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Rethink on trans-Tasman consolidation needed

Andrew Miller | April 03, 2009

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IF the alarm bells aren't already ringing in Canberra, they should be -- and loudly. In case it had escaped anyone's attention in the global financial crisis, the aviation industry is in trouble again.

Through no real fault of its own, the sector that we often take for granted is retreating under pressure from increasing losses (\$4.7 billion by the latest count) and a transnational collapse in premium and freight traffic.

For the capital and risk-intensive aviation industry, the current environment is anathema. Cash flows are drying up, access to capital markets is becoming harder and things are unlikely to improve until at least 2011 if recent projections are close to the mark. Australia is bearing up better than most, but there are disturbing signs of fragility. Qantas, still relatively robust by global standards, experienced a 68 per cent profit slump in the first half and is carving up its management ranks in response.

The outcome was even less sanguine for Virgin Blue, which suffered a \$101 million loss as its share price fell to a fraction of the float value six years ago.

Further evidence of the toxic operating environment emerged in Queensland with the state's largest regional carrier, Macair, being wound up with the loss of 180 jobs, followed by the collapse of another operator, SkyAirWorld, burdened by \$40 million in debt.

The repercussions raise issues for state and federal governments. Aside from providing key services, airlines play a key role as substantial employers and tourism growth drivers.

As such, the demise of one (or more) operators carries with it a considerable social and political cost. This was demonstrated with some clarity by the loss of Ansett in 2001 and its impact on employees and regional communities.

There can be little doubt that the pressures on Australian airlines will intensify over the next 12 months, and not just from the market situation.

Emirates and other airlines from the Middle East -- one of the few regions enjoying relative stability -- are growing their presence in the local market at a rate of 30 per cent annually at the expense of Qantas, in particular.

Virgin Blue's financial position is compromised by commercial developments, most notably the substantial cost implications of the launch into an unwelcoming market of its first long-haul brand, V Australia, on services to the US.

The airline's capital raising options also appear limited, given its weak share price and shareholder base.

One overseas solution to the prevailing crisis has been to seek safety in numbers through consolidation. In Europe, the US, and parts of Asia (mostly India and China), a number of operators are banding together to form more resilient units capable of riding out the financial storm.

In Australia, this is not a feasible option because of competition legislation. The frustrated efforts of Qantas and Air New Zealand to rebuild their partnership underscored the difficulties in negotiating regulatory hurdles.

Globalisation, it appears, is desirable from a government perspective for market liberalisation but not in the context of sensible industry consolidation.

Despite that, trans-Tasman consolidation remains a logical development for an industry requiring greater competitive ballast to counter the challenge of weakening markets and increasing aggression from foreign operators.

Mid-hemisphere operators such as Emirates and Etihad Airways will always hold an advantage over Qantas, Virgin Blue and other end-hemisphere carriers, largely because of their base in geographic hubs at the nexus between major markets, integrated government support and a strong product offering.

While Qantas is unlikely to pursue the Air New Zealand path again, it is possible that Virgin Blue may consider such an alliance at some stage given its involvement in the Australian, New Zealand and Pacific markets.

Depending on the circumstances, it is not beyond the realms of possibility that a relationship of this kind would also include a third party. After all, Air New Zealand, Singapore Airlines and Ansett entered into a three-way partnership in 1998 -- one that received the blessing of the competition regulators at that time, but never really developed fully and finally expired with Ansett's collapse in 2001-02.

The acid test for governments, the Australian Competition and Consumer Commission and New Zealand regulatory bodies is whether they would contemplate approving a resurrected version of the Air New Zealand-SIA-Ansett alliance with, say, Virgin Blue as the Australian partner.

Given the competitive implications there must be some doubt under the present policy parameters, even though such a triumvirate of airlines would provide an effective counter-balance to the Qantas-British Airways joint services arrangement and the Middle East carriers. It is interesting timing that the Qantas-BA joint services agreement, which has been extremely valuable to both airlines, is up for renewal by the ACCC in the middle of this year.

The commission has shown with its recent concerns over the Qantas-Japan Airlines partnership and Qantas-South African Airways codeshare arrangement that it is uncomfortable with alliances in markets monopolised by the two airlines involved.

However, the implications for government are more complex, especially if the survival of one of the prospective partner airlines is at stake.

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