Contrary opinion

Regional Express chairman Lim Kim Hai relishes his reputation as an industry maverick, writes ***Colin Baker***

Lim Kim Hai is an unusual figure in the airline industry. For a start his airline, Australia's Regional Express (Rex) consistently makes money - it has been profitable since 2003-4 and, Lim notes, has been the most profitable airline in Australia for the last two years. Although Lim would be the first to admit that that is a somewhat hollow boast.

He is also one of the few airline heads not to live in the county where his airline is based - he resides in his native Singapore. Lim is very much an industry outsider - his background is varied, but he is essentially an entrepreneur, with investments in various sectors including biomedical companies, property and mobile technology.

Lim first became involved with Rex in 2002 as a passive investor. However, after six months he left the board in February 2003. "I could see it was going pear shaped," he says. By June that year, Rex ran out of working capital and the minority shareholders asked him to come back as executive chairman. It scrapped a A$1 million pre-tax profit in his first year at the helm, and has accumulated around A$230 million in pre-tax profits up to the present day.

Lim's turned his lack of industry experience to his advantage, questioning orthodoxies wherever he saw them - something he continues to do to this day.

At a time when most airlines are increasing the proportion of their fleet that is leased, REX is buying aircraft that it currently leases. It plans to buy the 25 Saab 340s that it doesn't already own (out of a total fleet of around 50) by the end of the June financial year as they gradually go off lease. Saab Aircraft Leasing is the sub-lessor for these, which are ultimately owned by a range of financial institutions.

DIFFERENT APPROACH

At a time when many airlines are outsourcing their spare part needs, REX is doing the opposite. It recently decided to purchase the entire Saab 340 stock from Pinnacle Aircraft Parts, which is getting out of the Saab sector. REX's total spares stock is now over one million parts.

Both these deals had something in common. "Bulk purchases such as these are done at a steep discount. Investments like these actually bring returns in the short-and-medium term," says Lim.

As well as the steep discounts, there was another motivation for the parts deal, says Lim. "We take on-time performance very seriously. We want to be able to keep our aircraft flying, and so we've gone down the path of making sure we're totally self-sufficient."

These and various other investments are part of an A$50 million (US$45 million) capital expenditure programme designed to help mitigate the effects of an economic downturn in Australia that has led Rex to issue a profits warning.

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In the meantime, Rex is again going against the grain on its fleet. At a time when many airlines are racing to invest in brand new aircraft, Rex is sticking with its Saab 340s. The 50-strong fleet has an average age of around 20 years, with the range from newest to oldest around five years either side of that.

Lim is in no rush for fleet replacement - he expects to get at least another ten years out of them - and hopes for even more. "Saab has committed to another 20 years of maintenance, because they have won some military tenders for the same platform," he explains.

"We do not see any sharp increase in MRO costs - an aircraft which has gone beyond 15 years of age would have had most parts replaced and-or serviced. The only thing that is not replaced is the frame."

Fuel costs make up just 17% of total costs - which puts Rex at a distinct advantage, and means that the need for a more modern aircraft is not so obvious.

Another part of the A$50 million investment is going towards an avionics upgrade for the Saab fleet. Thomas Global Systems is supplying a new all-LED display avionics system. "We've worked on it for two years, got the prototype ready and are very satisfied. We're now going through the certification process and will then we'll roll it out across the fleet," says Lim. The new plug-and-play units, which include some mandatory updates, are replacing Rockwell Collins systems.

Lim doesn't completely rule out getting a new fleet at some point over the next ten years, but stresses that he doesn't see anything today that would warrant the effort and investment.

"If our platform was no longer able to do job - we'll look at another platform. As it stands today, I would probably be taking a smaller version of the other existing platforms, such as a [Bombardier] dash 8 or ATR 42."

SOMETHING RADICAL

But to really tempt him, airframe makers would need to update their product lines. "This is my hope - someone will build a good turboprop of the size I require, more efficient, with better avionics. These other aircraft, the dash 8 and ATR 42, do not bring much of an advantage in terms of avionics or fuel consumption. There is no point in going to another platform, unless its due to obsolescence. My hope is that someone comes up with a very modern, very fuel efficient aircraft with excellent avionics - that could be something I could transition. Right now, there is nothing on our radar."

The A$50 million package also funded a Saab 340 full flight simulator (FFS) built by FlightSafety International - the last one the US simulator and training provider built and the youngest of its type in the world. REX already has three non-motion Saab 340 simulators, and will continue its long standing relationship with the Ansett Aviation Training facility in Melbourne to use their Saab 340 FFS.

The new simulator will be installed at the Australian Airline Pilot Academy (AAPA) in Wagga Wagga - a training facility which is owned by REX and something that Lim is particularly proud of as he is seeing the first batch of cadets taken on when the facility opened five years ago now becoming captains.

The AAPA takes about 30-35 cadets a year, with the plan being that they stay with the airline for seven years. The first three years are spent as a first officer, and then the fourth year is a transitional year, when even though they are in the right hand seat, they will be pilot-in-command under a special civil aviation authority-approved programme, before becoming captains in the fifth year.

"One of the difficulties of the ab-initio programme is that all the cadet pilots do not have command hours - and of course you need 500 command hours to be captain," notes Lim. REX has had problems with bigger airlines poaching pilots in the past - it lost half its pilots in the 2007-2008 financial which caused a crisis and prompted the setting up of AAPA.

