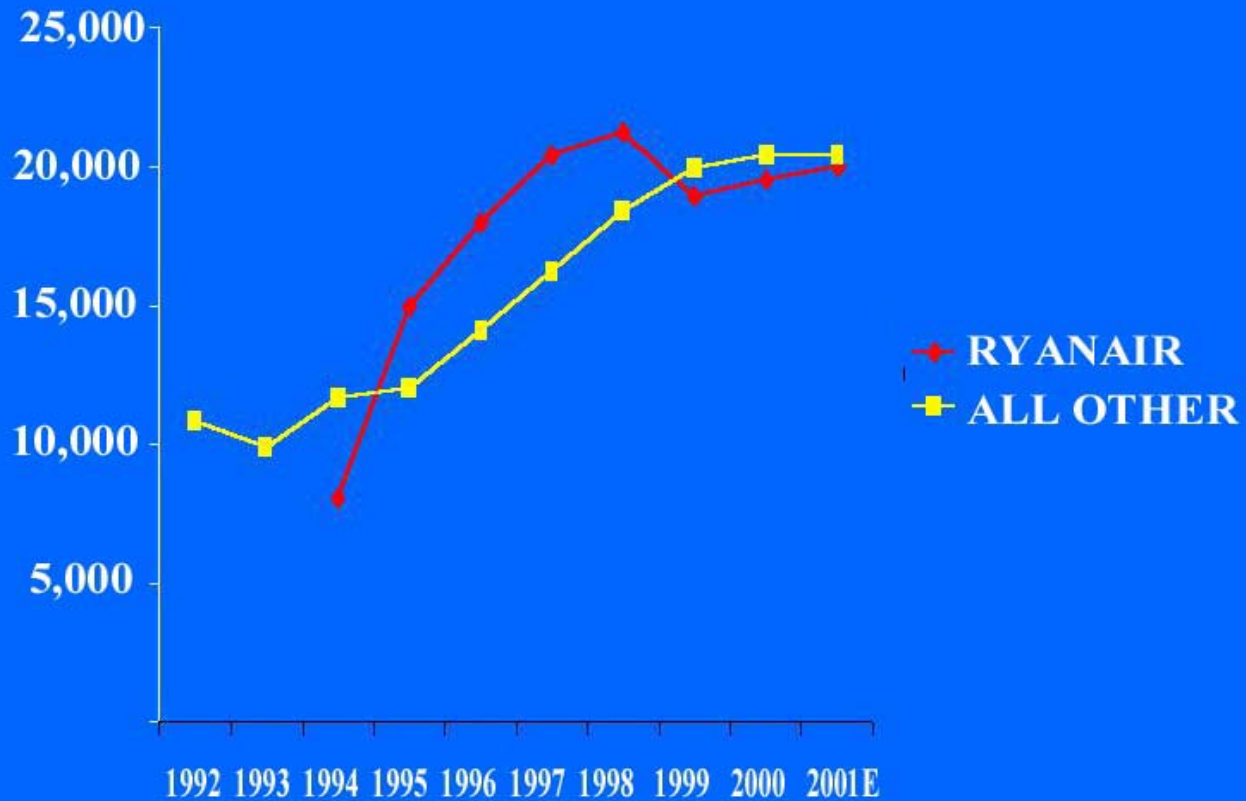
Source: Ryanair



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Low Cost Impact

GLASGOW – DUBLIN 1992-2001e



Low Cost Impact



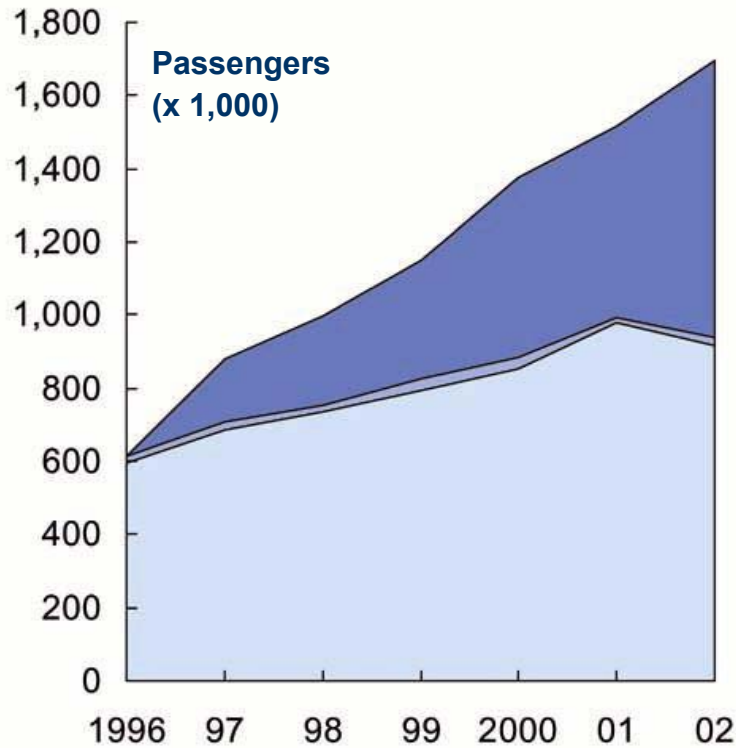
