

Regional Express



Hitting the sweet spot

by Gerard Frawley,
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Regional Express – or Rex – has been one of the big success stories of late in Australian aviation.

The airline was formed a little over four years ago out of the ashes of the Ansett collapse with the merging of Ansett owned Kendell and Hazelton. But the airline’s start was tenuous, posting a first year loss of \$24 million. There were disagreements between the airline’s then shareholders and the challenge of merging two different airline cultures to cope with, not to mention the competitive threat from QantasLink plus the usual economic and regulatory hurdles of operating a regional airline in Australia.

But any doubts to the viability of Australia’s largest independent regional airline have certainly been erased. In the 2005/06 financial year Rex reported a 140 per cent profit increase to \$15.7 million, on revenue double that of four years ago. It has consolidated its operations hubbing out of Sydney, Melbourne and Adelaide flying to regional centres in four states, acquired a 50 per cent holding in night freight operator Pel-Air and 100 per cent of Dubbo based Air-Link, floated on the stock exchange, and most recently announced plans for a complete fleet renewal with the acquisition of 25 Saab 340B Plus airliners.

“There’s no great secret to it all, it’s all fairly basic stuff,” Regional Express managing

director Geoff Breust said of the airline’s profitable growth in an interview with *Australian Aviation* at Wagga Wagga recently.

“It is a very tough industry, there’s no question about that. It is difficult, but by the same token you can be successful if you work extremely hard on making sure there’s a level of efficiency and that you’ve got control over your costs.”

Breust explains that there are “three basic platforms” to Rex’s turnaround and growth. These are operating reliably and on time, making fares affordable, and partnering with the regional communities it serves.

“The second part was to adopt the strategy of making fares much more affordable,” Breust explains. “Whilst that’s easy to say it’s really quite hard to do, because you have to really go out and work on your costs to get your cost structure right.”

Lower fares have driven increasing traffic numbers, with Rex passenger numbers up 15 per cent last financial year (to 1.2 million), with the airline now operating over 1200 flights a week to 32 destinations.

“The Rex average fare now is considerably lower than what it was when we first started,” says Breust. The average Rex one-way fare is around \$100, excluding the airline’s fuel surcharge. “And even with the fuel levy in it’s still some 20 per cent lower than what it was four years ago.”



The affordable fares strategy has created its own virtuous circle.

"Having the fares affordable has given us the ability to be able to increase demand, and we've had strong growth across the network as a result. That has then led to us increasing frequency and capacity, upgrading the aircraft from 19-seat Metro services to Saab 340 services, and increasing our economies of scale quite considerably and reducing our unit cost. That's basically the approach we've had to turn the losses around into considerable profits."

The airline has also been quite successful in working with the regional cities and communities it serves, especially council operated local airports.

"The third approach to it is that we very much see ourselves as being a regional operator and being a partner to the regional communities we serve," says Breust. "That's important because you need to be very much aware of the regional community, to be very much aware of the business activity and the travel requirements of those communities, and actually tailor your service to satisfy those needs."

Rex's partnerships with regional communities has been as successful as any airline's. In particular Rex has developed incentive based commercial arrangements with a number of local council operated regional airports which has resulted in increased passenger numbers and lower per passenger charges.

"One of the parts of that which we believe to be extremely important are the partnerships we've been able to enter into with local councils that operate airports. We see that the operation of the air service and the operation of the airport and the costs associated with those two go hand in hand."

Rex has a range of agreements with the regional airports it operates to, which help reduce the airline's costs and increase traffic numbers. Perhaps the best example of this is at its engineering home base of Wagga Wagga, where the charge for each passenger in excess of 70,000 per year falls by 75 per cent, and by 90 per cent where total passengers exceed 80,000.

"That's a great incentive to us to not only pass on that reduction through lower fares, but on top of that to invest in more services. And what's happened in Wagga is that we've now gone from four return (Sydney) services weekdays to six... That in itself has generated more market for the services because it is convenient."

Rex now has incentive based charging regimes at more than a dozen of the airports it flies to, so where would the airline be without them?

"It would be much more difficult for us, no question about it. We would not have been able to achieve the sort of growth levels that we've been able to achieve. But the feedback we have is that those communities where we have those arrangements in place are really seeing the benefit of that."

"We can provide a service which is affordable to the people who are using it, and one where we can use fare levels, because of the low costs, where we can further generate market growth."

An example of that growth is the increasing use of Rex services for workers to commute from homes in regional centres to the major cities to work during the week.

