

Transport & Tourism Sectors

Closing in on a Tasman Bubble

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The likelihood of a trans-Tasman bubble has increased materially in recent days as the New Zealand Government appears to be responding to heightened political pressure to ease restrictions. A bubble could conceivably open by mid-April at the earliest providing welcome relief to airlines, airports and tourism operators on both sides of the Tasman. Airports have the biggest leverage to the Tasman, and therefore will likely be the biggest beneficiaries. We're NEUTRAL on all three aviation and tourism players under our coverage: Auckland Airport (AIA), Air New Zealand (AIR) and Tourism Holdings (THL), recognising that sentiment will continue to over-ride fundamentals until a clear picture of the demand recovery profile evolves.

Timing and demand

It will take 3-4 weeks for airlines to prepare for a restart of the Tasman once the protocols dictating a bubble are confirmed. This timing reflects the need to (1) ensure aircraft are flight ready, having been mothballed for much of the past year, (2) allow airlines to prepare schedules and sell tickets, and (3) prepare crew rosters.

We expect the 'visiting friends and family' cohort will provide an initial boost from pent-up demand for the Tasman. However, we believe passenger numbers will ultimately be lower than pre COVID-19 levels despite available capacity by airlines because: (1) There will be no connecting traffic. Pre COVID-19 demand for Tasman travel included passengers connecting in both Australia and New Zealand. Connecting traffic represented ~30% of pre COVID-19 pax on the Tasman. (2) Consumers may be wary of travelling given the added risk of 'getting caught' in Australia or vice-versa if the bubble was to temporarily close. (3) Additional hurdles (pre-departure testing etc) to travel will add to cost and hassle of travelling. (4) Immune compromised or other higher risk groups may be reluctant to travel. (5) Business travel budgets have been cut. (6) While Kiwis and Australians 'have nowhere else to' go on holiday, the prospect of broader border openings in late 2021 or 2022 means the end is in sight.

Auckland Airport (AIA) is the biggest winner

The Tasman represented ~41% of total international pax (including transit) at AIA in FY19, but excluding connections, pure-Tasman pax represents ~30%. The high incremental margin of aeronautical and commercial activities at airports means a meaningful uplift in pax will drive a significant improvement in profitability. AIA is currently losing ~NZ\$4m per month at the NPAT line. We estimate this could swing by up to ~NZ\$20m per month into profit generation under a full demand Tasman scenario, driven by retail and aeronautical income.

Air New Zealand's (AIR) NAV dilution partly mitigated

We estimate that AIR's cash burn could reduce by up to ~NZ\$30m per month excluding any ongoing benefit from working capital (forward bookings) and potentially halve P&L losses, assuming pre COVID-19 Tasman demand and yields. We expect cash burn will continue (down from 2H21 guidance of NZ\$45m-NZ\$55m per month to perhaps NZ\$15m-NZ\$25m per month). However, the rate of cash burn would deteriorate in 1H22 given the end of government's PAYE deferral scheme from October 2021. P&L losses would continue but the rate of net asset value (NAV) dilution would halve (from ~3c per month through 2H21), providing some balance sheet support ahead of the upcoming capital raise.

Tourism Holdings (THL) least leveraged

The seasonal nature and historic reliance on long haul demand for RV rentals means THL has less to gain from a trans-Tasman bubble, when compared with AIA and AIR. Nonetheless, we expect its demand to increase and help partially offset 2H21 losses and further NAV dilution. We'd expect THL to increase its Tasman demand profile compared to pre COVID-19 in the event of a bubble given available capacity, more attractive pricing and its dynamic, commercially minded, sales approach.

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