

Industry insights

Westpac

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Tourism, hospitality and recreation

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Summary

Tourism, Hospitality and Recreation faces unprecedented opportunities and challenges. The mood among businesses we spoke to was overwhelmingly buoyant, but some sub-sectors are being forced to reinvent themselves.

New Zealand's tourism performance has been driven by demand from China, softness in Australia discouraging travel further afield, new airline capacity and routes as oil prices plummet, a weaker New Zealand dollar, and New Zealand's reputation as a safe haven. But businesses catering mostly for the New Zealand market, such as the performing arts, museums and sports venues are finding the going tougher.

This report summarises the recent performance of the Tourism, Hospitality and Recreation sector, considers its risks and opportunities and its resultant outlook. The outlook is based on analysis of key indicators for the sector and its sub-sectors, as well as in-depth interviews with industry leaders. This ensures a match between the numbers and the reality of real-world operations.

The sector's vital role

In 2015, tourism became New Zealand's largest export earner as visitor numbers set records and dairy prices fell. The wider Tourism, Hospitality and Recreation sector, the subject of this report, employed nearly 204,000 full-time equivalent workers (FTEs) in 2014, or one in 11 workers. It contributed \$11.0 billion, or 4.8%, to New Zealand's GDP.

The sector covers tourism services like air travel, travel agencies and accommodation, but also includes hospitality and recreation services consumed by local residents, such as food and beverage services, sports venues, gyms, museums, the performing arts, and regional parks.

Tourism, Hospitality and Recreation provides a large number of jobs for those with fewer qualifications, including tens of thousands of part-time jobs. Many of these are students working toward other qualifications, or new entrants to the workforce.

Highlights

Airlines are rapidly adding capacity onto New Zealand routes as operating costs fall. **Airports** are partnering with airlines to ensure route viability, and passenger numbers through airports are soaring.

Demand for **Accommodation** in the main hotel cities has driven higher occupancy rates and prices that are encouraging domestic travel to other parts of New Zealand, like the Bay of Plenty or the top of the South Island.

The **Food and beverage** sub-sector has added 31,000 FTEs since 2000, with growth led by takeaways. The **Fitness industry** is growing, but faces increased competition from lower cost models, and demand for localised services.

Lowlights

Increasing use of online booking services for hotels and transport, and more free independent travel are massively challenging the role of traditional **Travel agencies and tour operators**.

Performing arts, museums and live sports venues are losing the battle against outdoor-oriented activities that play to New Zealand's natural advantages. After strong growth, **Cinemas** face a plethora of online content competitors that are making the operating environment harder. **Betting agencies** similarly face increased competition from online providers, placing this sub-sector next most at risk after travel agencies and tour operators.

Outlook and what this means for New Zealand

- **Headline growth:** We forecast continued strength in services exports for the next 15 to 18 months. The biggest risk is that China's current economic travails could flow over into reduced demand from East Asia.
- **Air travel:** We expect airfares to fall further and more routes to be added as oil prices remain subdued. There will be casualties on some routes, particularly Trans-Tasman, where the number of operators may be unsustainable.
- **Accommodation:** The shortage of beds will remain for several years. Revenue per available room will rise while the shoulder season will continue to expand.
- **Food and beverage services:** Strong growth will be tempered by the difficulty in attracting and retaining good staff, disruptive technology, and security of tenure.
- **Travel, tour and vehicle rental services:** Travel agencies and tour operators will need to re-invent themselves through consolidation, and promotion of new and unique destinations and products. Vehicle rental businesses will need to be creative in managing capacity across the year.
- **Art, culture and recreation:** Only businesses offering outdoor oriented activities, and indoor activities with strong links to New Zealand's culture, history and national pride will succeed.
- **Sports and gaming:** Further declines in attendances at sports events are likely unless the gap between the cost of watching at home and watching at a stadium narrows. We further expect more rationalisation of the number of betting agencies and a greater focus on in-game sports betting.

David Norman
Industry Economist

Introducing the sector

- The Tourism, Hospitality and Recreation sector employs more than 200,000 workers and generates 4.8% of New Zealand's GDP.
- It provides a large number of part-time and lower-skilled jobs, fulfilling a vital role for those working while they study or first entering the workforce.
- The sector has widespread geographic reach as it is based primarily where New Zealanders live. Notable exceptions being our large tourism destinations of Queenstown-Lakes and Rotorua.
- Growth over the last 14 years has been strong, and we expect more recent data, when available, will show more further increases thanks to the current tourism boom.

The Tourism, Hospitality and Recreation sector employed nearly 204,000 full-time equivalent workers (FTEs) across New Zealand in 2014, or one in 11 workers.¹ It generated \$11.0 billion in value, or 4.8% of New Zealand's GDP.²

For the purposes of this study, Tourism, Hospitality and Recreation is divided into six sub-sectors:

- **Air travel**, which includes New Zealand-based airlines and airports.
- **Accommodation**, which includes everything from caravan parks to top-end hotels.
- **Food and beverage services**, which includes everything from fine dining to fast food franchises, pubs and clubs.

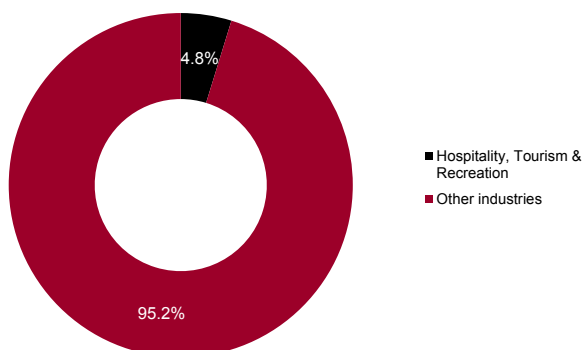
- **Travel, tour and vehicle rental services**, which include travel agencies, tour operators and vehicle rental companies.
- **Arts, culture and recreation**, which includes services such as museums and art galleries, zoos, amusement parks, botanical gardens, reserves and regional parks, theatres, and performing arts production companies.
- **Sports and gaming**, which includes gyms, sports stadiums, betting agencies, and casinos.

In terms of value added to the New Zealand economy, Food and beverage services is the largest sub-sector, generating \$3.4 billion in 2014. Sports and gaming is next largest, with \$2.4 billion. Our analysis shows that the huge role of Food and beverage services in value added is primarily due to the sheer number of businesses in the sub-sector, at more than 15,000. These Food and beverage businesses employ almost 109,000 FTEs, well over half of the sector's workers.

On the other hand, Sports and gaming has a far smaller share of businesses (16%) and employment (12%), but employs large amounts of built infrastructure – stadiums and the like – to deliver its services. The returns required on this capital investment mean that successful businesses in this sub-sector generate far more value than would be required for a Food and beverage services business, for instance.

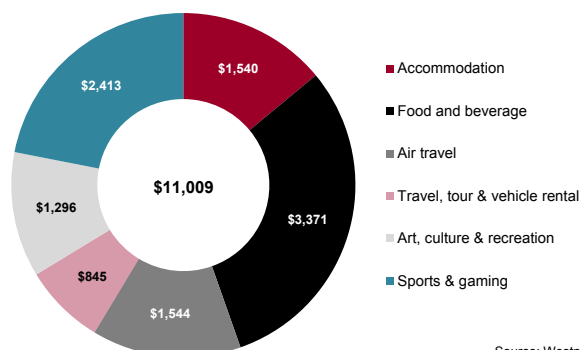
Air travel, with its small number of businesses (1.7% of all Tourism, Hospitality and Recreation businesses), employed nearly 18,000 FTEs (6.2%), and generated \$1.5 billion in value (14.0%) in 2014. As with Sports and gaming, large amounts of infrastructure ensure that to succeed, businesses have to generate considerable economic profits per worker, which explains the disparity between the share of Tourism, Hospitality and Recreation businesses, employment and value added by Air travel.

Tourism, Hospitality & Recreation value added, 2015\$m



Source: Westpac

Tourism, Hospitality & Recreation value added, 2015\$m

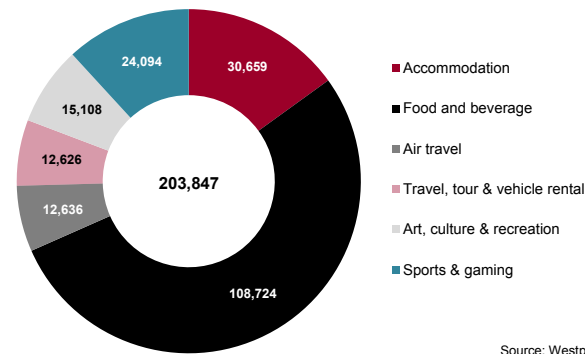


Source: Westpac

¹ We define Tourism, Hospitality and Recreation using Statistics New Zealand classification codes. We include all of Division H and Division R. We also include air travel and airports, sightseeing transport businesses, motion picture exhibition, vehicle rental services, and travel agency and tour arrangement services.

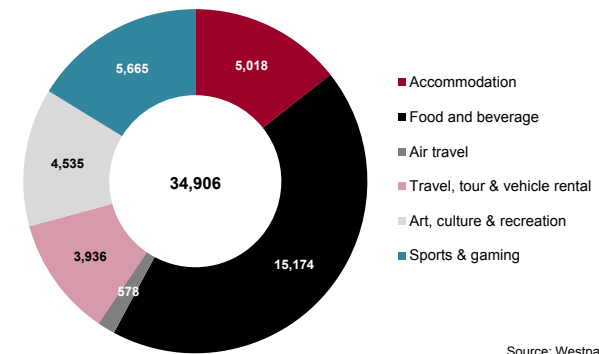
² New Zealand GDP and the constituent value added by specific sectors or sub-sectors consist predominantly of pre-tax and depreciation profits (economic profits) and salaries and wages. All GDP and value added figures in this report are in 2015 dollars.

Tourism, Hospitality & Recreation employment (FTEs)



Source: Westpac

Tourism, Hospitality & Recreation front doors



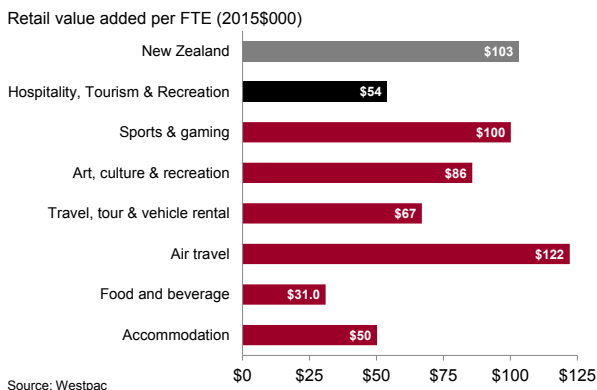
Source: Westpac

Accommodating part-time workers

Tourism, Hospitality and Recreation businesses are generally characterised by lower average value added (mostly profits and salaries) per worker than New Zealand workers overall. The sector plays a vital role in providing thousands of jobs for workers with fewer qualifications in frontline roles, such as hotel staff and wait staff.

Many of these workers may be students working part-time, or people on working holiday programmes. Our analysis suggests that much higher proportions of part-time employees work in Accommodation, and Food and beverage services than in most other industries in New Zealand. Food and beverage services, at just \$31,000 per FTE, has one of the lowest contributions to value added per worker in New Zealand. Although using FTEs rather than employees or workers for these calculations is a better measure, this particularly low value add per FTE may in part be explained by measurement difficulties.³

The latest estimate, of around \$54,000 in value added per FTE in the sector overall, is a little over half the average for the New Zealand economy as a whole.



Source: Westpac

The Air travel sub-sector has the highest value added per worker, at \$122,000, followed by Sports and gaming; and Art, culture and recreation.

Accommodation services has the second lowest value added per worker, at around \$50,000. Some of the characteristics of the

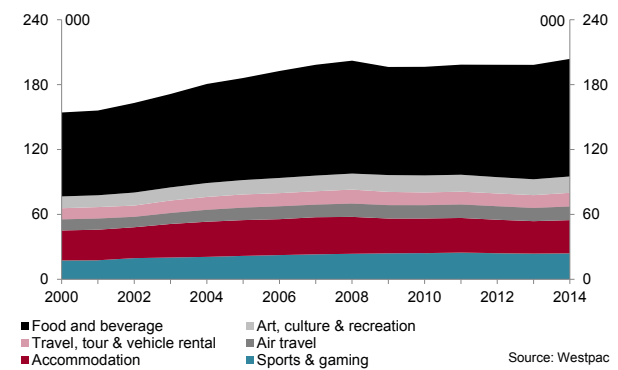
Food and beverage sub-sector apply here as well – a large number of lower skilled part-time workers.

