



***Regional Express Submission to the
Economics and Industry Standing Committee
Inquiry into Regional Airfares in Western Australia***

July 2017

Regional Express (Rex) intends this to be a public document as this is a matter of public importance and relevant to all of Australia. Most of the contents have already been released to the public in various forums and Rex intends to continue to release some or all of the contents to the public. We understand that we may lose parliamentary privilege and we are prepared to do so.

AVIATIONWEEK
TOP PERFORMING AIRLINE
ASIA-PACIFIC 2013

TRAVELLER
READERS' CHOICE
AWARD 2013
BEST REGIONAL AIRLINE

AVIATIONWEEK
TOP PERFORMING
REGIONAL AIRLINE
2009-12

ATW 2010
REGIONAL AIRLINE
OF THE YEAR

Best Under A Billion
Forbes
2009

CANA Aviation Awards for Excellence
REGIONAL
AIRLINE OF THE YEAR
2010, 2008, 2007

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1 BACKGROUND

Regional Express (Rex) welcomes the opportunity to provide a submission to the Parliamentary Inquiry into Regional Airfares in Western Australia.

Rex was founded in 2002 as the merger of Ansett subsidiary airlines Hazelton and Kendell following the collapse of Ansett in 2001. Both Hazelton and Kendell airlines had over 30 years experience prior to the collapse of Ansett. Rex is a dedicated regional airline that operates 52 Saab 340 turbo-prop aircraft (34 seats) to 59 destinations throughout Western Australia, South Australia, Victoria, Tasmania, New South Wales and Queensland. Rex carries around 1.2 million passengers on some 75,000 flights per year. Rex is a publicly listed company on the ASX.

Rex Regular Public Transport (RPT) Network



As such, Rex possesses great experience in servicing sparse population centres with most of regional centres on its network having a population of fewer than 30,000 with the largest regional city having only around 60,000. As a dedicated regional airline Rex is solely focused on the provision of regional air services.

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Over the past 15 years Rex has been very successful in growing regional passenger numbers to record levels with Rex's annual passenger numbers growing from around 600,000 in 2002/03 to around 1.2 million currently. This has been achieved through keeping fares affordable, focusing on efficiencies and on-time performance, all with heartfelt country hospitality.

In addition to Rex's focus on service reliability, Rex is mindful of the tremendous social and economic impact its services have on the regional communities and strives to work in partnership with these communities to balance their needs against the imperatives of providing a sustainable and safe regional air service.

Rex is also committed to giving back to regional communities by supporting worthy charitable causes which are focused on helping those in need. For first half of FY17 Rex contributed over \$300 thousand to various worthy causes ranging from fundraisers and sponsorships to important community events around Regional Australia. Rex also places a high priority on supporting cases of hardship, particularly out in the regions.

Rex has frequently been recognised as the world's best regional airline by aviation experts and as such Rex is eminently qualified to shine a light on why regional aviation has become so unaffordable prior to Rex's entry into WA and how the State could look to reverse this with the correct policies.

2 REX IN WESTERN AUSTRALIA

On 28 February 2016 Rex commenced the Perth Albany and Perth Esperance routes under a Deed of Agreement with the Western Australian (WA) government. This confers onto Rex the sole right to operate on the Perth Albany and Perth Esperance routes for a five year term beginning on 28 February 2016. This was a major milestone for Rex as it resulted in Rex establishing operations in WA for the first time.

From Perth Rex operates 23 weekly return services to Albany and 18 weekly return services to Esperance. Rex has 4 Saab 340 aircraft based in Perth of which 2 aircraft are allocated to the Albany and Esperance flight schedules, 1 aircraft is a dedicated back-up aircraft and the last aircraft used for maintenance and adhoc charter.

In 2016 Rex achieved controllable departure on-time-performance (OTP) (within 15 mins of scheduled departure time) of 93% across the Albany and Esperance routes, which well exceeded the contractual requirements of 80% controllable OTP. Overall on-time-performance including uncontrollable delays due to weather and Air Traffic Control exceeded 86%.

Rex has flight crew and engineering staff that are based in Perth and contracted airport ground handling arrangements in Perth, Albany and Esperance.