Source: Ryanair



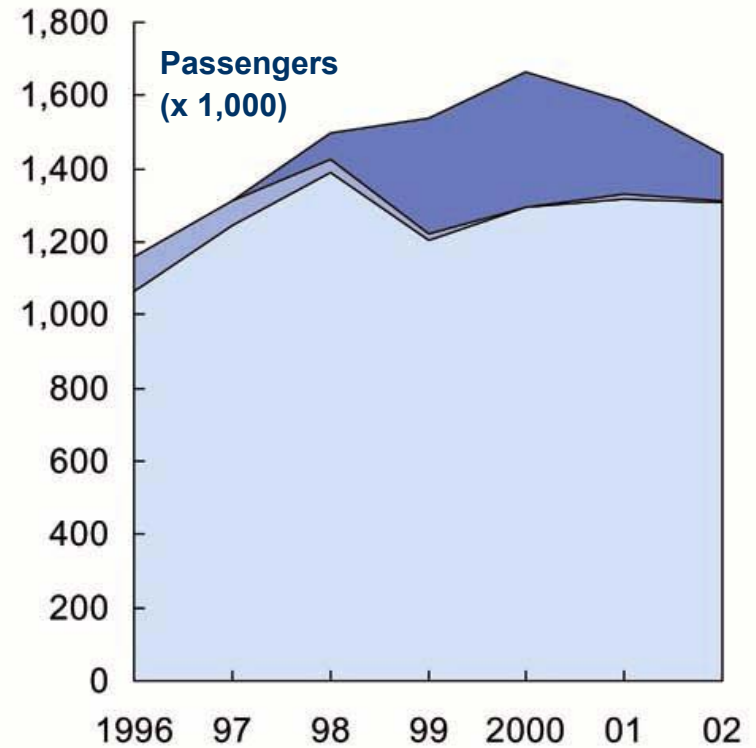
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Market Entry of Low Cost Operators Can mean growth for all carriers