Serving up employment growth

Employment in Tourism, Hospitality and Recreation grew 32% in the 14 years to 2014, or 2.0% a year, which is an impressive sustained growth rate. The solid growth was led by Food and beverage services. Already the largest sub-sector in 2000, it added a further 31,000 FTEs over the next 14 years, equivalent to 2.4% growth a year.

Other sub-sectors with strong employment growth included Art, culture and recreation; and Sports and gaming, which each also grew at more than 2.0% a year, albeit off a much lower base.

Tourism, Hospitality & Recreation employment growth (FTEs), 2000 to 2014



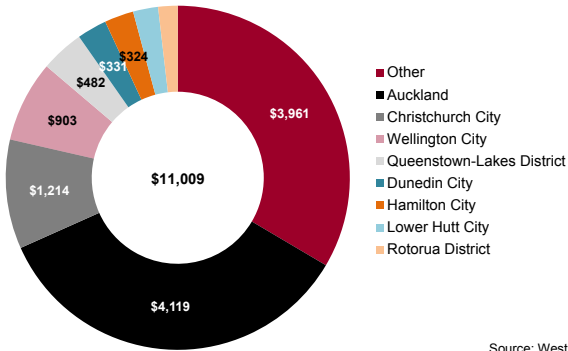
Source: Westpac

The pattern of growth in Food and beverage services, Accommodation, and the wider Tourism, Hospitality and Recreation sector as a whole are closely aligned. For instance, employment in Accommodation peaked in the year to February 2007. In the following six years, the sub-sector lost 4,000 FTEs, but has since seen a return to growth. Overall, however, Accommodation employment is up 11% over 14 years.

At the aggregate level, Tourism, Hospitality and Recreation employment recovered to surpass 2007 levels for the first time in 2014.

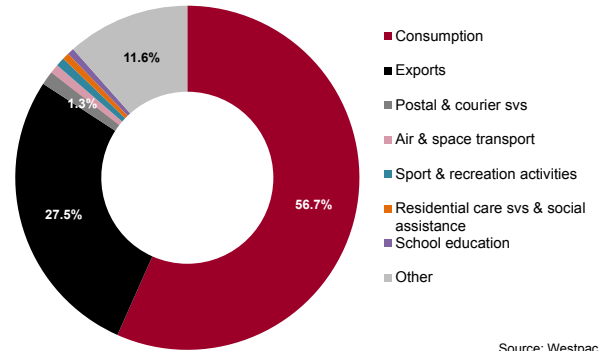
³ Food and beverage services are characterised by large numbers of part-time workers. FTE calculations count each part-time worker as half an FTE, and each full-time worker as one FTE. But it is possible that in Food and beverage services, three, four or even five part-time workers might each work six to 10 hours a week while studying. Four part-timers would equate to two FTEs, but may in total only do 40 hours' work a week (the equivalent of one actual full-time worker). This may inflate the FTE measure for Food and beverage services, meaning a lower value added per worker.

Tourism, Hospitality & Recreation value added, geographic distribution



Source: Westpac

Where outputs go



Source: Westpac

People to meet, places to go

Highlighting the fact that local residents are major consumers of Tourism, Hospitality and Recreation services, most of the cities and districts with the largest shares of value added by the sector are New Zealand's largest urban centres.

However, there are some significant exceptions. The Queenstown-Lakes district, New Zealand's premier tourism destination, has the fourth largest share of Tourism, Hospitality and Recreation value added, despite a resident population estimated at just 32,400 in 2015. The bulk of Tourism, Hospitality and Recreation services in this district are consumed by international and New Zealand visitors, rather than local residents.

Similarly, Rotorua District is the eighth largest by contribution to Tourism, Hospitality and Recreation value added, emphasising the role of tourism in that district.

Auckland nevertheless plays by far the largest role in the Tourism, Hospitality and Recreation sector, with its large population of almost 1.6 million, as the main gateway into New Zealand, the headquarters of Air New Zealand and several other major tourism-related businesses.

Where outputs go

National input-output tables allow us to examine which industries are major suppliers to the Tourism, Hospitality and Recreation sector, and where the outputs of the sector go. This helps clarify how closely the fortunes of certain industries are linked to Tourism, Hospitality and Recreation. In this section we consider where the outputs from the entire Tourism, Hospitality and Recreation sector go, while the source of inputs is examined for each individual sub-sector within the relevant sub-sector chapters.

Tourism, Hospitality and Recreation outputs are, unsurprisingly, mostly consumed directly by households in New Zealand. Given the role of tourism within the sector, a large proportion of outputs (28%) is exported, in the form of services to overseas tourists visiting New Zealand. The share of production that is exported differs quite widely across sub-sectors, from just 6.8% of Food and beverage services output, to 42% of Accommodation services output.

This implies that the overall success of the Tourism, Hospitality and Recreation sector is tied strongly to the health of the domestic economy, and to a lesser extent, to what happens internationally. But for certain sub-sectors such as Accommodation services; and Travel, tour and vehicle rental services, the relationship is fundamentally tied to tourism, and therefore, the attractiveness of New Zealand as a destination within the wider fortunes of the global economy.



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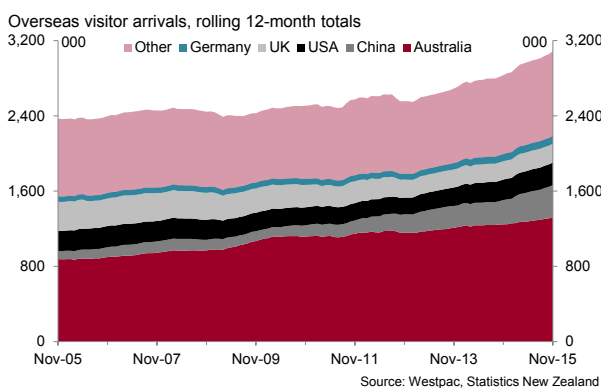
A healthy appetite for New Zealand?

- New Zealand has seen particularly strong growth in international visitor numbers over the last three years, including 9% growth in 2015.
- Growth in visitor arrivals in recent years has been driven by a number of factors including continued strength in demand from China, softness in Australia discouraging travel further afield, masses of new capacity and air routes as oil prices plummet, a weaker New Zealand dollar, and the perception of New Zealand as a safe haven.
- We forecast continued strength in services exports, including tourism, for the next 15 to 18 months.
- The biggest risk identified is that China's current economic travails could flow over into reduced demand from East Asia, or at least reduced growth in tourism activity. Even with China's growing importance in New Zealand tourism, this impact will likely be limited.

The Ministry of Business, Innovation and Employment (MBIE) publishes an annual tourism forecast. Its 2015 edition has a central growth scenario of 4% per annum growth in overseas visitors to 2021, with spending by international visitors to grow even faster, at 5.8% a year.

And if you look at just the 2015 growth figures, these estimates don't look unrealistic. Total visitor arrivals in the year to November 2015 were up 9%, including 34% growth from China, 9.6% from the United States, and 8.1% from Germany. Even Australia, already our largest source market, saw growth of 5.7%.

Longer term trends are also positive. Over the last three years, arrivals are up 21%, or 6.5% a year. Visitors from China have grown 21% a year over the three years, and 10% from Germany and the United States. Australia has grown 4.4% a year.



What's the big rush?

The question is what has been driving growth in overseas arrivals in New Zealand over the last couple of years, and whether these conditions are likely to change.

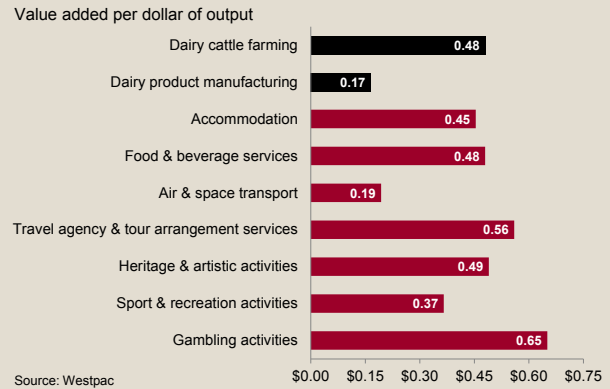
Industry sources suggested a number of reasons, some of which are long-running, and others a little newer:

- **International economic conditions:** Recent years have seen continued growth of the Chinese middle-class, a rebound in the United States and United Kingdom economies, and tepid Australian growth that has discouraged Australians from travelling further afield. An industry source estimated that travel demand grew at between 1.25 and 1.50 times real GDP growth as a rule of thumb. At a global level, this fits quite well, but does also indicate that to some extent New Zealand is flavour of the month, enjoying faster inbound tourism growth than world GDP growth would suggest.
- **How visitors from China travel:** There has been somewhat of a revolution in how Chinese travellers visit New Zealand. Not only are numbers surging, but visitors are staying longer. Whereas New Zealand used to be part of an Australasian trip mostly featuring Australia, Chinese visitors are now spending around 18 days in New Zealand, according to MBIE estimates.
- **Cheaper oil, cheaper flights, greater capacity:** Perhaps explaining some of the gap between the 1.5 times rule and actual tourism growth, the 75% decline in oil prices over two years has reduced the cost of providing air travel services. Some airlines have used this opportunity to return to profit, but many have upped their capacity and routes served, including to New Zealand. The greater choice, and lower prices, is spurring travel growth around the world.
- **A weaker New Zealand dollar:** A depreciation since the heights of July 2014 have made New Zealand a more affordable destination. This doesn't explain the solid growth seen in the 18 months prior, however, when the New Zealand dollar was at record highs.
- **A bucket list destination:** Some industry sources felt that New Zealand was viewed by many, especially in the North American market, as a far-flung, somewhat exotic place, and was more sheltered from price sensitivities.
- **A resurgent export education sector:** Growth in export education, particularly in the Indian market, is reminiscent of massive rises in Chinese students in the early 2000s. As family members come to visit students, this also bolsters arrivals.
- **A safe haven:** Many industry sources suggested that New Zealand is seen as a safe place to visit. Those with links to Europe indicated that demand for travel to those destinations, especially out of East Asia, had collapsed in light of the Paris terrorist attacks and refugee crisis across Western Europe. How long this view of travel to Europe will last is uncertain; tourism has shown remarkable resilience to these types of events in recent years, often rebounding within a year to 18 months.

Travellers versus tractors

Some have suggested that the strong outlook for tourism will counter the recent hit to the dairy sector. There is no doubt that the improvement in tourism is helping to offset the gaping hole left by the declining value of dairy exports, but a view that we're all square in net terms is a bit simplistic. We consider a number of factors that affect the net benefit to New Zealand below:

- **Magnitude of the offset:** While impressive, tourism's revenue growth as measured by Statistics New Zealand had not quite offset dairy's decline by September 2015. Dairy export revenues declined by \$4 billion in the September 2015 year compared to a year earlier. In this time, tourism revenues rose \$2.6 billion, or \$3.0 billion if education travel (people visiting to study) is included. Annual data for December, due in early March 2016, may well show this gap closing even further.
- **Value added to output ratios:** Even if revenues earned by the two industries rise and fall by equal amounts, this does not mean value added to the economy remains stable. Input-output analysis indicates that value added to output generated ratios vary widely across sub-sectors of Dairy and Tourism, Hospitality and Recreation. The net direct growth or loss to the economy from tourism and dairy will be determined by the relative growth rates of the sub-sectors in the graph.
- **Multiplier impacts:** The extent to which an industry depends on a number of upstream (supplier) industries, what workers earn, and how they spend their earnings in their own personal capacity (downstream effects) also affect how revenue gains or declines in different industries affect New Zealand overall.
- **GDP v GNI:** The most common metric of economic growth is gross domestic product (GDP). What GDP measures fail to

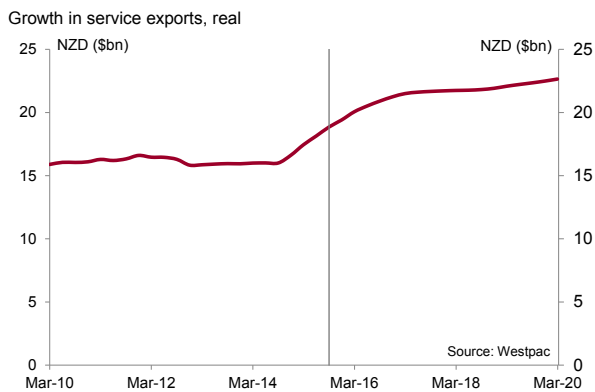


account for, however, is where a business is owned, and therefore the likelihood of profits staying in New Zealand. The dairy sector is overwhelmingly New Zealand owned, meaning any profits (or losses) remain in New Zealand. In contrast, many tourism businesses operating in New Zealand, particularly in accommodation and air travel, are overseas owned, which means profit is likely to be repatriated, reducing the economic benefits, and specifically gross national income here.