"The bottom line is you've got to have a cost structure that can enable you to be able to afford to do that, and that's why we particularly have been quite vocal in our comments about the cost of infrastructure and the cost of regulation, because we've worked really hard to get our cost structure right. The ones that we don't have control over, the costs of airports and landing charges, Airservices and the costs of regulations – they're the ones we really need to put some pressure on to get some efficiencies there. So that's why the partnerships with the councils and the airport operators are so important."

Tight controls on costs, fare levels that stimulate markets and larger aircraft operating more frequent levels of service all combine to give Rex a growing size and scale that other smaller regional airlines lack.

"There is also a need for a level of economy of scale. You need to have a level of activity which enables you to cover off the really substantial overheads that are involved. One of the difficulties that I see for regional aviation in this country is that there are quite a number of operators that really don't have that level of economy of scale, that don't have that critical mass. I see that as going to be an issue for the future."

"I see that possibly as an area whereby Rex can be the saviour in certain circumstances, because we've now reached the stage where we have got good economies of scale, we have a got a good level of critical mass and we can provide a service to a market on a cost basis which is lower than somebody who has only got a few aircraft."

Conversely Rex's size and scale for the most part sits comfortably under the Qantas behemoth. Rex's recent withdrawal of services from Armidale and QantasLink's withdrawal from South Australia and Burnie in Tasmania means Rex and QantasLink compete on just four routes – Sydney-Wagga, Sydney-Dubbo, Sydney-Albury and Melbourne-Mildura.



Regional Express managing director Geoff Breust was a former general manager and then CEO of Kendell Airlines. He joined Rex in January 2004.

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Rex was formed by Australiawide Holdings in February 2002, a consortium of Singaporean and Australian business interests. The airline was close to collapse before major Singaporean investors Lim Kim Hai and Lee Thian Soo gained control of the company and set about restructuring it.





Inside one of Rex's maintenance hangars at Wagga. Saab 340B VH-KDQ (foreground) is undergoing a C check, newly arrived Saab 340B VH-ZLX is being prepared for service entry with the airline.

"We compete quite fiercely on all those markets," Breust says. Rex also operates Sydney-Ballina, as does Jetstar and Virgin Blue, but the two jet operators fly non-business friendly schedules there.

"We still believe there are a number of (new) markets where Rex could be quite successful, but by the same token there is no great pressure on us to expand the network out further. There's no huge pressure on us to go out and compete heavily against QantasLink on other markets."

QantasLink too is moving away from its smallest aircraft, the 36-seat Dash 8 100/200, although some growing Rex routes could be the target of more efficient QantasLink Dash 8 Q300 services in the future.

Although only competing with QantasLink in a few, albeit key, markets, Rex says its approach to serving its ports is the same whether they are competitive or monopoly routes.

"Our approach for the routes we operate by ourselves is the same approach where we operate in competition with somebody else, particularly QantasLink. We try to keep fares as affordable as possible. We like to have fares in the \$99, \$109, \$119, \$129 lead-in type levels across the network, depending on the route length and other issues. And our whole approach to it is that as the load factors on all of those routes get to a point where we're above the 70 per cent,

75 per cent level, we'll start putting in extra capacity, either through upgrading from Metros to Saabs or additional frequency."

Breust says there's always the possibility another operator may tackle a Rex route, but it wouldn't put the company itself at risk.

"We've reached a position on most of our routes whereby we provide quite a high level of frequency and capacity and we also have fares which are very affordable. And for another operator to come along and try to compete either on price or on capacity or frequency – we'll make it extremely difficult."

Rex also sees traffic growth across its existing network continuing.

"There's still growth available to us on our current network, and we've said that we believe our profit in '06/07 will be a 10 per cent rise on what we did last year. We continue to get more efficiency Another Rex service departing Wagga.



out of the organisation as more of the Saabs come on line."

Even more Saabs will now come on line with Rex's announcement that it is acquiring 25 Saab 340B Plus Saabs to replace and augment its existing fleet, which will number 31 by the end of the year.

The new aircraft will begin arriving from January 2007 and will allow Rex to replace older Saab 340As and to add capacity and new routes to its network. These new aircraft, some of the last Saab 340s built (featuring noise cancelling systems, improved cabin interiors and better performance due to their extended wingtips), have an economic life of up to 20 years, says Breust. So the issue of fleet replacement for the out-of-production Saab is a long way off. Breust says the lease rates for the new aircraft are also significantly lower than for existing leases.

Eight 'new' Saabs will arrive in 2007, nine in 2008 and eight in 2009, with Rex having a fleet of around 40 Saab 340s once all are delivered.

