

LOW-FARE & REGIONAL AIRLINES

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Regional Express

**Crowning
glory for
Rex strategy**

AirAsia X London-bound



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Crowning glory for Rex strategy

Australia's Regional Express is confounding market trends by turning in a regular profit. Its executive chairman, Lim Kim Hai, discusses the airline's progress with Bernie Baldwin.

“A t the last forecast meeting, we said that we refused to forecast any more. There are just such huge swings in everything. But if things do not continue to deteriorate, we think we should be able to do as well as last year, if not better. But it's just too difficult to do any serious forecasting any more.”

It's rare, at present, to hear an airline boss speak about doing better in the next 12 months, never mind building on a profit of A\$8.3 million in the quarter which saw oil prices

hitting more than \$140 a barrel. That, however, is just what Regional Express's (Rex's) executive chairman, Lim Kim Hai, is doing.

PRICING IT RIGHT

The airline's fiscal year ends on 30 June, and for 2007-08, the annual profit was A\$24.3 million, up 3.0% on the previous year.

Significantly, Rex was not frightened to say to passengers, “Look, if fuel is too costly, we have to pass on that cost.” Although no

customer likes a price increase, the reaction was not too severe, partly because the airline's main constituency of business travellers recognised the market situation.

“Yes, that's part of the reason,” Lim acknowledges. “The other part is that we have brought down our fares such that, even today, with a A\$40 surcharge making a total average one-way fare of about A\$130, we are still cheaper than when we started six years ago. So a lot of business travellers still find

it cheaper than driving the car – it saves a lot of time.

“We are reaping the benefits of all of the efforts that we have put in in the last six years, so that even today, with a horrendous 30%-35% surcharge, travellers still find that it's not so bad. Which product has not gone up [in price] in the last six years?” he queries.

Moreover, while oil prices affect almost all businesses, few have such a high association with fuel. Aviation is first on the chopping block. “Look at all of the major airlines – currently, they range from something like 40% to as much as 70% for AirAsia in terms of the fuel component of total costs. So obviously, airlines are extremely vulnerable to fuel fluctuations,” Lim notes.

INDEPENDENT BUSINESS

With its fleet of Saab 340s going to smaller cities, Rex tends to carry many of the people who make ‘Australia plc’ work. “It is first and foremost a business service – that's how we started six years ago,” Lim confirms. “But by the way we have done our pricing and our business model, we have actually enlarged traffic by 50%-70%. This means that people not travelling

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LIM KIM HAI, EXECUTIVE CHAIRMAN

for business have got used to the idea that somewhere they want to go is ‘just a hop away, it's affordable, so why don't we do it?’ I would guess that the passenger split is probably in the region of 60:40 business versus leisure.”

Confident in its product, Rex has done little in terms of codeshares and interlines, working hard to keep its independence. “We made a very conscious decision to steer away from being close to other airlines,” states Lim. “Up to today, we don't have any agreements with any carriers. The only thing that we have – and that's a legacy from five years ago – is a baggage check-through agreement with Virgin Blue.”

As for recent reports about Rex taking shares in Virgin Blue, Lim is non-committal. “Rex has

said that whatever the shareholder does is the shareholder's business. And the shareholder has not responded to any of the allegations,” he emphasises.

PILOT PRECAUTIONS

Although Rex has been profitable in recent times, this has not been achieved without a struggle. In particular, the airline has had to suspend routes due to the pilot shortage in Australia. It has responded by opening a flight school, the first trainees from which have just graduated, but into an uncertain market.

“The situation has changed quite dramatically between around July and now. Before July, things were still fairly optimistic, and then things turned really, really bad,” says Lim. →



Rex recently bought four Saab 340Bs which had been operating in the fleet under a lease which expired in October 2008. The airline now owns 24 of the 40 Saabs it operates.



For the second year running, Lim Kim Hai receives the Centre for Asia Pacific Aviation's Regional Airline of the Year award from Peter Harbison, CAPA's executive chairman.