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Rex provides the following RPT services in WA under a Deed of Agreement with the WA Government:

Albany Perth (23 weekly services)

ALBANY - PERTH									
FLIGHT NO.	DEPARTURE	ARRIVAL	M	T	W	T	F	S	S
ZL2112	6:30 am	7:40 am	●	●	●	●	●	●	
ZL2114	10:15 am	11:25 am	●	●	●	●	●	●	
ZL2126	1:45 pm	2:55 pm	●	●	●	●	●		
ZL2132	5:40 pm	6:50 pm	●	●	●	●	●		●

PERTH - ALBANY									
FLIGHT NO.	DEPARTURE	ARRIVAL	M	T	W	T	F	S	S
ZL2113	8:40 am	9:50 am	●	●	●	●	●	●	
ZL2125	12:10 pm	1:20 pm	●	●	●	●	●		
ZL2131	4:05 pm	5:15 pm	●	●	●	●	●		●
ZL2133	7:25 pm	8:35 pm	●	●	●	●	●		●

Albany Perth (18 weekly services)

ESPERANCE - PERTH									
FLIGHT NO.	DEPARTURE	ARRIVAL	M	T	W	T	F	S	S
ZL2356	6:30 am	8:05 am	●	●	●	●	●	●	
ZL2358	10:15 am	11:50 am	●	●	●	●	●	●	
ZL2376	4:15 pm	5:50 pm	●	●	●	●	●		●

PERTH - ESPERANCE									
FLIGHT NO.	DEPARTURE	ARRIVAL	M	T	W	T	F	S	S
ZL2357	8:15 am	9:50 am	●	●	●	●	●	●	
ZL2375	2:15 pm	3:50 pm	●	●	●	●	●		●
ZL2377	6:25 pm	8:00 pm	●	●	●	●	●		●

The following also provides some context in regards to the operational dynamics of Rex’s WA Network versus Rex’s Traditional Network* for the first half of FY17:

	WA Network	Traditional Network	Comparison
Passengers	52,707	542,322	9.7%
ASKs (M)	32.8	368.0	8.9%
Load Factor	75.5%	56.0%	19.5% pts
On-Time Departure	86.3%	86.6%	-0.3% pts

* The Rex Traditional Network excludes QLD Regulated (Subsidised) and the WA Regulated Routes.

3 FACTORS CONTRIBUTING TO CURRENT HIGH COST OF REGIONAL AIRFARES

The dynamics of regional air travel inevitably results in higher ticket prices:

- Thin passenger numbers often less than 40,000 pax a year
- The need for day return capabilities for passengers originating from both the regional centre and the capital city. This means that:
 - o Aircraft needs to overnight in the regional centre to allow for early morning departure.
 - o Minimum 3 returns needed otherwise the capital city based aircraft and crew will be left stranded in the regional centre.

These factors result in extremely high inefficiencies with load factors typically in the 55-60% range when typical jet operators need at least 75% load factor to break even and even over 80% for the low cost carriers.

Rex would like to state categorically for the record that, contrary to popular folklore, competition in regional aviation can be particularly detrimental for all the smaller routes of less than 100,000 passengers a year. Competition does not ultimately result in lowering prices as Rex's vast experience has shown and in fact can destroy efficiencies and result in higher airfares and lower profits (or bigger losses) for all concerned.

A case in point is the example of the Adelaide to Port Lincoln route in SA. Before the entry of QantasLink (QL), Rex was servicing the port with 10 returns a day. After QL's entry, Rex now has only 6-7 returns a day and the average Rex airfare is 30% higher than what it was before QL's entry 7 years ago. This is because with the lower load factor that both carriers now face, higher average fares are required to compensate for the lower load factors and higher inefficiencies. The end result is negative for everyone – the community has fewer real schedule choices (QL's 3-4 returns essentially mirrors Rex's schedules) and the customer has to pay a much higher ticket price while the carriers see their profit margins at barely sustainable levels. The Adelaide to Port Lincoln route has around 175,000 total annual passengers.