- **Geographic winners and losers:** New Zealand's dairy regions, with a few exceptions, are not our major tourist destinations. Thus while at a national level, dollars of revenue earned by tourism may appear to offset dairy losses, the structural changes at a regional level carry economic costs of their own. Dairy farmers in far-flung, hard to reach areas don't become tourism operators overnight, and then switch back if the returns to dairy improve. The scale of the changes in dairy and tourism thus create structural challenges including capacity constraints in booming tourism areas, and large falls in the value of land used for dairying in other parts of the country.

The big picture for tourism growth

Westpac forecasts growth in service exports, a large proportion of which is travel for tourism, work and education purposes. Our latest forecasts are for continued growth over the next 18 months.

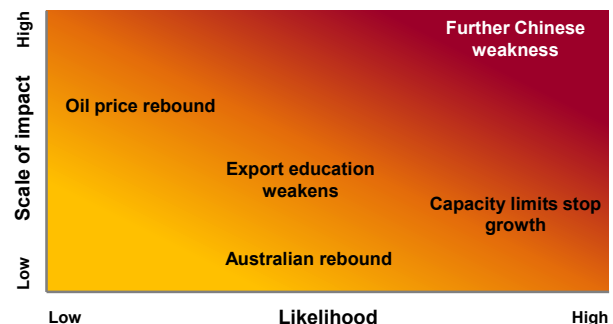


Between 2010 and 2014, growth in service exports was flat, but since then, there has been a sharp pick-up. The September 2015 annual

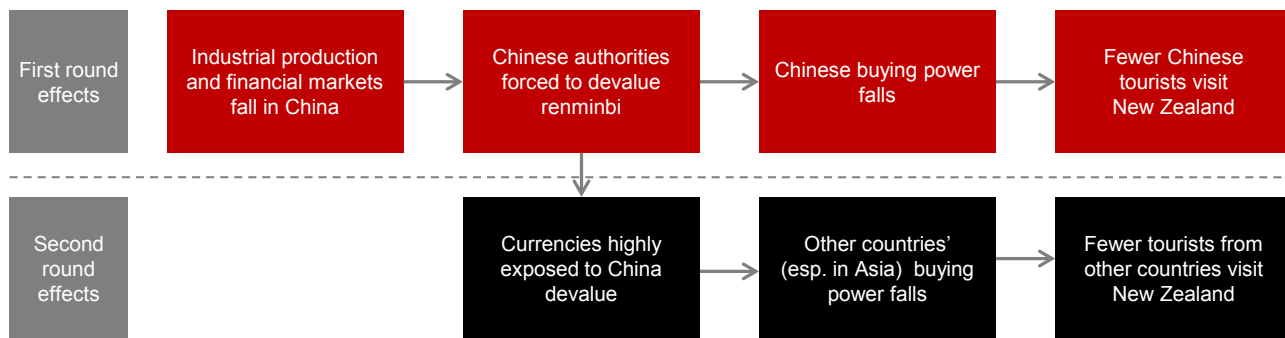
export figure was up 18% over a year earlier. Our discussions with industry sources on bookings for the year ahead and our own take on the state of China, Australia and other factors impacting tourism here point to strong growth in export services to at least March 2017.

What could go wrong?

Given this overwhelmingly rosy picture of tourism growth, we must ask how sustainable these patterns are. We briefly consider a number of risks here.



What China's woes could mean for tourism



- **Continued economic woe in China:** China's financial markets have taken a beating in recent months and industrial production has slumped. The official growth rate in that country for 2015 was 6.9% although some suspect the figure may in reality be far lower.
Businesses in China's manufacturing industry are being hit hard. That means fewer factory workers (possibly not earning enough to travel overseas) and managers (who were). More concerning though, is that China, as a result of an artificially pegged currency, is burning through foreign reserves when the true value of its currency is now lower than its pegged value. Many believe the country will soon have to devalue the renminbi. This will weaken the buying power of Chinese consumers, and may pull down other East Asian currencies that are tightly linked to trade with China. This in turn will reduce these countries' discretionary income to be spent on travel.
This risk is real, but it is important to remember that although China is our second largest source of visitors after Australia, it is still only a quarter the size of the Australian market. Nevertheless, even a small impact (say 10%) on demand from our second-largest tourism market could knock 1.3% off annual tourists, just by impacting Chinese demand, with second round effects reducing visits from other, particularly Asian, economies as well.
- **Australian rebound – a two-edged sword:** A strong turnaround in Australia is looking less likely as hard commodity prices continue to languish, a fact that continues to underpin weak emigration from New Zealand to Australia. However, should the country experience improving fortunes relative to New Zealand, with a falling unemployment rate, the impact on New Zealand tourism is uncertain. While it should benefit New Zealand, it can also have the effect of encouraging more Australians to travel further afield, say to Europe, Asia or the US, rather than to New Zealand. This would be the opposite impact of that seen during the GFC, when annual tourists from Australia to New Zealand topped one million for the first time.
The net impact of an improvement in Australia's relative economic performance is unlikely to be a large downturn in visits to New Zealand. Our view is that it is more likely to boost

the total number of Australians visiting New Zealand, even as demand for visits to other parts of the world grows for Australians.

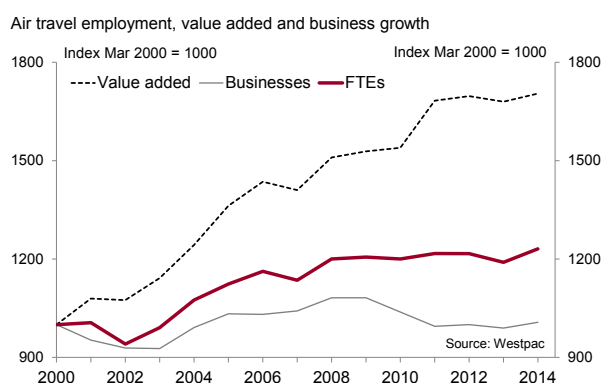
- **An oil price rebound:** An oil price rebound would see many of the new routes introduced in recent months across the world, including to and from New Zealand, become quickly unprofitable. We see this outcome as unlikely. Our forecasts are for oil to remain below US\$40 a barrel until the end of 2017.
- **Capacity constraints make us too expensive:** Another possibility is that as oil prices stay down, the price mechanism acts to stem growth in demand. As this report discusses in depth in the Accommodation section, New Zealand's major hotel cities are suffering a severe lack of capacity, boosting prices. As occupancy rates near 100% in the high season, more visitors are choosing to come in the shoulder season, but eventually, prices will rise so that new growth is limited, without new capacity being added. This is a significant risk that already appears to be playing out in Auckland and Queenstown in particular. This is unlikely to burst the tourism bubble, but will limit growth.
- **A collapse in export education:** New Zealand has previously seen a boom in the Chinese student market, only to see it burst a few years later, and student numbers collapse. India is the new China for export education. As India's wealth grows students may increasingly look to study in Australia, the United States or United Kingdom. We may see a fall in Indian student numbers in three to five years, and a commensurate decline in associated tourism visits by family. This risk is modest, and the overall impact is likely to be limited as India remains a relatively small source of visitors.
- **A catastrophic event:** These types of events are, by their very nature, all but impossible to forecast. A terrorist attack in New Zealand, earthquakes as experienced in Canterbury, or the outbreak of a disease easily transmitted through travel are examples. The impact of such an event will be determined entirely by the circumstances, how widespread it is, and how long it lasts.

Air travel

- The Air travel sub-sector has seen strong growth in value added across New Zealand over the last 14 years.
- Airlines are adding enormous amounts of new capacity onto New Zealand routes as oil prices have plummeted making more routes feasible, and where fleet configuration and delivery of new aircraft allows for expansion.
- This is increasing choice for consumers and plays a large part in the outcome that New Zealand's higher end accommodation is bursting at the seams. It will also drive demand on regional routes as domestic tourists are driven out of the major cities by accommodation prices.
- We expect airfares to fall further as competition heats up, and for new routes to continue to develop as oil prices remain subdued for the next several years.
- There will be casualties on some routes, particularly Trans-Tasman, where the number of routes may be unsustainable.

Value added takes off

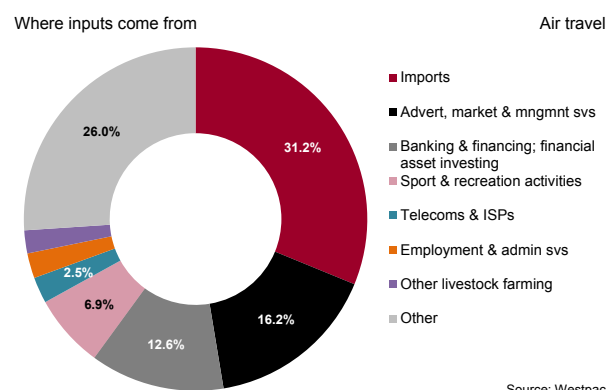
Value added by the Air travel sub-sector, which includes airports and airlines, has grown sharply since 2000, and is up 70% over 14 years, or 3.9% a year. Over this time, employment is up a lot less, at around 23%, which implies a substantial improvement in production per worker of 38% since 2000. At 2.4% a year, this growth in labour productivity is far higher than the rise across all industries in New Zealand.



Particularly interesting was the resilience of Air travel through the Global Financial Crisis. The turn downward was barely noticeable before strong growth returned. As a major new lower-cost entrant began flying in the New Zealand domestic market, overall travel figures grew sharply, and value added by the sector surged.

Where inputs come from

Major costs of operating an airline include the purchase or lease of aircraft, and the import of huge volumes of fuel. As a result, imports account for the largest share of inputs into the sub-sector.



A range of business services play a role in the operation of airlines and airports. These include advertising services, financial services, and with the growth in direct online sale of tickets to the public, telecommunications services.

Plane sailing

A clue as to the fortunes of the Air travel industry in New Zealand in recent years has already been provided by the evaluation of value added and employment growth. Growth in passenger numbers has been commensurate with the strength in these other indicators.

Across New Zealand's four busiest airports, growth particularly in international passenger numbers has been strong in recent years. International passengers (the sum of arrivals and departures, excluding transit passengers) rose 130% in four years at Queenstown Airport and 19% in Auckland. In Christchurch, passenger numbers have bounced back from the fall seen post-earthquakes, passing 1.5 million in the year to September 2015. Wellington growth was strong as well, up 23% in four years.



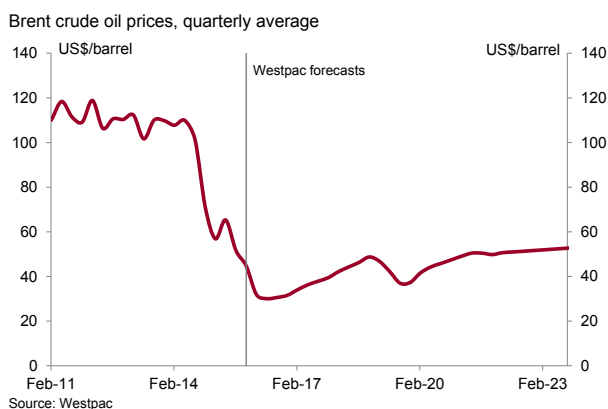
Domestic growth has been solid, but generally not to the same extent as international growth. Queenstown saw an increase of 36% in domestic passenger numbers in the four years to November 2015. Auckland saw growth of 22%, while Christchurch saw an 8% increase. Domestic passenger movements through Wellington also grew 8% since 2011.

This slower growth on domestic routes is in part because a higher proportion of travellers on these routes are local residents, meaning growth is limited by population growth, economic growth, and changes in propensity to travel by New Zealanders. The increase in international travel direct to Queenstown, for instance, rather than through Auckland or Christchurch, has led to growth in international numbers without a commensurate rise in domestic travel.

In response to the strong growth in passenger numbers, airports are undergoing a constant process of infrastructure upgrades. For instance, Queenstown Airport opened a new international terminal in 2015 that doubled its international visitor capacity.

Fleet of foot

Recent months have seen a massive increase in the number of routes, and capacity on routes, in New Zealand and abroad. The ability to respond to market conditions by introducing new capacity depends on two key factors – fleet configuration and aircraft delivery schedule. Some airlines have, through planning or happenstance, had the right type of aircraft delivered just as fuel prices have fallen, allowing them to add capacity at the right time. Other airlines, with a lumpier schedule for the delivery of new aircraft, have not been able to take advantage to the same extent.