London - Barcelona



London - Milan

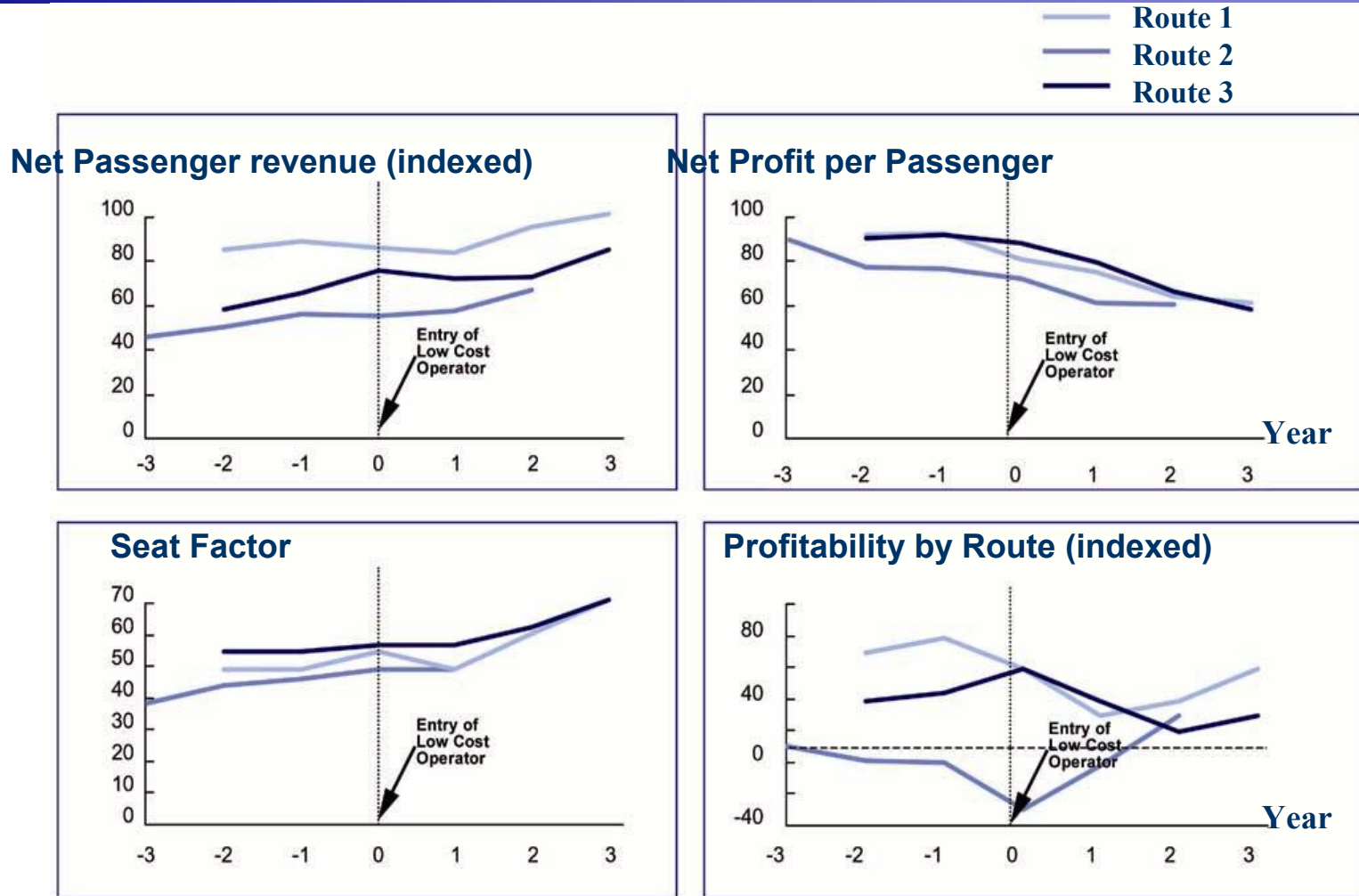


Source: McKinsey Presentation, Frankfurt Aviation Conf., 8.7.03 Civil Aviation Authority UK



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No impact on profitability of established carriers in the medium term (despite initial drop)



Source: McKinsey Qtrly, 2002 No.4, McKinsey Presentation, Frankfurt Aviation Conf., 8.7.03



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Network Carrier Response

-create more value

Costs

- **load density** – one class/seating density/galleys/toilets/load factor, etc
- **in-flight** – no or reduced services -food/entertainment, more aggressive selling
- **airport/handling** – secondary a/ps, reduced scope
- **marketing/distribution** – direct sell (internet), scaled back loyalty progr
- **aircraft productivity** - faster turns, shorter sectors, longer hrs
- **crew productivity** – single a/c type, reduced manning, flexibility/hrs

Revenue

- **targeted discounting** – int. shorthaul/trunk, advanced sales, yield mgt
- **use of network strength** – connectivity, flexibility, brand loyalty



Connectivity - still important - particularly to NZ inbound tourism

STAR (24.8% Int. RPKs)

- Air Canada
- Air New Zealand
- All Nippon
- Austrian
- British Midlands
- Lauda
- Lufthansa
- Mexicana
- Scandinavian Airline System
- Singapore
- Thai
- Tyrolean
- United Airlines
- Varig

ONEWORLD (18.6% RPKs)

- Aer Lingus
- American
- British Airways
- Cathay Pacific
- Finnair
- Iberia
- Lanchile
- Qantas