"The good thing that we've been able to have the benefit of is the regional jet operations put a number of Saabs on the market at pretty cheap rates, and we've been able to take advantage of that. What's now happened with fuel prices is that the attractiveness of the turboprop has come back a little bit, so their prices have come back a little bit, but we're still buying very, very well."

So Rex will be a significant Saab operator for many years yet, with no replacement aircraft in sight.

"Moving to decide on a new type at the moment is virtually impossible. There's only a couple of manufacturers and they're relatively old technology. I think what we have to do is look at a new type on the basis of what the next generation is going to be, but that's some time away, we've got time to sit back."

And Rex is not looking at expanding further with bigger aircraft types. "It may well be that the next fleet type we will have will be a larger type, but I'm not necessarily convinced of that. I still think there's still going to be a very major role for the 30 to 40 seat turboprop type aircraft in Australia, but I can't crystal ball that far ahead!"

So for the medium term the Saab will form the basis of the Rex fleet, and Breust speaks effusively of the Swedish built workhorse.



Eight Saab 340B Pluses will arrive in 2007, nine in 2008 and eight in 2009, with Rex having a fleet of around 40 Saab 340s once all are delivered. Pictured is 340B VH-RXE.

“It’s got to be one of the best aircraft for regional operations in Australia because of its operating economics, its passenger appeal and its reliability. It’s a well made, well thought out aeroplane. It’s just a great package.”

Rex’s current mixed fleet of Saab 340A and B models of varying performance capabilities, ages and interior fit standards does present the airline with some small challenges. The A and B models have different engines, a maintenance planning complication, while some As have older interiors which lack overhead bins and feature older style seats. The 340A also faces some operating restrictions in

hot weather where seat numbers have to be restricted because of performance limitations. But with the B Pluses coming on line the six remaining As will be progressively retired from passenger service.

Certainly the 34-seat Saab seems particularly suited to the Rex network, and has been a key contributor to Rex’s success.

“I think the success of Rex is because we’ve very much understood the niche we’re in and we’ve worked on the strengths of that,” Breust explains.

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but also in terms of moving to a single aircraft type in the Saab, by becoming involved with Air-Link and using Air-Link’s strengths in terms of its 19-seat capability, plus getting involved in Pel-Air to work on the strengths of Pel-Air in freight and charter activity.

“I think all of those things combined put us in a position where we can be really quite strong.”

The acquisitions of Air-Link and Pel-Air are also illustrations of what Breust says is a management structure, led by executive chairman Lim Kim Hai, that is “particularly adept at being able to move quickly to take opportunities as they arise”.

(left) Rex has its own engine shop at Wagga. (right) Inside newly arrived Saab VH-ZLX.





Saab 340B VH-RXQ at Merimbula. Thirty-one 340s will be in the fleet by the end of the year.

Rex's recent aborted bid to take over Sunshine Express is another example of Rex's ability to move quickly to take advantage of opportunities. The Sunshine Express negotiations ended acrimoniously with the two sides waging an unusual public battle via press release (Sunshine Express sought an apology from Rex, saying a Rex press release of August 31 was "defamatory"), but the speed at which the deal almost came together was impressive.

"Over time there could well be other opportunities like that (Sunshine Express), or indeed opportunities that might arise from operators that say 'we don't think we can do this any more'," Breust explains.

"We think there probably will be some opportunities that will come along over the next year or so and we'll take those up as they come," says Breust, who points out that Rex has no debt and has cash available to fund acquisitions.

"So when the opportunity arises it's then very, very easy for you to be able to go out and source aircraft and resources to be able to do that."

Even with the Sunshine Express deal collapsing, there could be opportunities for Rex to expand into Queensland at some stage.

"We see that Brisbane is now becoming more and more a service centre for communities in the northern part of New South Wales. Again there is no pressure for us to do anything but if the opportunity arises and it makes sense commercially we would certainly look a lot closer at it."

Of those opportunities already taken, Rex is exercising a \$6 million option to acquire another 25 per cent stake of Pel-Air (the sale contract allows Rex to take the final 25 per cent stake next November, if Pel-Air continues to meet profit targets).

"Our aim is to develop Pel-Air, particularly in the freight area, we see that as market that still has potential. We also believe there's a good market in charter activities, and we'd like to see Pel-Air, and indeed Rex and Air-Link, develop some of those activities."

Rex's control of Pel-Air hasn't brought significant change there. "It's certainly not broken, so why fix it? The idea with it is it should operate as a separate entity."