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To better understand the operating cost situation in WA we have benchmarked against Rex’s vast Traditional Network of more than 50 routes throughout SA, VIC, NSW, TAS and QLD as outlined in the following table;

First Half FY17	Albany	Esperance	Traditional Network
Flight Duration (hours)	1.16	1.58	1.16
Average airfare per pax (excl. airport taxes & GST)	\$144.25	\$171.83	\$162.18
Average airport charges per pax (excl. GST)	\$53.76	\$44.19	\$15.58
10% GST	\$19.80	\$21.60	\$17.78
Average airfare per pax (Inc. airport taxes and GST)	\$217.81	\$237.62	\$195.54
Revenue to Rex per pax, per hour (Excl. head tax and GST) (% of traditional network)	\$124.35 (89%)	\$108.75 (78%)	\$139.81 (100%)

Based on the above, we can draw the following observations:

- A. The cost of airport charges in WA are astronomically high, some 300% – 350% higher than the rest of Australia. To put this into context, the revenue received by the airports for the Albany sector is 40% of the revenue that Rex receives (excluding airport taxes and GST).
- B. Rex is one of the most efficient regional operators in the world and Rex’s traditional network average fare given in the table above represents the lower limits of regional airfares in Australia. In the case of the Adelaide to Port Lincoln route cited earlier, Rex’s average fare per hour of flight is some 7% higher than the average of Rex’s traditional network and between 20% and 40% higher than the Albany and Esperance routes operated by Rex. This illustrates that Rex’s average fare is not exceptionally high due to lack of competition.
- C. Regional aviation is inherently more expensive than domestic or international aviation due to the poor economies of scale associated with needing to respond to regional dynamics highlighted earlier. The operating costs for a regional carrier are around 3 times higher on a per seat basis than a larger carrier operating larger jet aircraft on significantly higher volume passenger routes. Even with Rex's high level of efficiency associated with operating more than 50 aircraft on 75,000 flights per year, Rex's FY 16 operational profit before tax amounted to only \$4 per passenger per flight hour of over 400 km. This means that on a ticket price of about \$200, a \$5 reduction in average fare would put Rex out of

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business. A taxi driver would make more profit carrying the same passenger 18km between Perth Airport and Perth CBD.

- D. The Rex average fares on the Perth Albany and Perth Esperance routes represent very good value for money. If we strip away the airport charges, on a per hour basis it equates to \$15 - \$30 reduction over Rex's average fare in its traditional network. When we consider that Rex's profit is only \$4 per hour of flight, we realise how significant the reduction is. We invite the Standing Committee to examine the average airfares of other operators in WA that fly the smaller regional routes with turbo prop aircraft to compare the hourly rates exclusive of airport charges.
- E. The Rex standard full economy fare (excluding airport charges and GST) for Perth to Albany represents \$0.65 cents per km flown and for Perth to Esperance represents \$0.49 cents per km flown. The Rex full economy fare for the Rex traditional network represents an average of \$1.22 per km flown. The standard full economy fare is the benchmark fare for all other published fares that are available.
- F. Virgin Australia Regional Airlines (VARA) operated the Perth Albany and Perth Esperance regulated routes prior to Rex with higher published fares than those currently offered by Rex. VARA publicly announced that the routes were not profitable and they therefore did not put in a submission for the current licence term. VARA subsequently exited the Albany and Esperance routes in February 2016.

4 IMPACTS THAT HIGH-COST REGIONAL AIRFARES HAVE ON REGIONAL CENTRES FROM A BUSINESS, TOURISM AND SOCIAL PERSPECTIVE

Regional air services linking remote and regional communities with Capital Cities are critical to the socio-economic wellbeing of Regional Australia. Regional air services are essential in the provision of business (including mining), government, medical and education related travel. Discretionary travel, including visiting friends and relatives is also very important for the social wellbeing of regional communities. As such regional communities will be severely affected if air travel is out of reach.

We believe that once air travel becomes unaffordable, the entire socio-economic fabric of the regional communities will enter into a terminal downward spiral. On the other hand, affordable fares will stimulate the economic activity of the regional cities as more industries will be attracted to set up their businesses there.

5 IMPACT OF STATE GOVERNMENT REGULATORY PROCESSES ON THE COST AND EFFICIENCY OF REGIONAL AIR SERVICES

In Rex's experience, the current regulatory process is efficient and does not impose a heavy cost burden. However the regulatory policies may need to be reviewed if the State is serious about achieving lower regional airfares.

The currently regulatory process did provide Rex with a structured environment to enter WA and this would not have been possible in the absence of the route regulation. Rex sees this as positive measure as it encourages new entrants to the State which in turn makes for a more competitive aviation landscape.