Oil prices have plummeted by 70% since the highs of April 2011, with most of the change occurring since June 2014. International Air Travel Association data suggests that fuel accounted for around 30-32% of airline operating costs when oil was well over \$100 a barrel. Despite the massive decline in oil prices, the fall in plane ticket prices has been pedestrian.

Three reasons are posited for this weak pass-through of cost savings:

- **Hedging:** Many airlines have historically hedged against the possibility of higher fuel prices, sometimes up to two years in advance. This means that plummeting fuel prices are passing through more slowly. In addition, airlines that did not foresee the falls in fuel prices and hedged at too high a price are losing out to those that picked lower prices or hedged for shorter periods.
- **Profit-taking:** With the cost to serve falling sharply, many airlines globally are using the opportunity to return to profit, a goal that escapes many airlines, sometimes for years in advance.
- **Capacity growth:** The most obvious change seen in recent months is the explosion in domestic and international routes that airlines are launching across the world. One medium-sized US airline, for instance, used the opportunity afforded by lower fuel prices to launch 42 new routes in one fell swoop. Lower fuel prices make certain routes viable on lower load factors (seat occupancy rates) at the right price point. In New Zealand, the last nine months alone have seen:
 - Air New Zealand introduce three new international routes
 - Jetstar introduce four new regional routes in New Zealand
 - China Southern begin services direct to Christchurch
 - Emirates announce a direct service between Dubai and Auckland, in addition to its three daily services via Australia
 - United Airlines announce flights between Auckland and San Francisco
 - AirAsia X announce a return to New Zealand
 - Singapore Airlines announce a Singapore-Canberra-Wellington route
 - Kiwi Regional Airlines introduce three new regional routes.

The rapid expansion in routes is impressive within an industry in which huge amounts of money are invested when new (particularly international) routes are established. The level of investment required means airlines usually spend months or even years evaluating new destinations.

Over time, this growth in capacity and resultant competition is likely to see stronger reductions in price flow through although at present the decreases have been quite modest.

Is it a bird? The changing role of airports

While much of the discussion in the sector is about airlines, the infrastructure needed to serve passengers and freight is undergoing its own transformation. For several years, airports have been changing their business models. Whereas the focus in the past was simply to be an efficient transport interchange, in the last decade growth has come from development of retail facilities within the airport, and a property portfolio across the wider airport precinct.

We have also begun to see tie-ups between airports across the world, and most notably in New Zealand, Auckland's purchase of shares in Queenstown Airport. As we have seen in the port sector, these tie-ups help to secure traffic for airports, which can now negotiate landing rights and partnerships with airlines across more than one city. Tie-ups also enhance the long-haul proposition of the larger airport in the arrangement.

Airports are also increasingly partnering with airlines, rather than simply providing on-ground services. It is in the best interests of airports to see their airlines succeed, as this provides the certainty of landing fees, and foot traffic through retail facilities that will boost profitability.

The outlook for Air travel

Over the next couple of years we expect a number of trends in Air travel:

- **Oil prices to remain weak:** Westpac forecasts that oil prices are forecast to remain below US\$50 a barrel until 2021. This will improve profitability for New Zealand-based airlines as well as overseas airlines flying to our shores.
- **Ticket prices to fall:** It seems inevitable that the growing capacity on existing routes, and the plethora of new routes

available to travellers in New Zealand and internationally, will push airfares down as competition heats up.

- **Routes and capacity to increase:** We expect to see further growth in capacity and routes as airlines seize the opportunity provided by low oil prices to increase market share where fleet configuration and aircraft delivery allow, and to grow potential new markets. On some routes, this may in fact create over-capacity. For instance, Trans-Tasman routes are now served by Air New Zealand, China Airlines, Emirates, Jetstar, Lan Chile, Philippine Airlines, Qantas, and Virgin Australia, with Singapore Airlines and AirAsia X soon to commence flights.

At the same time, some argue that direct routes from China are still underserved. If economic conditions there improve, we may see greater frequency and new routes develop. Another underserved region is South America, with only Lan Chile flying to Santiago and Air New Zealand to Buenos Aires. We may well see further routes there.

- **More demand for regional routes:** As we point out in the section on Accommodation services, a lack of capacity in major hotel cities is driving hotel prices up, and pushing domestic tourists out. We may see strong growth in regional routes, such as the four Jetstar has already introduced, as propensity to travel outside of the main centres heats up for New Zealanders.
- **There will be casualties:** The number of airlines entering the New Zealand market, and the number of routes being established, many including the dog-leg to New Zealand via Australia, will almost certainly be rationalised over the years to come, even without an oil price bounce.
- **More airport tie-ups:** Where possible, we can expect to see larger airports look for a share in smaller airports, continuing the trend toward spreading risk and enhancing their position and bargaining power across the country.
- **Airports to focus on property and retail businesses:** We expect the big four airports in particular to focus increasingly on their property and retail businesses.

We expect further growth in capacity and routes, and lower ticket prices as oil prices remain weak.

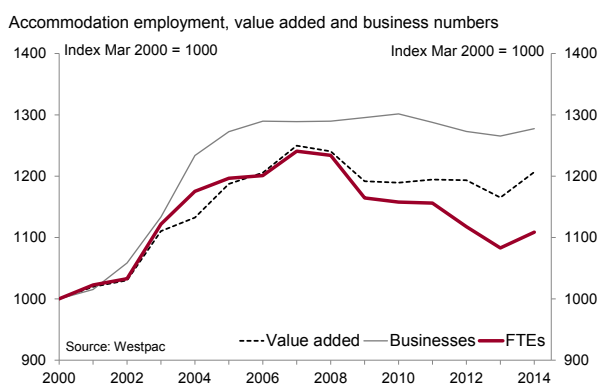


Accommodation

- Strong tourism growth means there is a large shortfall of beds across New Zealand's major hotel and tourism centres. This seems unlikely to be eliminated in the next five years outside of a major reduction in tourism or a huge boost in supply.
- As a result, return on equity for firms in Accommodation has increased. This trend is likely to continue with higher occupancy rates and prices. However, asset revaluations may reduce these yields on paper or for the next owner in the event of sale.
- Demand for higher end accommodation is growing fast as the over-50 demographic becomes an ever-larger proportion of visitors, placing further strain on the hotel sector.
- With occupancy rates approaching 100% in major centres over summer, the shoulder season will continue to expand and regional centres may benefit as domestic tourists are priced out of the major tourism markets.

Bedding in

After strong growth in the number of Accommodation businesses between 2000 and 2005, increases have petered out. Interestingly, this flattening in business numbers growth occurred before the GFC, rather than in response to it although it could be argued that the GFC prevented growth from re-emerging. This lack of growth in the number of Accommodation businesses is something we delve into later.



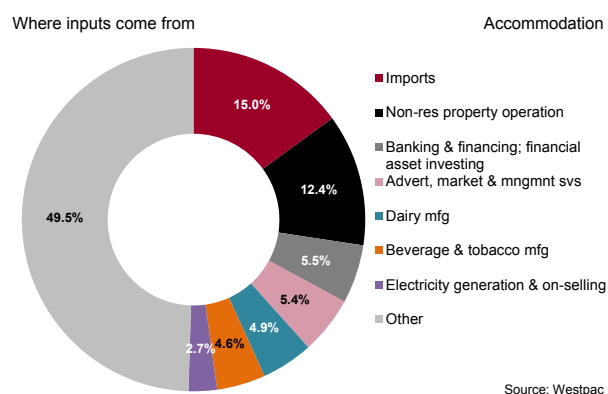
Employment continued to rise until the GFC hit, at which time it fell away sharply, only rebounding in 2014. Initial indications are that employment probably rose again in 2015.⁴ The pattern

for value added has been much in line with employment growth, ticking up in 2014.

The weak overall growth in employment since 2000, coupled with stronger value added implies a productivity gain of around 9% per worker. Growth in business numbers indicates a fall of 5.5% in value added per business as the average business size, measured in employment terms, has fallen.

Where inputs come from

Inputs into the Accommodation sub-sector come from a wide variety of sources. The top eight sources of inputs account for roughly half of all inputs. Some of the major inputs include non-residential property operation; banking and finance services; and advertising services. However, with many Accommodation services also offering food and beverages, dairy manufacturing, and beverage manufacturing are also important input industries.



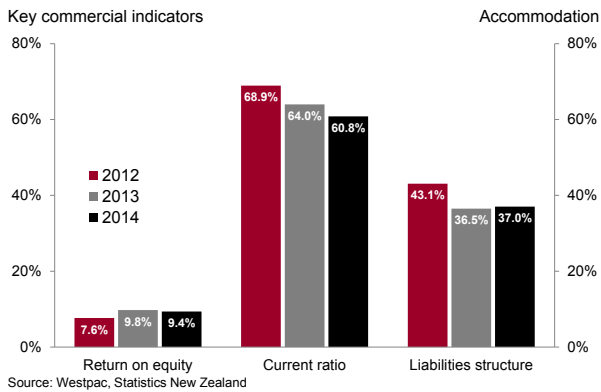
The figures imply that a wide range of service industries in particular benefit strongly from supplying the Accommodation services sub-sector. Their commercial success is tied to the fortunes of the Accommodation sub-sector they serve.

Benchmark indicators

Businesses can monitor their own commercial performance against that of other businesses in their sub-sector by comparing themselves to sub-sector averages. Where possible, this report provides the most recent available information on three key commercial ratios for each sub-sector.

The three indicators are return on equity, current ratio (current assets divided by current liabilities), and liabilities structure (share of total liabilities provided by shareholder or owners' equity).

⁴ Complete data for 2015 is not available as Statistics New Zealand datasets used to derive FTE employment and GDP by industry have not been made public yet.



Returns on equity hovered around 9% for the last two years for which data is available. With occupancy rates and room prices rising, figures for 2015 and 2016 may pass the 10% mark. However, businesses that are revaluing assets based on expected future earnings, or selling on that basis, may well see returns on equity fall in paper terms. Some major recent hotel sales have been made on the basis of expected returns of 7-8%, for instance.

Current ratios over 100% are generally seen as the benchmark. Ratios over 100% imply that the business has more than sufficient current assets to meet its current liabilities. The current ratio in Accommodation services fell to just over 60% in 2014. This low figure is likely skewed by a large number of smaller, less liquid businesses primarily outside the major centres.

The liabilities structure indicates that shareholder equity has fallen from 43% to 37%.

Room to grow capacity

Several industry sources believed a shortage of accommodation was the number one handbrake on growth for the international and domestic tourism markets. The shortage in capacity was allowing strong growth in accommodation prices in major centres, pushing many domestic tourists out of these markets (or at least out of high season) and toward other regional tourism centres.

Over the last three years, New Zealand has seen a return to tourism growth like that of the heady early 2000s. By October 2015, monthly guest nights were averaging over 3 million in seasonally-adjusted terms, compared to around 2.6 million three years earlier.

Growth in guest nights has been across the geographic board. Stand-outs over the last three years have included Southland, Canterbury (partly as tourism recovers from the earthquakes), and

Otago. In the year to October 2015, Southland has seen a 9.6% rise in guest nights, and over three years, guest nights have grown 7.2% a year.

At the same time as guest nights have grown strongly, capacity has not. As a result, occupancy rates in New Zealand are the highest they've been in 11 years. Auckland's occupancy rates of over 70% across all accommodation other than holiday parks is higher than even in October 2011 during the Rugby World Cup. Occupancy rates in Otago, led mostly by the Queenstown-Lakes District, are the highest they have been in the last 20 years.

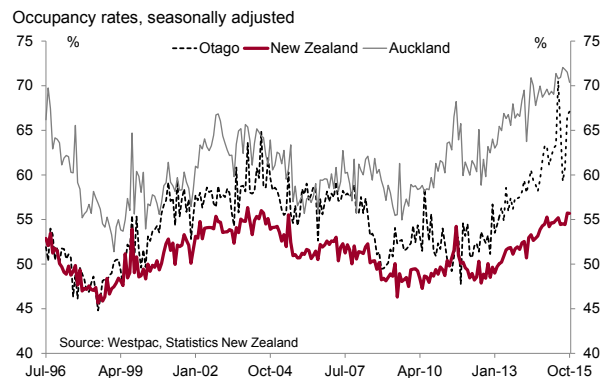
When we consider higher end accommodation – three to five star hotels – occupancy rates are such that in peak season, there are severe capacity constraints. In 2015, occupancy rates in Auckland hotels averaged 84%. This implies that during the peak season, occupancy rates were near 100%. Rotorua, Wellington, Christchurch, and Queenstown were not far behind, all with average occupancy rates above 75%.