On the flightdeck of Saab 340A VH-EKD.



With Rex beginning to roll over its Saab fleet, some of the older 340As it retires could be converted to freighters for service with Pel-Air.

Breust also flagged the Rex group's interest in operating resource charter work. "Because we've got the availability of quite a range of aircraft we're able to put resources in relatively easily."

Rex's Air-Link acquisition, meanwhile, gives it the ability to service markets more suited to smaller aircraft, in particular the 19-seat Beech 1900D.

"It's an extremely well run regional airline," says Breust, "and its success running the Beech 1900D between Dubbo and Sydney really showed us that an aircraft type like that can be very, very effective. So we see that the development of Air-Link into 19-seat markets is a way of the future."

Since coming into the Rex group Air-Link has acquired a second 1900D for operations in New South Wales.

"The great thing with the Beech 1900 Air-Link operation and our own Rex operation with the Saab on Dubbo is that we've now been able to offer a high level of frequency on that market, which has again grown the total market. We're getting very close to the stage where we can consider replacing the 1900D on Dubbo with additional Saab services, and then redeploy the 1900D to other routes in New South Wales that are more appropriate to that size aircraft."

Some of these could be existing services such as Rex's Sydney-Bathurst



Rex and QantasLink only cross paths on four competitive routes: Sydney-Wagga, Sydney-Dubbo, Sydney-Albury and Melbourne-Mildura.

route, or Air-Link's Sydney-Mudgee, currently served by a Piper Chieftain.

"I think there's going to be some further changes there (New South Wales) and we should be in a position to be able to take those opportunities when and if they come along."

Rex itself has now completely moved out of using 19-seaters on its network. Its last scheduled RPT passenger Metro 23 service was due to operate on October 15. Rex still has four Metros on its books – one of which is on lease to Sunshine Express – and the Metro will continue to operate a regular charter for BHP from Adelaide to Olympic Dam in South Australia.

"We're still going through options as to how we might redeploy the Metros," explains Breust. Other airlines have expressed interest in purchasing them, "but we see them as still very good aircraft for the group, not only for passenger and charter work but also particularly in the freight activities at Pel-Air."

With both the 19-seat 1900D and Metro now in the Rex group fleet, Rex is well placed to appreciate the merits of the two aircraft.

"In reality the 1900D is a far more attractive aircraft in terms of passenger appeal... I think the Metro in regional passenger operations is probably getting towards the end of its acceptance, especially if there's alternatives, but as an aircraft it's very efficient. Kendell and Rex and to a degree Hazelton did very well operating Metros, particularly in the South Australian market where you have a lot of long thin routes and the Metro has really been the saviour. It's done extremely well over a long

period of time. But where there is an alternative it really does struggle because of its (small) cabin and its noise levels."

More efficient aircraft are improving Rex's operating efficiencies, but good old fashion cost cutting plays a significant role in improving profitability. Rex has a productivity committee which has the goal of taking \$2 million in costs out of the business each year, which it has achieved by renegotiating contracts and supply agreements for items like fuel, ground handling, insurance, IT, accommodation, telephones and catering.

"If you're not on top of those all the time, it can just blow out on you," says Breust, who explains how changing catering practices reduced costs. "A lot of the cost was associated in making up the meal package so it was the cost of the

Rex staff are receiving a profit share bonus of around \$3200 for the last financial year.



labour of putting things on a tray and then putting it in a trolley. So what we did was we went back and bulk loaded a lot of that and the flight attendant hands out the individual items."

Rex's staff have come to see the benefits of the airline's efficiency drive but "we had to be fairly forceful in getting the message out initially, but our people are understanding it."

In turn staff loyalty has been rewarded by perhaps the local airline industry's most generous profit share and share gift arrangements.

"When we said to them we'll give you 10 per cent of profits if we meet our profit targets for the year there was a lot of skepticism initially, particularly from the union movement, who didn't want to have anything to do with it, but our staff understood it and all the EBAs came through that way."

For the 2005-06 financial year staff are receiving a profit share bonus of around \$3200 each, "which is fantastic, really fantastic. And on top of that they get two per cent of their salary in shares."

"One of the great things about Rex is because it was both Kendell and Hazelton, both very much family type companies, there was always a very strong sense of family in it... We've been able to build on that here and I think that's going to be another good reason for the success of Rex because if you get the staff in behind it, attached to it, feel very much part of it and with ownership of it, that makes all the difference, and I think that's one of the difficulties that some of the other operators have." □