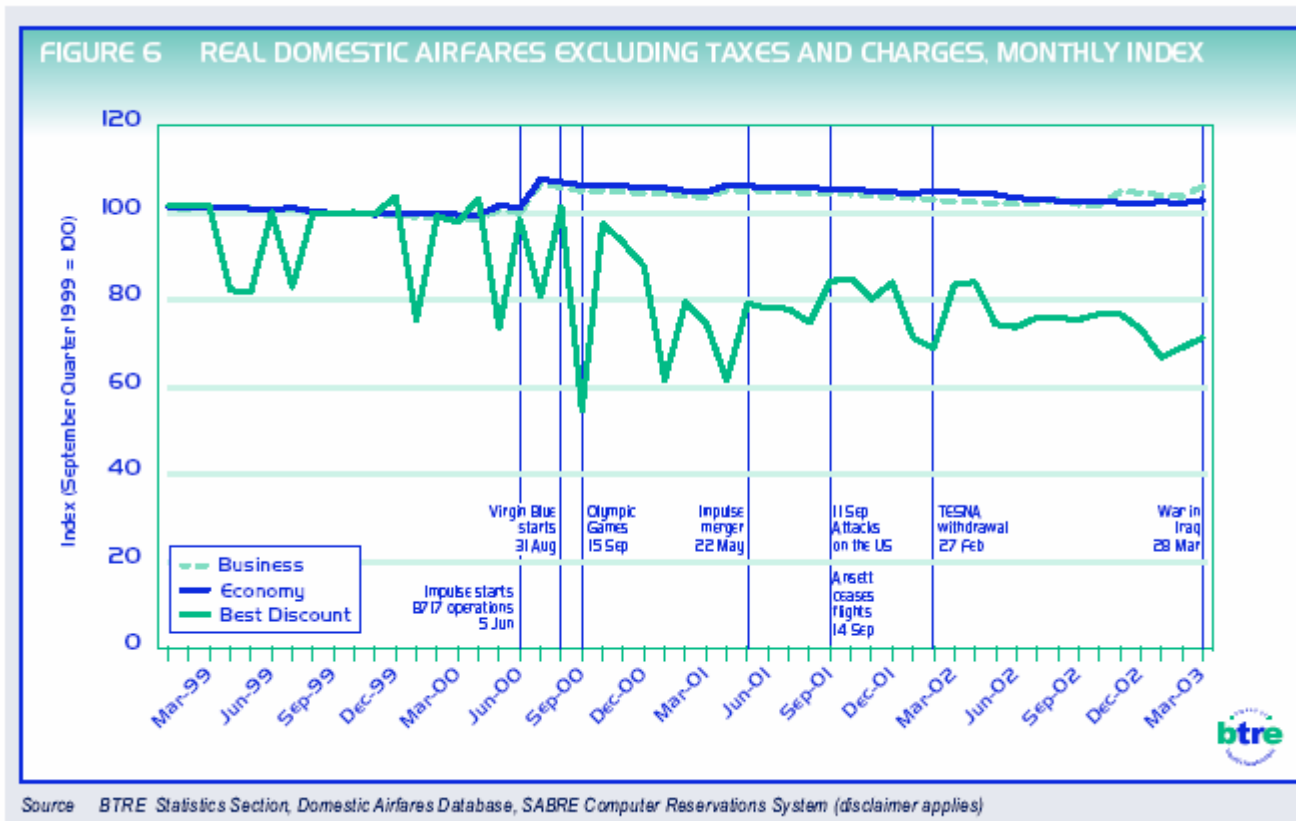
Conclusions

- **The world has changed (again)**
- **Air NZ is positioned better than most to prosper**
 - well to well down the path of creating more value
 - ⇒ Freedom
 - ⇒ Domestic Express
 - ⇒ Tasman Express
 - also has strong continuing network/connectivity capabilities
- **VBA entry will grow total market and create opportunities for Air NZ products**
- **Virgin Blue will be a manageable competitor**
- **For NZ public-max benefit from continuing competition and innovation it brings**





Australian Market Developments



1992 to 2002 Australian domestic:

- discount fares down 18%
- fully flexible full economy fares up 9%
- business fares up 34.5%



New Zealand Airfares