The strongest growth in guest nights in the last year has been in hotels, rather than in motels or backpackers' accommodation. In the year to November 2015, hotel guest nights grew 5.6% nationwide. However, over the last three years, most growth has been at the high end and the low end of accommodation. Motel guest nights rose just 11%.

Combined with the data on occupancy rates, this trend implies an acute shortage of higher-end accommodation in the major leisure and corporate markets in New Zealand. Industry sources point to the fact that it takes several years to develop a hotel proposal, get funding, receive consent and build, meaning that these major centres will suffer from a shortage of hotel accommodation for years to come.

It is important to note that Christchurch's high occupancy rates are in part because only 2,200 out of 3,900 pre-quake beds are now in place. The high number of government workers and consultants (e.g. engineers, architects etc.) travelling to the region to assist with the rebuild will also have boosted demand.

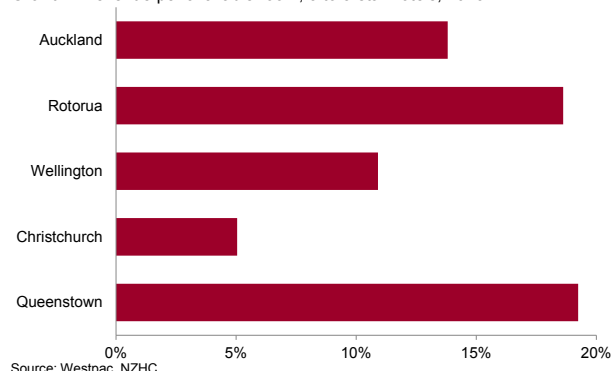
In some cases, even if all the proposed new hotel capacity materialises over the next five years, it may make little difference to occupancy rates if guest nights continue to grow at current rates. One example is Auckland, where an estimated 10,000 three to five star hotel beds are in place. Around 1,800 additional beds are proposed, but even if all these projects proceed and are completed in the next five years, this would equate to growth of just 3.4% a year over five years (18% in total). Over the last five years, Auckland guest nights overall have grown by 27%.



The high demand for hotel beds in these centres has allowed hotels to increase the rates they charge as well. Revenue per available room rose by between 5% and 19% in calendar year 2015. The lowest growth was in Christchurch, where capacity is finally being added as the city recovers from the earthquakes.

Strong demand and associated price rises begs the question: Why hasn't new capacity been delivered already? Industry sources pointed to a number of factors holding things up:

Growth in revenue per available room, 3 to 5-star hotels, 2015



- **Cost to build:** With a construction boom in Auckland in particular, construction firms have lifted their prices. As a result, some hotel businesses estimate the cost to deliver a room has risen upward of 50% in the last five years, massively reducing the profitability of bringing new rooms on-stream.
- **Length of process:** The process of performing due diligence on a proposal, getting resource and building consent, and construction and fit-out can now take five years. This makes it hard for the market to respond quickly to an observed uptick in demand.
- **Fear of a bubble:** Directly linked to the time it takes to see a project through to completion, investors fear that by the time new beds come on-stream, they may have missed the tourism boat. This may be in the form of lower tourism demand by the time beds are delivered, or may be the result of additional capacity being delivered all at once. Both would lead to a sharp fall in room prices.

Conventional wisdom?

One further factor that will see a spike in tourism in the years to come is likely to be a wave of new convention centres. Auckland's plans are most advanced; earth on the new centre has been turned. But Queenstown, Christchurch and Wellington are all in the process of evaluating options with a view to adding to the range of convention centres of different sizes.

The benefit-cost ratios of convention centres across the world varies substantially, as does the robustness of the analysis, and the financial case for most convention centres almost always hinges on local or central government support. The question that must be answered is whether the wider tourism; business networking; and in the case of Christchurch, recovery stimulus benefits are sufficient to justify the ongoing funding from government.

Convention centres are expensive, and decisions on what, when and how big to build need to be made carefully, and in concert. The wrong mix of convention centres will simply see them

cannibalise each other, and with that, the purported additional economic benefits to New Zealand.

Destined to succeed

Several industry sources from Auckland and other parts of the country talked about the city's transition from being a gateway, or hub city, to a destination. In the past, as home to the country's largest airport, many passengers have been required to overnight in Auckland, even if the city was not part of their travel plans.

But redevelopment of the waterfront, and the attraction of major events including the NRL Nines, and the World Masters Games 2017, as well as new activities across the Auckland region, were making it a place where people wanted to spend more time.

In contrast, the Canterbury earthquakes had a major impact on that region's reputation as a destination. Demand for travel to Christchurch fell, while Queenstown saw direct flights there grow strongly. Visitors to the South Island became less likely to spend much time in Christchurch.

Queenstown has benefitted from this, growing its reputation as a tourism destination even further over the last five years.

But the data shows that guest nights are growing again in Christchurch, and the opportunity to become a destination again is growing. This may have the benefit of attracting more flights direct to Canterbury from overseas, and more flights from other parts of New Zealand. For instance, Air New Zealand has already announced an 18% increase in capacity on domestic flights to Auckland.

Meanwhile, other regions around New Zealand will be looking to grow their attractiveness, perhaps as a place for weekend getaways, but increasingly for longer stays as well.

The outlook for Accommodation

A number of key trends are evident for Accommodation:

- **Ongoing capacity shortages across major centres:** We anticipate a shortage of three to five star accommodation across the five major hotel markets for at least the next three years, and for more than five years in Auckland. It takes years for new capacity to be added, and a large proportion of proposed new hotel projects do not proceed.
- **High occupancy rates and higher prices:** We expect that given the shortage of capacity in the major tourism centres of Auckland, Queenstown, Christchurch, Rotorua and Wellington, occupancy rates will remain high and prices will continue to rise.
- **More growth in demand for higher-end accommodation:** The growth in demand for accommodation services is mostly from higher-spending American, European and Chinese visitors. Many visitors are 50 years old or more. These visitors can afford and prefer the quality of accommodation and service that comes from higher end accommodation. For instance, between 2004 and 2015, the proportion of visitors from China on visitor visas who were aged over 50 grew from 34% to 45%. The number of Chinese visitors over 50 grew from 25,000 to nearly 150,000 in 11 years. Similarly, the proportion of visitors from the UK and the United States and South Korea aged over 50 is approaching 50%.

- **A broadening shoulder season:** Shoulder season is expected to continue to widen as far as it can, to provide a tourist season that stretches from September to May in Summer-oriented destinations. This is the only way that the severe accommodation shortage can be partially overcome. Some markets are more likely to respond to this than others, however, which will limit the extent to which this works. Some regions with less attractive weather will further be limited in how much the shoulder season can expand.
- **A greater role for the regions:** With the increase in prices in the five major hotel centres, these destinations will become less attractive to domestic tourists, which will likely mean that some other regions of the country will benefit.



The ongoing shortage of hotel rooms in major centres will support higher occupancy rates and prices, and will encourage domestic tourists to visit regional centres.

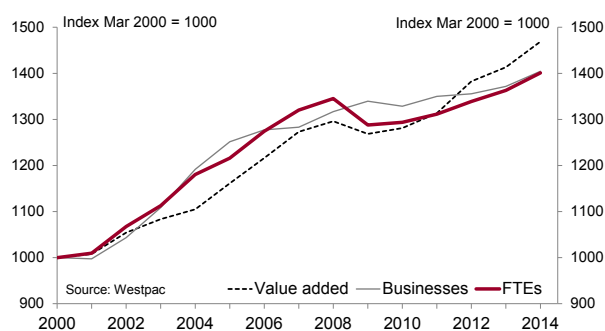
Food and beverage services

- Unlike Accommodation and Air travel, Food and beverage services, the largest employer in the Tourism, Hospitality and Recreation sector, primarily provides services for local residents.
- The sub-sector has grown strongly since 2000 although rates of growth have stuttered in recent years, with most growth in percentage terms being in Takeaways.
- Some of the key challenges facing Food and beverage services include difficulty in attracting and retaining good staff, disruptive technology, security of tenure, and the demand for transparency about products and processes.
- In the years ahead, the sub-sector will need to face these challenges, and deliver to a customer-base that is increasingly diverse, and demands a wider range of product and service offerings.

Upsizing

Growth in employment, value added and business numbers in Food and beverage services has been remarkably similar over the last 14 years. This implies that the average size of businesses has remained fairly constant, both with regard to number of workers and value added.

Food & beverage employment, value added and business numbers



Since 2000, real value added has grown by 47%, or 2.8% a year. Even the GFC did little to dent this growth. After just one year of weakness, the sub-sector bounced back in employment and value added terms. There was practically no slowdown in business numbers growth.

This growth path suggests there has been little improvement in productivity per worker (around 5% in total across 14 years). However,

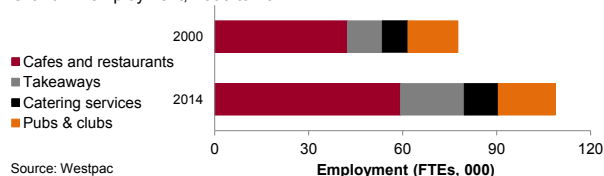
some of the industry sources we spoke to indicated they had achieved some meaningful productivity gains in their own businesses.

Despite the growth in employment, many industry sources, with some exceptions, commented on how difficult it was to recruit and retain good staff. Many have begun employing predominantly people on working holiday visas or recent migrants to plug gaps in available staff.

Fast food takes it away

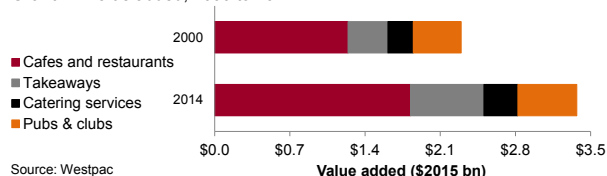
Cafés and restaurants remain the largest employer and generator of value added in the sub-sector, with more than 59,000 FTEs in 2014, up from 42,500 in 2000. Yet the strongest growth in employment terms was in Takeaways, up 84% in 14 years (4.4% a year), with a similar gain in value added per business. The weakest growth was in Pubs and clubs, with employment up 14% and value added up by 23% since 2000.

Growth in employment, 2000 to 2014



Source: Westpac

Growth in value added, 2000 to 2014



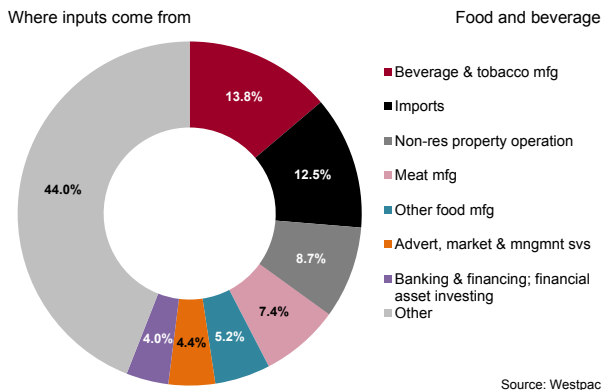
Source: Westpac

These changes support the anecdotal evidence supplied by industry sources of the trend toward more growth in chain type Food and beverage businesses (in terms of value added and employment if not actual business numbers) and fewer independent restaurants.

Where inputs come from

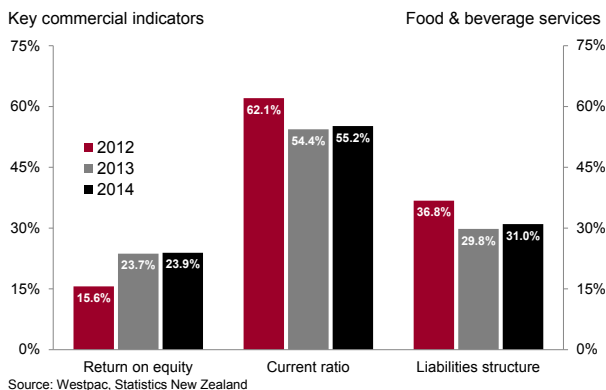
The largest share of inputs into the sub-sector comes from within beverage manufacturing. Although meat and other food manufacturing also make big contributions to the inputs, non-residential property operation plays a key role as well. Around one-eighth of inputs are imported.

These figures imply that a large number of manufacturing and service businesses benefit from the operation of the more than 15,000 Food and beverage businesses across New Zealand.



