

ASIAN AIRLINES & AIRPORTS

Regional Upstart

Lim Kim Hai
REX, Chairman

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Regional Upstart

Few carriers in the world can boast the operating margins or turnaround in fortunes seen at Australia's Regional Express. The man behind it, Lim Kim Hai explains how it was done and what lies in store for the future

writes Colin Baker

There can be few airlines in the world that have as impressive record in terms of profit margins recently as Australia's Regional Express (Rex). Interestingly, the man at the helm during this period, who turned two failing airlines into one successful one, is an avowed industry outsider.

"I don't have a passion for the industry. I have a passion for business," states Lim Kim Hai, Rex's thoughtful and engaging chairman. Still, it is obvious when he explains how he transformed the loss making entity into a cash earner that this airline is a subject dear to his heart – and that he is a man who will do what it takes to get things done to his satisfaction.

Lim was a passive minority investor as Hazelton Airlines and Kendall Airlines were turned into Regional Express in the wake of 9/11 and a steep industry downturn. The new concern continued to hemorrhage cash and it quickly became apparent that things were reaching crisis point.

Different View

"We were stupid and naive," admits Singaporean Lim. "We didn't know that the airline industry was not like any other industry. Almost all the aspects



looked good. The two carriers had a long history; forecasts were in line with the past; it was a fire sale; there were government incentives and we had the ability to cut labour."

In fact, Lim says that most of these aspects actually turned out as planned, but there were two surprises, one positive and one very negative. "The one we were dreading was the unions – but this turned out to be fine. They were reasonable chaps to negotiate with," remembers Lim. "The second issue was the management," Lim explains.

"This we didn't really expect. It was the management that sank the company. Since we were passive investors, we weren't expecting to have to take a hands on approach."

In 2002 the merged airlines nearly collapsed for a second time, with losses of A\$35 million in their first year. After much boardroom wrangling, Lim and other minority shareholders got together and took control. With this support, Lim and his supporters sent in a resolution sacking the entire board. "We went in and we took control of the

company.” This was July 2003.

“This was quite a shock,” recalls Lim. “It’s a rather complex industry – very highly specialized with some very peculiar habits.” Lim and his partners initially went in to see whether it was worth continuing or time to call it a day. “What we saw was that all the money that had been put in had been lost – and more. On the other hand we saw that this was an outfit that was running reasonably well, with 50,000 take offs per year. That takes quite a bit of logistics – and they were handling it pretty well.”

Lim explains, “this was a company that was not totally broken. Profit wise yes, but operationally it was fairly ok. We then said it would be a pity to let this go totally, and we decided to give it one last try.” This project was financed by the remaining shareholders. “We would rather lose the money ourselves than pay someone else to lose it for us.”

Managing Issues

The key to the turnaround was management. “The strange thing was that all the people who were supposed to be the highest ranking people were the ones causing the company to go down the drain. Because these are the ones who have been in the industry the longest. These are the ones who will always tell you it cannot be done. These are the ones who are perpetuating the whole airline culture. So we reached into middle and lower management and we managed to, in a couple of months, identify good people who are willing to rise to the challenge.”

Lim makes no qualms that this was an approach he saw had some risks. “One of the key elements is getting rid of the people you cannot afford to lose. These are the guys who are the technical experts, so it takes a big leap of faith to say, ok, I’ll cut you off.” But, he says, keeping them there would have meant nothing changed.

After one year, the number of top managers had been reduced from 27 to four. “And I myself have no knowledge of aviation,” he points out. Lim knew

Regional Express at a glance

Rex financial performance 07-08	2008	2007	Change
Total revenue (A\$ mill.)	260.5	225.2	16%
Pre-tax profit (A\$ mill.)	32.4	33.1	-2%
Pre-tax margin	12%	15%	
Fleet			
Saab 340A	6		
Saab 340B	37		
Total	43		
<i>Note: Financial year to 30 June 08</i>			

exactly the sort of people he was looking for though. “Aviation is full of people who are, excuse the language, bull shitters. People who like to talk – and turn a negative scenario into a very positive one. Some are very convincing when they talk. But when it comes to actual execution, they will either say it can’t be done or they will not do it. So the people who we look for are the people who have the basic technical knowledge, and who are willing to get their hands dirty, to work, and to take ownership of the problems. You will almost never find this at the top level.”

He emphasizes that success means getting physically involved. “You need to see through the nitty-gritty. To count through the numbers. To walk the beat. There’s no point in having a nice beautiful concept. Any improvement will be hard earned. It will only come about when you yourself go in, understand it, take ownership, go and talk to the people involved, go and tell them you better do it or else.”

Lim says a system-wide approach is needed. “To succeed in aviation, it is not enough to do two-or-three astoundingly clever things. You must do 1,000 small things right.” As an example he gives excess baggage – something he started tackling back in 2004. “I said even though we are small, we need to charge, because we are weight-limited and by not charging we are encouraging a lot of people to bring baggage that will give us more problems.” Sometimes luggage needed to be unloaded because of weight issues, so there were operational as well as revenue benefits

to be had. Lim told his managers that something had to be done.

“I got the classic response – are you sure? The safety and on-time performance will be affected. Are you willing to take the risk?” Lim responded by saying, ok, let’s try and work out what the potential problems might be and see if we can mitigate them. Rex started charging, getting around A\$20,000 a month in total. And then, after nine months, it started coming down to around A\$15,000.