6 ACTIONS THAT THE STATE AND LOCAL GOVERNMENT AUTHORITIES CAN TAKE TO LIMIT INCREASES TO AIRFARES WITHOUT UNDERMINING THE COMMERCIAL VIABILITY OF RPT SERVICES

Rex believes there are several actions that the State and Local Government authorities can take to limit increases to airfares without undermining the commercial viability of RPT services.

Local Government

In Rex's vast non WA network of 55 airports, around 70% of the council owned regional airports are not able to even recover the operating expenses from the airport charges. However they understand that charging a head tax rate to cover operating expenses would make the marginal air service completely not viable.

Regional airports were vested to the local councils at no cost (often with a large sum to offset future maintenance costs) by the Federal Government prior to 1991. Regional airports are a vital piece of community infrastructure and form a valuable community asset.

Local Councils should not consider the airport as a cash cow. Regional airports should be treated no differently than local roads and bridges as critical local infrastructure that has broad ranging benefits across the entire council municipalities. Yet, most regional airports adopt a user pays approach that requires the 'airport business' to stand-alone at no cost to the council ratepayer and in many cases generate a substantial surplus back to council.

Regional airports are dynamic with ever-changing passenger throughput and activity levels. In a competitive environment, regional airports should consider passenger and activity growth (and subsequent improved airport efficiencies) rather than simply applying routine increases of either CPI or greater.

Rex estimates that it costs about \$600,000-\$700,000 annually to effectively operate a regional airport, which includes having an adequate sinking fund to undertake significant airport works. In

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the case of the WA regional airports to which Rex operates, Rex generates airport revenue of between \$1.0M to \$1.6M – some \$0.4M to \$1M above the normal operational needs. The Standing Committee should seek to understand why the needs of the WA airports are so high when 70% of the airports in Rex's network can sustain an air service with less than \$600,000 revenue a year.

From Rex's experience, the high cost of depreciation is often cited as the basis for needing much higher airport revenue. It is well and good for regional airports to receive State and Federal Government funding for airport investment however this increases the asset value of the airport which in turn causes airport depreciation costs to spiral out of control.

The concrete steps that the local councils can take to lower the cost of airfares are:

- Reduce airport charges / reduce the airport passenger tax. If this reduction is translated into lower ticket fares, there will be a stimulatory effect on the passenger numbers. More importantly it will create a positive impact on the socio-economic well being of the community. The net gain to the community far outweighs, in our opinion, the drop of airport revenue and local councils should get out of the myopic mindset and think of the bigger and longer term good of their community. Separate from the social advantages, the economic activity generated through a regional airport far exceeds any perceived short-falls in a regional airports financial position.
- Work in Partnership with the airline. Rex has pioneered and successfully implemented many partnership programmes with various cities where both parties invest into growing the passenger numbers by reducing the airfares. This has also been successfully implemented in the WA ports Rex services as will be described below.
-

State Governments

The WA State Government has little control over the airport charges at both Perth airport and the regional airports. However it could license more routes and then use this ability to regulate the number of carriers such that it could achieve the following:

- Achieve the highest level of operational efficiency through higher load factors;
- Ensure that the efficiency gains are passed on to the passenger by ensuring the carrier only makes a fair economic return on the route. By so doing, the added efficiency would automatically translate into a lower ticket price;
- Ensure more frequencies as the passenger demand is stimulated.

The awarding of the Albany and Esperance routes to Rex through a competitive tender has clearly shown how this model could work. From a money-losing venture for VARA, the route now has

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more frequencies, lower published fares, and a sustainable service since there is a sufficient fair economic return for Rex to want to continue servicing the routes.

This approach could and should be applied to other city suitable city pairs like Perth-Geraldton for example. A tender could be called to assess the commitments a carrier is prepared to make if given the right to be the sole operator - even on routes that already has competition. This is done by the Queensland Government who has regulated the Brisbane to Roma route that had over 200,000 annual passengers.