Benchmark indicators

Recent benchmark indicators have varied in direction. Return on equity, already strong in 2012, grew to nearly 24% in 2014. Yet the current ratio, measuring businesses' ability to service short-term debts, fell sharply to around 55%. Businesses with rapid turnover of inventory, such as Food and beverage services, can get away with lower current ratios, but a ratio as low as 55% may be a cause for some concern.



The share of liabilities accounted for by shareholders' equity has also fallen, from 37% to 31%, implying higher levels of long-term debt across these businesses.

The outlook for Food and beverage services

There are a number of disparate but important trends that will continue to affect the sub-sector:

- **Flexibility of menu and customer demands:** Customers are demanding a wider variety of menu options, and variations on existing menu offerings. Several fast food chains, for instance, have formally introduced options that allow customers to customise their orders. Menus will need to be reviewed more regularly to keep up with customer preferences. "Healthier" options need to be offered as well as traditional staples.
- **Transparency:** Customers want to know more about what they are eating. This will be reflected in a number of ways, from Food and beverage businesses providing nutritional information on their products, to highlighting whether their products are organic or fair-trade, to redesigning stores so customers can see how clean and organised the kitchen is.
- **A bigger role for technology:** From allowing customers to order their meal online before picking it up, or using technology to select an order in-store, to proactively creating or responding to publicity in the media, Food and beverage businesses will need to be digitally savvy to succeed.
- **Risks over security of tenure:** Strong growth in commercial property values in Auckland in particular, but also in some other parts of the country, will likely see large increases in rents for some Food and beverage businesses. Redevelopment of commercial space to increase gross lettable floor area may also reduce security of tenure for the sub-sector.



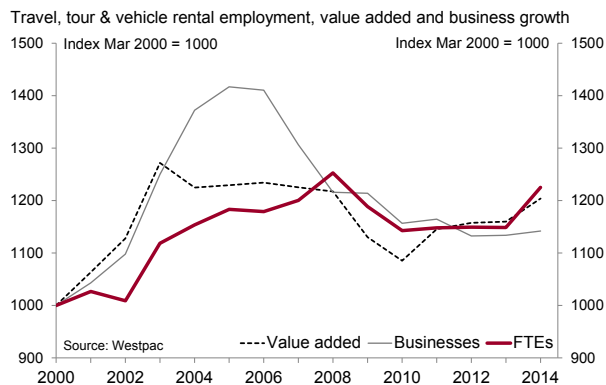
Customers are demanding a wider variety of menu options, variations on existing menu offerings, and more transparency about what they are eating.

Travel, tour and vehicle rental services

- Travel agents and tour operators face the most challenging operating environment of all sub-sectors covered in this report.
- Online booking services for hotels and transport are reducing the value proposition of these services in the minds of many travellers.
- At the same time, the rise of Free Independent Travel (FIT) in traditional tour-oriented markets like Asia and outbound tourists over 50 is changing demand for travel agent and tour agency services.
- The rise of FIT is, by contrast, benefitting the vehicle rental market although it creates huge variation in demand between low and high season that operators need to bridge.
- Travel agencies in particular will need to re-invent themselves through consolidation, and promotion of new and unique destinations and products.

Consolidation revs up

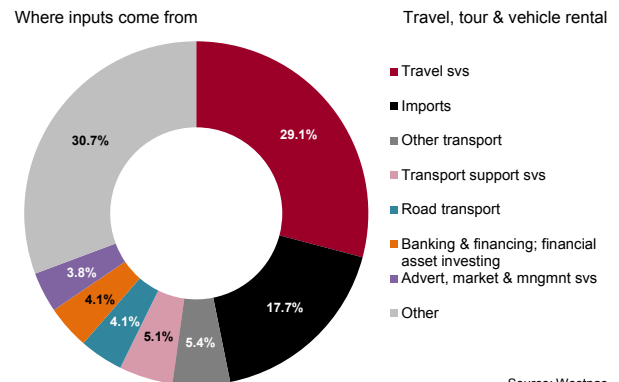
After an explosion in the number of Travel, tour and vehicle rental services businesses in the five years to 2005, the sub-sector has seen a dramatic consolidation. Businesses numbers increased by 42% between 2000 and 2005, before falling by 20% by 2014. The bulk of these changes were in rental car businesses, which have halved in number since 2005, shedding nearly 1,200 front doors.



Over the same period, employment was a lot more stable although it is also down from the 2008 peak. Value added declined during the GFC, and remains well below the heights of 2003, implying weaker production per worker in recent years.

Where inputs come from

The largest proportion of inputs into the Travel, tour and vehicle rental services sub-sector are from within travel series itself. This is followed by imports, with nearly 18% of inputs provided. This is because of the import-heavy nature of outbound travel, which involves the purchase of overseas tourism services, and the import of large numbers of vehicles for the rental car fleet.

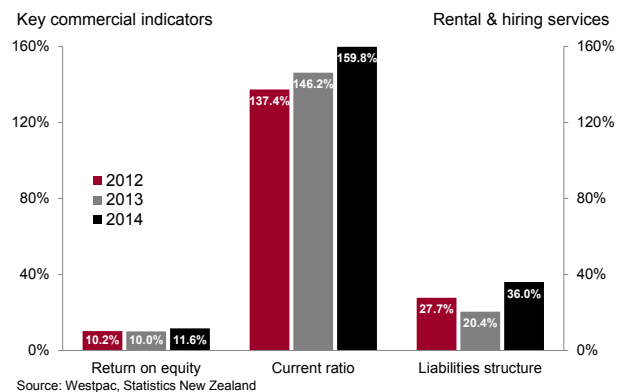


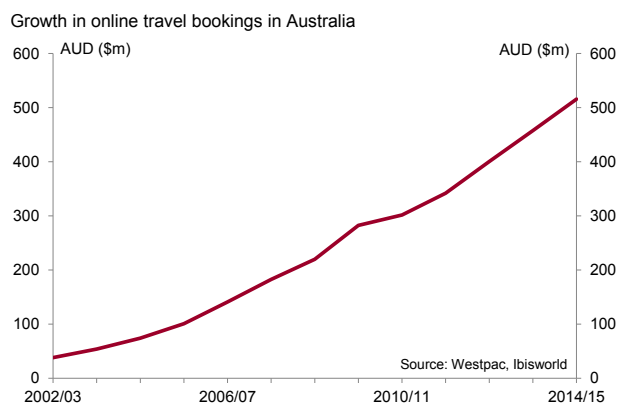
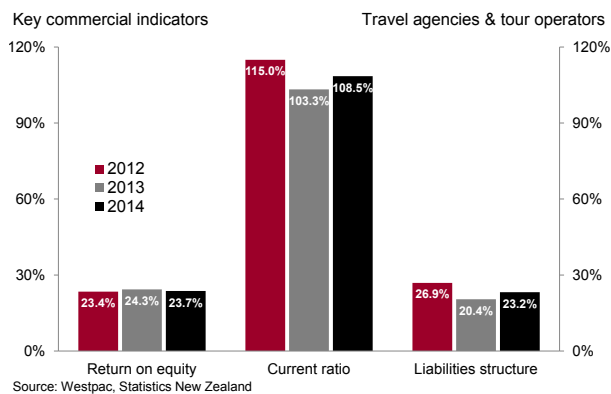
Various transport industries also provide significant inputs into the sub-sector as a result of its role in arranging coach tours, jet-boating and other transport activities.

Second round effects, not captured in the figure, will include the role of boat and bus manufacturers across New Zealand. They supply the inbound tour and travel service market.

Benchmark indicators

Most benchmark indicators in the sub-sector were strong in the latest years for which data is available. Returns on equity ranged from 12% for rental services (including vehicle rental) to around 24% in travel agency and tour services.





The current ratio for these businesses also remained above 100% at all times, indicating that as a whole the sub-sector was well-placed to meet its short-term debts. Owner equity formed a relatively small portion of overall liabilities, at 36% for rental businesses, and 23% for travel agencies and tour operators.

The challenges currently facing the travel agency industry in particular will require businesses in that industry to transform rapidly to stay relevant and ensure ongoing success. Meanwhile the strong growth in organised tours, especially among older demographics, may help boost the financials for tour operators. Growth in the FIT market of international and domestic tourists in New Zealand will likely support improved returns for vehicle rental businesses, as long as the shoulder season can be broadened to increase use of vehicles across the year.

Have computer, will travel

Travel agencies and tour operators are the two business types that arguably face the biggest challenges of all those covered in this report. Just seven or eight years ago, the difficulty of doing your own flight or hotel bookings meant that most people used travel agencies to help them book accommodation, flights and activities.

By 2016, disruptive technology has radically changed the business environment for travel agents and tour operators. The plethora of accommodation booking websites, direct sale of plane tickets by airlines at the same price offered by a travel agent, and the growth of FITs who don't use organised tours, has diminished the perceived value of these go-between businesses.

Direct sales of tickets by airlines to the public means the commission the travel agents' commission has shrunk. Meanwhile internet-based accommodation and activity services bookings are far outpacing growth in revenues for bricks-and-mortar travel services. While data for the New Zealand market is unavailable, estimates of the growth in revenue for the Australian online travel booking industry gives a strong indication of the trend in a very similar market. It is important to note that this growth is in bookings through online-only companies with an Australian presence or subsidiary, and does not include bookings through businesses based outside Australia, which would increase these numbers.

In 2002/03, bookings in Australia through online portals with a local presence were estimated at \$38 million. By 2014/15, sales revenue had soared to \$516 million, an increase of 1,250%.

The growth of online booking sites, including third-party and direct sales by airlines and hotels, and review websites like Tripadvisor.com has also introduced a new level of transparency with regard to pricing, products and service.

To be successful, travel agencies in New Zealand will need to:

- **Consolidate and promote their brands:** An example of this, announced in 2015, is the consolidation of United Travel, Harvey World and some Air New Zealand Holiday stores into the single Helloworld brand. This will create greater brand recognition.
- **Promote the security of their services:** Travel agents offer an advantage over travel booked by individuals across multiple websites if something goes wrong. Travel agents can rearrange travel plans, and often put clients' payments into trust accounts until such time as suppliers of travel services, such as hotels, have to be paid. This gives the traveller more confidence they will get their money back if the provider of accommodation or other services ceases operating.
- **Position themselves as "travel professionals":** With the opening up of new travel markets and air routes, the travelling public have access to places that were not even on the radar a few years ago. Some of these destinations have poor tourism infrastructure or lack a meaningful online presence. In these instances, travel agencies can add significant value by helping clients navigate this uncertainty.
- **Develop better online tools:** The best way for travel agencies to compete with offshore online travel businesses may be to further improve their own online service offering as a hook for getting clients on the phone or in-store. The challenge for travel agencies in this space will be how to make a website useful for potential clients without providing all the information they need to then do their own bookings while excluding the agent.
- **Focus on the right demographic:** A lot of growth in travel is occurring among the over-50 age group, who may not be as comfortable using the internet to book their travel. This is a prime audience for agencies. The preponderance of cruises, most popular among older demographics, and advertised in traditional media like newspapers by travel agencies, is evidence that this focus is already growing.

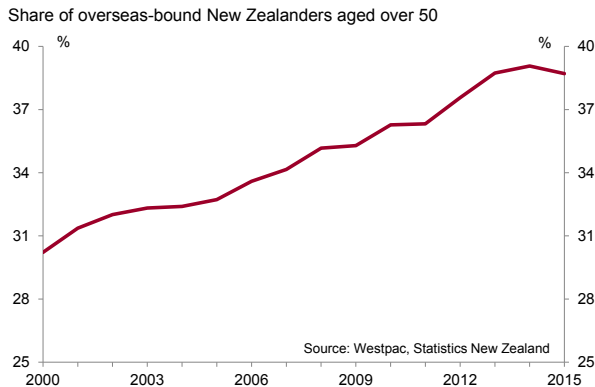
Shouldering capacity constraints

Capacity constraints are not only an issue for Accommodation services. Vehicle rental businesses also have to deal with huge demand over summer, and far less demand over winter (especially for campervans), and with the challenges of relocation of vehicles after the busy summer.

The boom in New Zealand's tourism sector has seen the main season expand from September to May, from what used to be a November to March season, by extending the shoulder. This has helped lessen the variation in demand for rental vehicles to some extent. However, rental businesses are being creative to meet high demand in summer without being stuck with large capital investments in the form of vehicles that are not used through the rest of the year. For instance, some businesses import vehicles used in the northern hemisphere season, use them through the high season here, and then sell them off to private purchasers in New Zealand.