“So I spoke to my managing director, who was an industry veteran, and he told me that A\$15,000 was about what we could achieve in excess baggage. I replied, no – I don’t think so. Today – we have about the same fleet size, but we are collecting A\$110,000 per month.”

Hard Work

He notes: “This big improvement doesn’t come about easily.” Some agents in the field were waiving the excess charges, Lim says. “We collect statistics so finely, that we started to be able pinpoint the reasons why these guys are avoiding it – they put a lot of the waivers down to on-time performance issues and also VIP travelers.

“So I said, I don’t care who it is, I don’t want to see any more VIP exceptions – if they complain ask them to come and see me. So essentially it needs a lot of follow up, monitoring and analyzing. We had no absolute benchmark to aspire to, but we just wanted to go as far as we can.” Putting the collection through the global distribution system, rather than doing it manually,



was a big help Lim says.

Rex has “productivity committees” tasked with coming up with new initiatives that are then tracked to see what is actually achieved. “I have looked at the amount of productivity gains over five years – and I would say more than 50% of our profits came about because we embarked on these initiatives. That’s why our margins and profitability are great – because we can squeeze out every last drop.”

Having the right fleet has also helped. Lim says the Saab 340 scores highly on the three areas of fuel efficiency, asset price and maintenance cost. “There used to be a time when turboprops were looked down upon. But that’s changed. Now 30-50 seater jets are almost never making money. Even the 70 seater is questionable.”

Rex is in the process of bringing in 25 Saab 340Bs and phasing out the older 340As. “We think we have come to the

stage where we can afford to have a better product.” All aircraft are funded by cash rather than debt. “We used to be laughed at by all the analysts,” Lim recalls. “They would say we had a lazy balance sheet.” Lim feels vindicated on this issue. “That’s the Asian way. We try not to borrow money if we can help it.”

Forecast Maintained

The current economic downturn has seen passenger numbers drop by around 3-4%, Lim says. “Fortunately, the elasticity of demand means that we have been able to put in a slight increase in prices. So we are still maintaining our forecast of making as much profit as last year. This is not too bad in an environment like this. Most people would foresee at least a 30% drop in profits in this environment.”

Lim notes that a number of Australian regional airlines have already collapsed, and makes no bones that he

fully expects others to follow suit in the not so distant future. In mid-January, Queensland’s MacAir, a fellow Saab (and ATR) operator, ran into financial difficulties, asking the state government for a A\$7 million bail-out to tide it over in difficult times. The carrier’s creditors have been lodged winding up orders in court.

The state government has refused the A\$7 million bail out request, but has agreed to a top-up to the A\$4.7 million MacAir receives under the essential air services contract. But to receive the extra money, the carrier’s essential services contract is to come up for renewal around the end of March.

Rex was actually approached by MacAir last year to see if they were interested in buying it, but Lim said no then and sees no reason to change his mind. Indeed, Lim will clearly need some convincing before he puts his money into Australian regional carriers.

“Even the more solid ones are heavily reliant on resource charters – if that turns out badly they will be in trouble as well.” For the very small ones – Lim expects many to go to the wall. “It’s not just the economic situation – it’s the fact that the regulators are getting more and more stringent, which requires more and more resources.”

Pilot Problem

The downturn has at least resolved a pilot shortage problem that was a thorn in Rex’s side. “For the past financial year – 07/08 – we lost 50% of our pilots. I don’t know any airline that could lose 50% of its pilots and continue largely unmodified. Since this financial year started in July, attrition rates have dropped back down to almost a stable rate, which is 15-20%.”

The pilot shortage, sky high fuel prices contributed greatly to what Lim described in the company’s financial report for the year to June 2008 as an “annus horribilis”.

“Not even the most solid of airlines could survive this twin onslaught without massive damage. Yet survive we did. And more. After a hesitant start to the first half, Rex’s second-half operating profits improved by 15% over the previous year.” He added: “What is even more pleasing is that in the fourth quarter when the oil prices reached the giddy heights of US\$140 a barrel, we managed to improve our profits further by 32% over the prior period.”

“I do not know of many airlines which improved on their profitability in those three months. In fact, practically all airlines lost money in those three months if we take away the oil hedging affect.”

Lim doesn’t rule out acquisitions in the current climate – but makes it clear that it’s got to work for Rex. “In the last 18 months two smaller operators came to us – essentially saying ‘take my airlines for a dollar’. We walked away as it didn’t make sense. We are looking for synergies. Is this new operation something that we

could tap onto our expertise? It could be operational expertise, engineering expertise, aircraft or so on – but by themselves most small regional ops will be unprofitable.”

Lim also feels that the strategy of not hedging against fuel has been vindicated. “Was it the right thing to do? It was the correct strategy for Rex because when fuel was going up we could recover the entire increase through fuel levies without any impact on our passenger numbers. And to put it in context, even at the height of the fuel price rise we were still cheaper than six years ago. We had brought fares down so much we were still cheaper than when we started – so the consumer was very forgiving.”

Of course, many carriers that have hedged are now feeling the pain. “I always told myself it would turn – you’ve seen the results of that,” says Lim. “You are making huge losses – you’re committed, but passengers are saying, hey, can I have my fuel levy back – so you have this pressure. This was a scenario I was afraid of.”

In the meantime, Lim says the Saab fleet will serve the carrier’s needs for the next ten years. “I’m really hoping that a new turboprop is developed over the next three-to-five years. Jets are too expensive for the market we have. If nothing comes along in the meantime, I will end up taking aircraft that are no better than what we have today.” Still, those seem to be a pretty good job. ■