On larger routes that have several operators, Rex would also like to see both State and Federal Governments strictly enforce the best fare of the day (BFOD) travel policy for government related travel, in the absence of public servants being able to personally from frequent flyer or loyalty reward programs. This will ensure a level playing field for all carriers whilst also protecting taxpayers' money. The larger carriers have been able to charge significantly higher airfares to public servants travelling on government business due to the public servants being enticed by personal loyalty rewards. Without strict enforcement of the BFOD policy, public servants will find ways to circumvent the BFOD policy to end up flying on a higher priced fare in return for personal benefit.

In addition to costing the Government more, this practice has the nefarious effect of driving the small regional competitor out of business and without competition, the larger carriers are able to charge even more extortionist pricing as evident on some of the routes in WA. Without Governments strictly enforcing BFOD travel policies they are effectively contributing to the higher cost of air fares.

7 ACTIONS THAT AIRLINES CAN TAKE TO LIMIT INCREASES TO AIRFARES WITHOUT UNDERMINING COMMERCIAL VIABILITY OF RPT SERVICES

In regional airline terms Rex is an extremely efficient operator, and we have already set about making airfares as low as sustainably possible on the Perth Albany and Perth Esperance routes. We have also seen above that Rex has delivered average fares in WA that are around 25% lower than the prevailing levels elsewhere in Regional Australia.

Furthermore, Rex has introduced a revolutionary Community Fare scheme on the Albany and Esperance routes in partnership with the City of Albany, the Shire of Esperance and Perth Airport. The Community Fare is priced at \$129 fully inclusive for both the Albany and Esperance routes and on an annual basis we have seen more than 8,000 community fares sold on each of the routes (in the first year of the scheme and this will no doubt increase in subsequent years) which equates to approximately 15% of total passengers and about \$1.2m savings for the community based on the average fare.

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The scheme has been so successful that all of the stakeholders have recently signed on for a 3-year extension of the scheme through until 30 June 2020. To achieve the \$129 fully inclusive price for the customer Rex has to lower its core fare to \$63 (Albany Perth) and \$73 (Esperance Perth) in order to accommodate the airport charges at Albany, Esperance and Perth. This is a significant investment undertaken by Rex to make fares more affordable and to stimulate passenger growth.

8 RECENT ACTIONS TAKEN BY OTHER AUSTRALIAN GOVERNMENTS TO LIMIT REGIONAL RPT AIRFARE INCREASES

NSW: In NSW, intrastate routes with less than 50,000 annual passengers have historically been licensed to a single operator. The NSW Government has deregulated some routes and is in the process of deregulating the remaining routes. This is not expected to have any impact on fare affordability.

QLD: The QLD Government has the most enlightened approach and has the most successful, innovative and progressive programme that Rex has been involved with.

As part of a competitive tender process, the QLD Government has regulated 7 routes of which 5 routes were awarded to Rex. As foreshadowed earlier, even large regional routes like Brisbane - Roma (historically more than 200,000 passengers) are regulated to a single operator and put to tender.

The tenderer will stipulate all the committed service levels including fare levels and also the required level of subsidy for thin routes or payment to the Government for the larger routes.

This system ensures that every route is operated at its maximum efficiency, fair economic returns are generated for the operator, the community gets fair pricing and schedule and the supernormal profits are returned to the community.

SA has only one licensed route and it has no impact on fare levels.

Rex is not aware of any other initiatives by other Governments that will limit RPT airfare increases.

9 SUMMARY AND CONCLUSION

- Regional airfares on thin routes are condemned to be at least 300% more expensive than the equivalent airfare of a large jet on big routes due to the inherent rigidity and inefficiencies of regional air travel. This is true everywhere in the world from Rex's vast experience with its overseas counterparts.
- Rex's airfares in WA are significantly lower than its average airfares in the rest of its network due to the higher load factor achieved. Rex acknowledges that this lower airfare may not be representative of other regional routes and operators in WA.
- Both Perth and the regional airports charge a passenger head tax that is much higher than in the other States and this pushes up the fully inclusive ticket prices up by about \$30 for each one way flight.
- The State Government could bring effective lower fares by licensing the bigger routes of up to 200,000 annual passengers and putting these routes out to tender. Rex estimates that airfares could fall by over 25% if tendered out correctly with the proper safeguards.

Rex welcomes this opportunity to provide the Economics and Industry Standing Committee with this brief position paper and offers to share our vast experience in regional air services, including our experience with the QLD model, through more in-depth face-to-face discussions.