Fifty and free

Another shift in travel has been in how over-50s travel. The growth of travel among this age group is well-documented. Among over-50s today, the children have left home, and the mortgage is paid off. Improved health, longevity, and discretionary income over generations past have combined to support massive growth in travel by this age group. As we pointed out in the section on Accommodation, this is having a big effect on inbound tourism, most classically highlighted by the growth in the cruise market. But it is also affecting growth in travel by New Zealanders in this age group.



Overall, the number of New Zealanders travelling abroad has grown by 4.3% a year since 2000, but the number of over-50s travelling has grown by 6.0%. A more recent change, however, is how over-50s travel. More are travelling independently, rather than as part of a tour group, or by cruise ship. Those that do cruise, are more often arranging their own activities ashore.

This change is a function of improving health and mobility, and increased use of digital technology by older people. It poses a significant risk for both travel agents and tour operators, who will need to show the additional value they add to secure business.

The outlook for Travel, tour and vehicle rental services

We expect to see a number of trends play out in the Travel, tour and vehicle rental services sub-sector over the next few years:

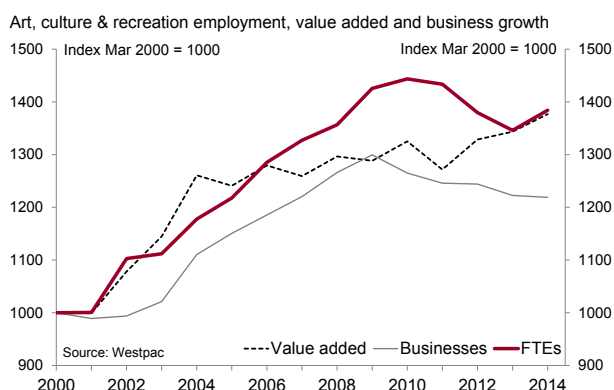
- **Tighter commissions for travel agents:** As increased air capacity drives competition between airlines, commissions from airlines will likely be squeezed further for travel agencies.
- **More consolidation in travel agencies:** We expect to see rationalisation of the number of bricks-and-mortar travel agencies and possibly brands as they face increased competition from online travel agents and from direct sales by airlines.
- **Growth in boutique travel agency services:** We expect to see more differentiated product and service offerings from travel agencies to allow them to remain relevant. They are likely to focus more on developing unique, more complex products or newer, less accessible destinations.
- **Boutique tour and activity operators:** A rebound in the traditional North American and European inbound tour markets has been good for New Zealand tour operators, but there is also a trend for older demographics and traditional package tour markets toward more FIT travel. This will require tour operators, like travel agents, to differentiate their product offering to remain relevant. We expect to see more specialist, niche tours or more of a smorgasbord approach where travellers purchase the basic tour plus specific add-ons (experiences, attractions and transfers) at the time of booking the tour.
- **Capacity flexibility among vehicle rental businesses:** We expect to see vehicle rental services take further action to grow and release capacity as required.

Art, culture and recreation

- The Art, culture and recreation sub-sector includes services such as museums and art galleries, zoos, amusement parks, botanical gardens, reserves and regional parks, theatres, and performing arts production companies.
- Local residents play a far larger role in the Art, culture and recreation sub-sector than in Air travel and Accommodation.
- The plethora of recreation choices available has led to strong competition across industries for a share of consumers' wallets, with clear winners and losers.
- Outdoor-oriented activities have seen much stronger growth, while the performing arts have seen weak growth. Museums, movie cinemas and amusement parks have seen more mixed results.
- The clear message is that more New Zealanders and tourists want outdoor oriented activities that take advantage of New Zealand's natural advantages, and indoor activities with strong links to New Zealand's culture, history and national pride.

Employment pirouettes

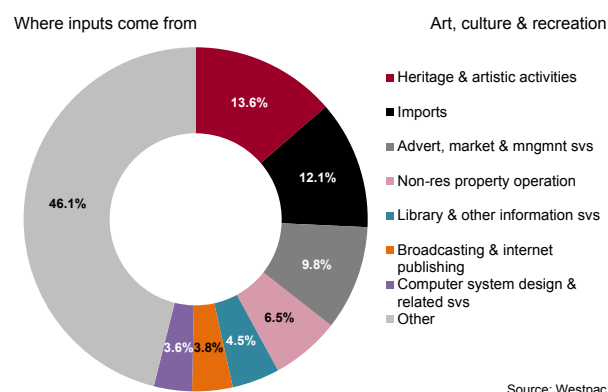
The Art, culture and recreation sub-sector saw impressive growth in both employment and value added over the decade to 2011 although much of the growth in value added was in the early years. Since then, value added has continued to climb more modestly to 2014, while employment has weakened.



The number of businesses in the sub-sector has not done as well. Business numbers fell 7% between 2009 and 2014. This implies that more marginal (and probably smaller) businesses have disappeared from the industry, while the average size of remaining businesses, measured in both employment and value added, has risen.

Where inputs come from

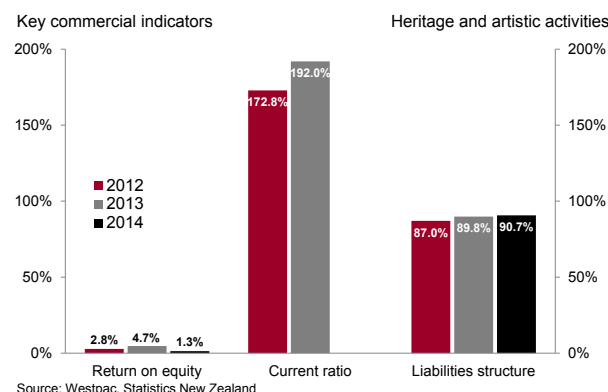
Inputs into the sub-sector come primarily from within industries in the sub-sector, like Heritage and artistic activities, and Library services, as well as a number of services that serve the sub-sector, like Advertising and Computer support services.



Many significant operators in this sub-sector are in their own dedicated spaces, often owned by government agencies such as local government. As a result, Non-residential property operation services plays a relatively small role in the sub-sector's inputs, despite many business units requiring large spaces to operate.

Benchmark indicators

Heritage and artistic activities, a sub-set of Art, culture and recreation businesses, is characterised by a very different profile from most other businesses examined in this report. For starters, these businesses have much lower returns on equity. This is predominantly because they are often government-owned facilities that own their own assets, meaning a high denominator, and they are often not intended to be operated for profit, meaning a lower numerator. This is also reflected in the liabilities structure, where owners' equity accounts for 91% of all liabilities.

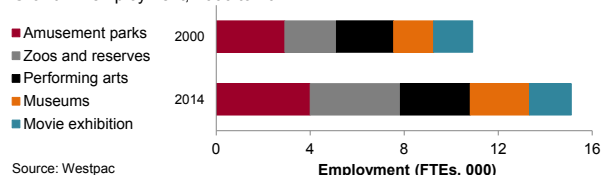


As a result, the current ratios for the industry are high, averaging over 170% because debt is low relative to equity.

From the zoo to you

The industries within Art, culture and recreation are largely in competition for tourist and local resident discretionary spending. Among these industries, by far the most growth in the last 14 years has been in zoos, botanical gardens, reserves and parks operation. Employment is up 75% and value added by 84%.

Growth in employment, 2000 to 2014



Growth in value added, 2000 to 2014



At the other end of the spectrum, movie exhibition and the performing arts saw much slower employment growth – 7% and 22% respectively. As we point out later, employment in movie exhibition may well fall as online movie streaming (both legal and illegal) grows.

Yet value added in the movie exhibition industry soared between 2000 and 2014, up 87%. This implies that businesses are operating far more productively than they were before, and that businesses have been able to generate higher returns per customer in real terms.

The performing arts meanwhile have grown employment by 22%, yet value added has not kept up, rising just 2% since 2000.

The changes within the sub-sector indicate changing preferences among New Zealanders and visitors for the types of recreation activity they want to participate in. There is a clear shift toward outdoor activities and away from traditional performing arts activities. Sandwiched in the middle of the growth profile are museums and amusement parks, each with modest growth. As we point out later, the success or otherwise of museums and similar organisations depends largely on the subjects they deal with, and how well those link to the New Zealand psyche, more than they cater for tourists.

Increasing choice and the challenge of relevance

One recurring theme within the Art, culture and recreation sub-sector is the struggle of incumbents to stay relevant, and to adjust to a wider range of options competing for attention and dollars. In this section, we examine two examples across the movie exhibition, and museum industries.

Now showing at your place

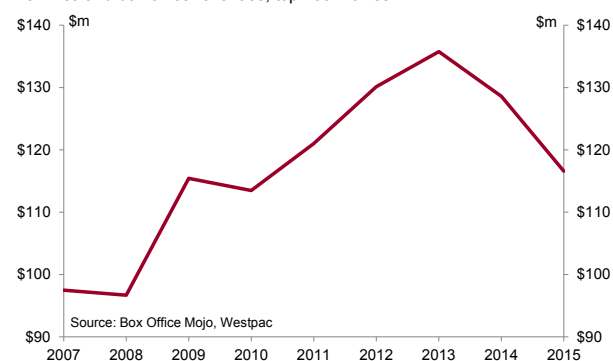
One industry struggling to keep customers coming through the door in recent years is movie exhibition. At the same time, the

industry appears to be boosting value added growth most likely by taking a greater share of the customer’s wallet through food and beverages and other merchandise.

The industry did quite well between 2008 and 2013. By 2013, annual revenues from the top 100 movies shown in New Zealand were up 40% compared with 2008, helped by the release of Avatar, the last two Harry Potter movies, Boy, and the first two Hobbit movies.

But even the third Hobbit instalment and the latest Star Wars movie could not arrest the decline that has hit the industry in the last two years. Revenues from the top 100 movies for 2015 were down to their lowest since 2010.

New Zealand box office revenues, top 100 movies



There are many factors that affect movie-going in any given year – blockbusters (especially in successful franchises) or the absence thereof, weather variation across years, and release dates of blockbusters. The latter in particular can affect sales – if a movie is released in the US well outside New Zealand’s holiday periods, for instance, this places pressure on New Zealand distributors and exhibitors to show the movie before the prime season to avoid losing customers to pirate copies or parallel imported DVDs and the likes. This can force New Zealand distributors and exhibitors to release a movie earlier than they would like, not maximising holiday audiences.

But far the biggest change in the last two years is the launch of numerous movie streaming services in New Zealand, and direct access to overseas based services. The existence of these legal streaming services are an improvement on piracy, as users do pay for content, but is hitting demand for both terrestrial broadcasters and movie exhibition businesses in New Zealand.

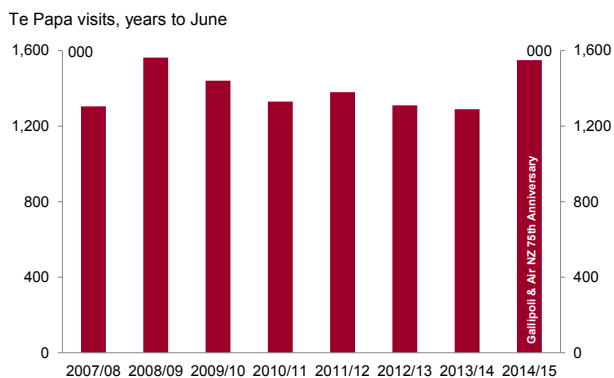
In addition, online streaming services are developing their own content which, if of a quality and style that the viewing public want, could further eat into the dollars available for spending on digital entertainment.

That said, as we pointed out earlier, total value added in the movie exhibition industry grew sharply even in 2014, a year in which box office revenues began to fall. This implies that cinemas have been able to boost value added capturing a greater share of customer’s wallets, perhaps through sale of food and beverages or other merchandise associated with a visit to the cinema.

There has also been a rise in “experience cinema” – cinemas with couches, wine served in glasses and the like, which charge a premium with a focus on higher quality food and beverages. Mainstream cinemas have followed suit by introducing “Gold Lounge” (Reading Cinemas) and “Gold Class” (Event Cinemas) theatres that typically cater to an older audience with higher discretionary incomes.

Night at the museum?

Another example of falling attendance is in the museum and art galleries industry. An example is provided by the national museum – Te Papa Tongarewa. Visitation peaked in 2008/09 with a Monet artworks exhibition and the addition of the colossal squid to the permanent exhibition. Since then, visits have fallen steadily, until a spike in the latest year with an exhibition coinciding with the centennial remembrance of the battle of Gallipoli, and another with Air New Zealand's 75th anniversary.



The figures for the latest year and for 2008/09 provide a powerful insight into what New Zealanders want to see – exhibits with strong links to the national identity, and exhibits associated with world-famous names.