“Together with the whole financial system collapsing, everybody now realises that they are going to be in for a bad time for the next 12-18 months or even two years.

“So the impact of that is that many of the airlines in Australia have shelved their expansion plans, and we’re seeing a period of reprieve in terms of the aggressive poaching of our pilots. We are now at a level where we are losing about 20% of our pilots annually. That’s a level we are comfortable with. The previous financial year, we lost 50% – that was very difficult. Twenty percent, if it stays, is the natural flow that we would expect.

“On the other hand, we have started the school, and this is designed to provide between 15% and 20% of our pilot strength every year. So with the school alone, if the attrition rate doesn’t go beyond 20%, we would be able to supply enough pilots without having to go outside to look for them.

“The net result is that the situation is turning very rapidly, and we expect to be in a healthy position if this attrition rate keeps up [at 20%] by the time we are in January or February,” adds Lim. “We will keep the steady supply to our own airline, and the advantage is that with this steady supply, we would be almost bullet-proof against any future attempts to recruit pilots from our ranks.

“The school’s main purpose is actually to shelter Rex from any future waves of recruitment. And we must not kid ourselves – the order books are still there. We know what is on the order books; it’s still frightening when you look at the total combined orders to be fulfilled in the next three years.

“So while there is a temporary reprieve, we want to be sure that we can insulate ourselves from the next big wave if it does come. However, after mastering the mechanics of the school, it is obvious that we would continue to drive economies of scale so that we could even turn out pilots for other airlines. We think that the school can easily produce about 200 pilots a year. So we’ll be needing 30-40, and we think that we have the capacity to take on some pilots from the other carriers.



Piper Warrior aircraft are among those used for training at Rex’s flight school, the Australian Airline Pilot Academy.

“I think that the need for pilots generally will not decline significantly. There may not be a sudden surge, but there will still be a very strong, steady demand,” he summarises.

As most airlines do when spending money to train pilots, Rex protects its investment by having new pilots sign a bond for six years of service before they can move on. If they want to leave before then, they have to buy themselves out of the bond, and that is not easy for the individual in the current climate. So if any bigger carriers really do get desperate, they will have to come up with the money to buy a Rex pilot with something akin to a transfer fee.

■ SMALL-TOWN SERVICE

To reach further into the New South Wales hinterland, Rex has used its subsidiary Air Link, operating to eight destinations from Dubbo. Six of the destinations will stop receiving service on 20 December, though (the other two will be taken over by Rex itself) due to a change in federal government policy making the routes uneconomical.

Lim explains the dilemma. “After the collapse of Ansett, in an effort to try to maintain services to regional areas, the federal government put in place a scheme to waive the en-route air services charge. So the government has been reimbursing these charges to assist regional aviation. This was a measure put in place to try to help the regional airlines, and whether you fly

to a small town or to a fairly sizeable regional town, this waiver is applicable. But the federal government announced recently that it will stop giving this en-route rebate quite soon.”

Unlike the US, with its Essential Air Service programme, and Europe’s Public Service Obligation routes, with the rebate gone Australia has no other mechanism to help to pay for small-community services. “It’s quite strange because Australia is a country that almost has to have regional air services,” Lim opines. “There are some state governments that have subsidised certain air services to really remote and small areas, but that is about the extent of it.

“Also, in the big scheme of things, the subsidy they’ve been giving for this en-route charge is not huge on the national scale. It’s probably about A\$6-8 million a year for the entire regional aviation industry. And it’s about the only thing they ever do for regional air services.

“The impression I get is that everybody pays lip service to the regional air services,” Lim continues, warning to the theme. “They don’t put very much priority on them. In a way, that is the price we pay for being successful. Because it would appear that it’s doing well: our passenger numbers have grown in the last six years by 70%, if not more. It would appear that Rex is in good health, so why would the government want to do anything for something that seems to be doing well?”

With Air Link now a charter-only operator, Rex will be concentrating on its main network using its 40 Saab 340s. As mentioned, the growth since inception has been considerable, so is a point approaching where certain routes could handle a larger aircraft?