CAPTAIN CONCERNS

Today things are more stable, but not ideal. "Right now there is not much of a problem with pilot numbers, but we have a problem with captain numbers, because the bigger carriers, when they start to poach our pilots, are targeting captains. Of course, it's much more difficult to get a captain than a first officer."

The flying school is just one of various diversified

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airline related offshoots that the company is involved in. It is also bidding for a search and rescue service for the whole of Australia - which would involved four-to-five Saabs if it wins the contract.

Its charter division Pel Air has a contract with the Victoria State Government for air ambulance work, using Beechcraft King Air 200s. It also carries out fly-in, fly-out missions for mining companies and various other work, including Defence work, using its fleet of four Learjets, six IAI Westwinds, four King Airs, three Saab 340 freighters and one Saab 340 passenger aircraft.

REX though, has not been immune from Australia's economic malaise. "The general economy has shrunk. We do rely quite a bit on business travel, and we can see that that has reduced quite a bit," notes Lim, adding that as a result, yields are under pressure. "These are very tough times in Australia," he says, putting this partly down to the "delayed effects" of the financial crisis, where Australia was cushioned to some extent by the commodity boom.

For the last full financial year to end-of-June 2013, the airline reported a pre-tax profit of A$19.2 million on revenues of A$258.3 million. This was sharply down from the previous year's figures of A$35.1 million and A$273.1 million - but worse is expected this year. "We've given some guidance that profits will deteriorate significantly this year," warns Lim.

Lim already runs quite a tight ship. "We don't wait until there is a crisis. We are continually trying to be more effective and more productive." The carrier has a productivity committee, which comes up with 10-20 initiatives a year.

"So we don't wait until the crisis hits us before we initiate cost-savings. However, when you have a sharp downturn, you may want to look at a few other additional measures," Lim explains. "In the extreme, this would involve retrenchment. We're not looking at that - yet."

TAKE YOUR PICK

Still, at least it is making a profit. Australia's aviation industry is in a pretty disastrous shape, with New South Wales operator Brindabella Airlines the latest of a string of regional airlines to run into trouble. It went into receivership in mid-December last year, and REX plans to pick up its Moree, Cobar and Mudgee routes.

Australia's major carriers, meanwhile, are losing money hand-over-fist. Qantas and Virgin Australia are involved in a vicious battle for market share in what Lim describes as a "race to the bottom".

Lim questions the rationality of this. "My view is that in some of the competitive markets we are in with Qantas and Virgin Australia, the presence of these carriers in some of the markets may not be necessarily rational, in that the market is too small for three carriers to be there," he says.

"When times were relatively good, then this becomes too small an issue to really bother anybody, especially the big carriers. When times are really bad, they will start to question why they are there." he adds. "But given that the positions of Qantas and Virgin Australia are so entrenched, I don't see how any of them can back off, even though commercially, it doesn't make sense."

Qantas has been defending its "line in the sand" of 65% domestic market share. "It's one thing defending that 65%. It's another not knowing where you would retreat to. Especially as it seems to be a war of attrition, because it's one thing if one is losing and the other is making money. But if both sides are losing money then it's a war of attrition. The only reason you're there is to force out the competition."

The problems at Qantas have been well documented, and while the outcome is still far from certain, one possibility is renationalisation. "That's something they will think very carefully about, but a real possibility. In the old days, when Qantas was owned by the government, you also had Ansett - it's not something new," Lim points out.

While Virgin Australia appears to have the upper hand at the moment, he says that this could have negative consequences for the carrier. "Nationalised carriers have a tendency to lose money, and with big government behind them, that could continue for a long time, " he notes. "If I was Virgin, that wouldn't be the outcome that I desire."

COMMON SENSE APPROACH

Lim has long been critical of the airline industry's poor track record on making money. "It's an industry where there is too much passion, too much ego and too much glamour - and not enough common sense. if you look at all the guys that start airlines, usually you can put them into one of these three categories."

Not surprisingly, he has never considered setting up a low-cost airline. "I have not got into any industry that starts to attract other people." But he see the entire airline industry as "irrational and unviable" and adds, "It's not just the low-cost business - the entire aviation industry sucks."

And Lim doesn't see it getting better any time soon. "In fact, I see it getting worse and more irrational. And in certain ways its getting more dangerous. Because you see carriers that sign up for 200-250 aircraft. These carriers, in some cases, weren't around ten years ago."

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Lim is now, ironically, something of an industry veteran, having clocked up nearly 12 years at Rex. The biggest change he has seen in that time has been the end of flag carrier supremacy. "The flag carrier was always dominant, always the biggest and always the most powerful. Now, we've seen in last couple of years - the flag carrier is no longer dominant."

Pointing to the example of Malaysia Airlines and the eventually abortive takeover attempt by AirAsia, he says, "We've seen a situation where the flag carrier was almost brought by the upstart. In some countries the flag carrier is in trouble - and is in some cases even smaller than the upstart. We've seen it in three counties around us - Malaysia, Indonesia, and the Philippines - and it could happen in Australia."

Predictions for the rest of the decade? "I hope rationality will come back, but I doubt it. I personally predict that some of the low-cost carriers will see some form of catastrophe."

He notes that there has been one example of this already in the not too distant past. "At one awards ceremony I attended there was this Indonesian carrier Adam Air that was awarded Airline of the year. One-or-two years later, they were gone." ✈

REX