Without the right types of exhibits that are seen as relevant to the New Zealand and visiting public, visitor numbers will likely continue to fall.

We are not amused: the problem of accessibility

Amusement parks, indoor and outdoor active attractions have seen middling growth over the last 14 years, with employment up 37% and value added by 15%. One challenge the industry is facing is the difficulty of access to attractions.

Because many attractions require a lot of space, they are unlikely to be located in the city centre. While New Zealand's main city centres are well-served by public transport, reaching

the outer limits of cities is far more difficult, particularly for out-of-town visitors, whether international or domestic. As a result, many attractions rely almost exclusively on local residents, and the opportunities to benefit from the significant growth in international tourism, for instance, is limited.

The answer to this problem is not simple. The argument can be made, and apparently has been by local government, that as the primary beneficiary of a public transport service to these types of attractions would be private businesses, any such service should be funded by the attractions. At the same time, when convinced, local governments do provide funding for infrastructure or transport services that benefit specific private businesses, if there are sufficient spill-overs to other businesses and industries to justify the investment.

One solution is that a group of likeminded businesses band together to provide a shuttle bus or similar service that links a number of activities. Some we spoke to are now considering this option.

But until such time as an accessibility solution can be found, amusement parks and other active attractions are unlikely to capture as big a share of the tourist spend as they otherwise could.

The outlook for Art, culture and recreation

Trends for the sub-sector that are expected to emerge include:

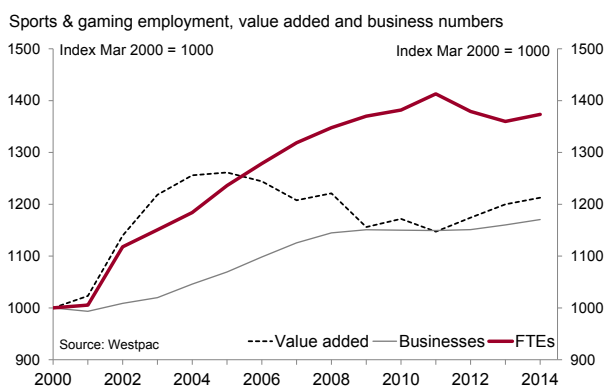
- **Falling business numbers:** The number of businesses in the sub-sector is expected to continue to fall slowly over time as more marginal propositions or businesses that no longer offer something that people identify with, fail.
- **Increasing local content:** Businesses that succeed, particularly in the performing arts, museums and galleries industries will be those that are able to tap into the psyche of New Zealanders. Exhibitions and events linked to New Zealand's history and culture seem to do far better than those that may be more popular in Europe or North America.
- **Continued growth in outdoor and active attractions:** Outdoor activities including zoos, botanical gardens, reserves and regional parks have been the strongest performers in the sub-sector and this is likely to continue. People appear to be wanting more of what New Zealand is famous for – its great outdoors – and this is likely to be the driver of growth for local residents and tourists alike.

Sport and gaming

- Sport and gaming includes all sport facilities and venues for live sport, gyms, and gaming businesses.
- Venues for live sports are struggling with dropping attendances, and betting agencies face increased competition. This means the sub-sector is probably next most at risk after Travel agencies and tour operators.
- Further declines in attendances at sports events are likely without the gap closing between the cost of watching at home and watching at an event.
- We further expect more rationalisation of the number of betting agencies and a greater focus on in-game sports betting.
- In contrast, the fitness industry's fortunes are better, but premium businesses will still need to become more accessible and highlight their unique proposition to compete with cheaper, no-frills businesses.

Picking growth becomes harder

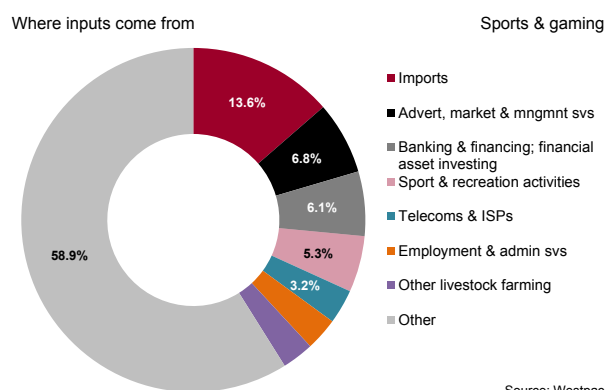
Sports and gaming has one of the most remarkable growth profiles within Tourism, Hospitality and Recreation. Employment surged more than 40% between 2000 and 2011, but value added and the number of businesses saw nowhere near as much growth. In fact, value added in real terms was lower in 2014 than a decade earlier.



This implies that value added per worker has plummeted by around 12% over 14 years, even as the average business size in employment terms has grown 17%. As we point out below, it is hard to see a reason for significant growth in value added or business numbers in this sub-sector over the years ahead given the major changes occurring in it. There are likely to be moves to boost productivity per worker, however.

Where inputs come from

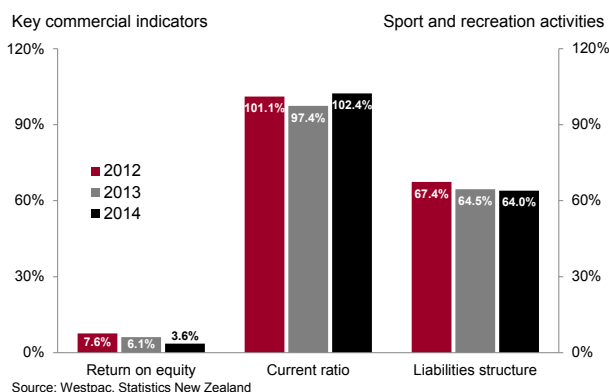
Inputs into the Sports and gaming sub-sector, and thus industries that are to a significant extent reliant on Sports and gaming are largely service industries like telecommunications, internet service providers, marketing and advertising, and banking services.



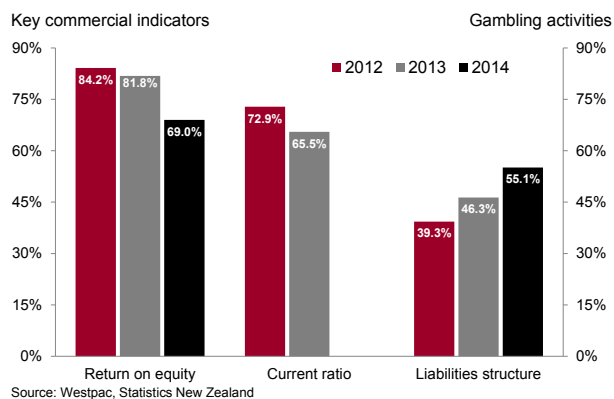
In fact, the top seven sources of inputs provide only 41% of the total, implying that a wide range of other goods and services are also important for Sports and gaming in delivering its outputs.

Benchmark indicators

Like the Art, culture and recreation sub-sector, the sports component of the Sports and gaming sub-sector often makes use of large pieces of infrastructure, like stadiums. As a result, return on equity has traditionally been quite weak. In addition, in recent years where attendances at sports events have fallen, returns on equity have plummeted to just 3.6%. Current ratios are relatively weak as well, hovering at around 100%, while the major role of owner's equity is reflected in the liabilities structure.



In contrast, gambling is characterised by particularly high returns on equity. This was 70% in 2014. This high return will be in part because capital investments required for small betting agencies and online channels is small relative to turnover. Current ratios are relatively weak, perhaps made possible by the low capital high turnover model for many businesses in the sub-sector. Owner's equity has grown strongly in recent times, however, to reach 55% of the liabilities structure by 2014.

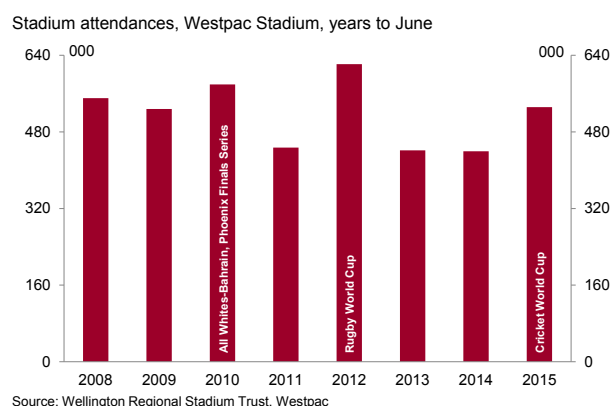


Sporting empty seats

As with the Art, culture and recreation sub-sector, some parts of the sports industry are struggling to remain relevant. Attendances at sports stadiums are falling at many venues. Factors that are being blamed include the relative price of attending live sport versus watching on TV; the cost of food and drink at stadiums, and in the case of some events, the “non-family-oriented atmosphere”.

Whatever the reasons, the difficulties facing stadiums and other sports facilities, often council-owned and funded, is well-documented. This includes the Otago Regional Stadium, with estimates of a \$1.8 million per year revenue shortfall over the next decade.

Analysis of attendance at Wellington Regional Stadium over the last several years yields a picture that is being broadly repeated across the country.



Aside from years when major events have occurred, linked to world cups and/or good performance by New Zealand teams – attendances are dropping by around 9,500 per year.

These results imply that for stadiums to be more profitable, more will need to be done to attract major events in any given year, and New Zealand teams will need to be successful. While stadiums

themselves have little control over the latter, these findings do suggest that sporting codes, event organisers and operators of stadiums and multi-sport facilities have their work cut out to stop the slide in attendances.

Healthy competition in the fitness industry

One industry within Sports and gaming that is seeing increased competition is fitness – gyms and health clubs of various kinds. There has been a sharp increase in the number of “boot camp” type activities. These may be scheduled at gyms, but are also run in community centres, or outdoors, often on a pay-per-session basis, or a fixed fee for a short-term course, typically six to eight weeks. At the same time, the global rise of no-frills, cheaper gym chains has not skipped New Zealand.

As a result, incumbent gyms are having to respond. Some of the emerging trends in the industry include:

- Shorter commitment periods, or pay-as-you-go memberships
- Differentiating their product offering. e.g. emphasising the premium service they offer
- Offering a wider range of services, whether in group classes or virtual gym sessions
- Focusing on being geographically accessible to members who increasingly want to cycle or walk to the gym and then to work.

Interestingly, industry sources suggest that the proportion of people that join or regularly attend gyms has not changed dramatically in recent years. Instead, New Zealand and most other advanced countries appear to have a growing dichotomy between a massive obesity epidemic, and large numbers of people who want to remain fit, and often to increasing levels. The lack of growth in the proportion of the population using gyms means that most growth for the industry is likely through population growth, and most individual business growth will be through grabbing market share.

Betting on sport: the gaming industry

Along with travel agencies, the gaming industry is probably the one facing the most disruption within the Tourism, Hospitality and Recreation sector in New Zealand. Factors that have had an impact on the industry include:

- Disruptive technology that has hugely increased competition from offshore betting agencies through online channels
- A decline in popularity of the traditional subjects of betting – horse and dog racing
- The need to stay current with slot machines, where technology changes again can make a particular game lose popularity quickly
- Increasing compliance and regulation costs
- Changes in drinking laws that are reducing betting in pubs around the country.

Some of these challenges will be hard to negate, and will require incumbent firms in New Zealand to differentiate themselves carefully. For instance, large offshore betting agencies may have the scale to offer more attractive spreads, but lack the certainty and security that comes from knowing you can walk into a local branch to collect winnings.

The best investment by the industry may be to continue to grow the sports betting part of the business, where much of the growth has been in recent times. And within sports gaming, the best opportunity may well come from in-game betting. In this type of betting, the focus is on live action during play, such as who will score the next try or lose their wicket next.

The outlook for Sports and gaming

The outlook for Sports and gaming includes a number of key trends:

- **Decreased attendance at sports events:** We expect the decline in sports attendance to continue without a large revision in pricing. In addition, the gap in price between watching at home and watching live is likely to widen as more events are unbundled and become available on a pay-per-view

basis. This allows customers to purchase individual games, all games played by a favourite team, or seasons of games to view live online, at a price much lower than an annual subscription to pay TV.

- **Rationalisation of the number of betting agencies:** We expect to see some rationalisation of the number of dedicated betting agencies, whether stand-alone stores or pub-linked, as marginal agencies lose out on online betting.
- **Continued growth of sports betting and in-game betting:** We expect to see the switch away from horse and dog racing and to sports betting to continue.
- **Localisation of fitness businesses:** We expect to see more, smaller footprint gyms and other fitness options that allow the core demographic to use active modes to get to the gym are likely to continue to grow.



Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

David Norman, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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