“I think if you are talking about a larger aircraft in terms of a higher number of passengers a year, that’s the wrong debate,” Lim responds. “To give an example, we service a town called Port Lincoln, which has only about 10,000 inhabitants, eight times a day. You could put a larger aircraft and serve it four times a day or three times a day, or you could even put on a 747 and do it once a day.

“Even if we had an aircraft that was completely compatible, and it was a 50-seater, we’d have to ask ourselves, given the route that could support that size of aeroplane, would we want a revised frequency with a bigger aircraft?” he questions. “Obviously, the traditional argument is that a bigger aeroplane is more efficient. That’s true to some extent, but on the other hand, a bigger aircraft limits your frequency. That’s the mathematics.”

The other part of the mathematical equation is the economic life of the Saabs. Even the newest of these was made in the late 1990s.

■ NO AGE CONCERN

“I think that for any aircraft, when it has reached 10 years of age, the maintenance costs will not change much whether it’s 10 years, 15 years or 20 years [old]. By the time you reach 10 years, you’ve done nearly all of the things you need to do in terms of changing all the main parts,” Lim argues. “Therefore, the age of the aeroplane, in terms of the maintenance costs, doesn’t really go up very much more. Maybe a slight creeping of a few percent more, but that’s about it.

“So maintenance costs are not an issue, especially for an operator like Rex,” he adds. “We’ve been maintaining these aircraft for the past 20 years. We are probably the most efficient maintainer of this fleet in the world. We have a huge amount of spares; we know the aeroplanes pretty well. So maintenance is one of the reasons why we can operate this very well.”

Lim is confident that his aircraft will be going for the next 10 years without any difficulty, particularly as Saab has extended the life of the 340 with an increased number of cycles.

The aeroplanes obviously play an important role in delivering the product – what Rex offers the passenger for his or her money. The key offering, though, according to Lim, is time. “Usually, the distance by road [between Rex destinations] is about five hours in terms of the drive time. So for a five-hour drive, you are exchanging it for one and a half hours – one hour’s flight time and some ancillary time. That’s a lot. Gaining three hours for a businessman and paying 100 [Australian] bucks one-way for it doesn’t seem like a bad deal.



“However, it’s not even A\$100 really, because if you had to drive the five hours yourself, imagine the fuel for which you’d have to pay. So a businessman taking the car and driving for a meeting would probably save only A\$20, not including a sandwich and a coffee. So it’s a no-brainer for the business traveller,” he declares.

Although this sounds like classic regional aviation, Lim believes there are important

differences. “If you tried to transpose the Australian model onto Europe or America, you’d find that it’s totally amazing. How often would you have small villages and hamlets of 10,000 people having three returns a day? We have many of them with 10,000-15,000 people, where we give them five frequencies a day. How often do you see that?” he challenges. “Imagine how that transforms the city, because it becomes like a bus. One hour is what people would normally take to drive to work.

“So the entire model, in fact, is staggering. If you look at it from an American and European point of view, you can never understand it. Or what we’ve achieved giving them this frequency, this convenience for such small cities, and at the same time being able to make money.”

■ COMMUNITY PARTNERS

Despite this contribution, Lim does not see Rex as an outright community airline. “We have no choice, as we are restricted by our aircraft type. We do not deliberately go and serve the community,” he comments, “but obviously, in the process of making our business model work, we also bring a tremendous amount of value to the cities we serve. We view ourselves as partners, and that’s what we always tell them. We tell the town councils that there are three stakeholders to this – the airline, the town council that owns the airport, and the community. Our model has resulted in all three partners gaining tremendously.

“The council gains because the amount of throughput at the airport means they collect a lot of airport tax. The community gains, of course, because we bring down fares and bring up the frequency, and we gain by more people flying,” he explains.

“I don’t look at our operation as a kind of monopoly, even though – in effect – we are a monopoly. We have about 35 routes, and on 30 of them, we are the only provider. But we have moved away from the monopolistic model and gone into a model where we are our own fiercest competitor, and that has been shown to be tremendously successful,” Lim concludes. ■