

ECONOMICS AND INDUSTRY STANDING COMMITTEE

INQUIRY INTO REGIONAL AIRFARES IN WESTERN AUSTRALIA



**TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
WEDNESDAY, 13 SEPTEMBER 2017**

SESSION TWO

Members

**Ms J.J. Shaw (Chair)
Mr S.K. L'Estrange (Deputy Chairman)
Mr Y. Mubarakai
Mr S.J. Price
Mr D.T. Redman**

Hearing commenced at 10.16 am**Mr WARRICK LODGE****General Manager, Network Strategy and Sales, Regional Express, examined:**

The CHAIR: On behalf of the committee, I would like to thank you for agreeing to appear today to provide evidence to the committee's inquiry into regional airfares. My name is Jessica Shaw and I am the Chair of the Economics and Industry Standing Committee. I would like to introduce the other members of the committee to my right: Yaz Mubarakai, member for Jandakot; and Stephen Price, member for Forrestfield. The deputy chair, Sean L'Estrange, has just stepped out and will be rejoining us, and Terry Redman, member for Warren—Blackwood, is an apology for today. It is important that you understand that any deliberate misleading of this committee may be regarded as a contempt of Parliament. Your evidence is protected by parliamentary privilege; however, this privilege does not apply to anything you might say outside of today's proceedings. I also advise that the proceedings of the committee's hearing will be broadcast live within Parliament House and via the internet. This broadcast may include documentation provided by you to assist the committee in its investigations.

I would like to thank you for your submission to the inquiry. Before we begin with our questions, do you have any questions about your attendance today?

Mr LODGE: No.

The CHAIR: Would you like to make a short opening statement about your submission?

Mr LODGE: Yes, I would, thanks.

The CHAIR: Fire away.

Mr LODGE: Regional Express welcomes the opportunity to provide a submission and to attend this public hearing for the parliamentary inquiry into regional airfares in Western Australia. Rex was founded in 2002 as the merger of Ansett subsidiary airlines—Hazelton Airlines and Kendell Airlines—following the collapse of Ansett in 2001. Both Hazelton and Kendell airlines had more than 30 years' experience of regional airline operations prior to the collapse of Ansett. I have been with the airline for some 25 years, having started out with Kendell Airlines back in 1992. My first role was checking in passengers and loading bags at Wagga Wagga airport in New South Wales. As someone who grew up on the land, I am passionate about regional Australia and I understand the critical nature of the services that we provide.

Regional air services are essential services and not just a "nice to have" service. Rex is a dedicated regional airline that operates 52 Saab 340 aircraft that have a capacity of 34 seats. We operate with two pilots and one flight attendant. We operate a vast regional network servicing 59 destinations throughout Western Australia, South Australia, Victoria, Tasmania, New South Wales and Queensland. We carry 1.2 million passengers on around 75 000 flights per year. We are a publicly listed company on the ASX. Over the past 15 years, we have 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 our operating efficiencies and also delivering our services with a high level of on-time performance. As a dedicated regional airline, we are very mindful of the tremendous social and economic impact our services have on the region of communities that we serve, and we

strive to work in partnership with these communities to balance their needs against the imperatives of providing a sustainable and safe regional air service.

On 28 February 2016, Rex commenced services to Perth, between Perth–Albany and Perth–Esperance, under a deed of agreement with the Western Australian government. This confers onto Rex the sole right to operate on the Perth–Albany and Perth–Esperance routes for a five-year term commencing on 28 February 2016. This was a major milestone for Rex in establishing operations in Western Australia for the first time. From Perth, we operate 23 weekly return services to Albany and 18 weekly return services to Esperance. We have four Saab 340 aircraft based in Perth, of which two aircraft are dedicated to the Albany and Esperance routes, one aircraft is a dedicated back-up aircraft and the last aircraft is used for maintenance and ad hoc charter. This is a significant investment that has been undertaken by Rex. We have 21 flight crew and four engineering staff who are based at Perth, in addition to contracted airport ground handling arrangements that see the employment of local staff in Perth, Albany and Esperance.

[10.20 am]

The current regulatory process that saw Rex enter the Albany and Esperance routes did provide Rex with a structured environment to enter Western Australia, which would not have been possible in the absence of the regulation. With that said, Rex still had to take on a significant amount of commercial risk, particularly with some of the high operating costs that have evolved and become quite entrenched in the marketplace over many years. As outlined in our submission, regional airfares on thin routes are condemned to be more expensive than the equivalent fares offered on high volume and passenger number routes that are operated by larger jet aircraft due to the inefficiencies and high costs associated with regional air travel; this is true the world over. Our fares in Western Australia are significantly lower than the average fares that we achieve across the rest of our network due to the high load factor that we are able to achieve on the licensed routes. This is despite both Perth and the regional airports charging a per passenger head tax that is significantly higher than the other states, and this pushes the full inclusive ticket prices up by about \$30 for a one-way ticket. Rex believes that the state government could lower fares by licensing the larger routes of up to 200 000 annual passengers, and placing these routes out to tender under a similar process that we undertook for the Esperance and Albany routes. We estimate that airfares could fall by around 25 per cent if it was tendered out correctly with the right safeguards in place. Once again, Rex welcomes the opportunity to contribute to this important inquiry and we look forward to expanding our presence in Western Australia for the socioeconomic benefit of the state over the years ahead. Thank you.

The CHAIR: Thank you, Mr Lodge. That is a very informative opening submission, and I would like to also thank you for the submission that Rex provided. You are a regional operator in a range of states. Is there any material difference that you would observe about doing business in Western Australia? You are only operating the Albany to Esperance routes but what is the material difference about an airline such as yourself doing business here in WA?

Mr LODGE: I guess one of the strengths that we brought to operating in Western Australia is that as a regional airline operating more than 50 aircraft, we have 1 000 staff and we have very good economies of scale in regional airline terms. We were able to bring that efficiency and that scale to our Western Australian operation, even though having four remote aircraft in Western Australia has some inefficiencies attached to it. But it is outweighed by the broader efficiencies that we bring to it. We are able to share a lot of our overheads amongst our services in WA. If we were a small airline trying to do what we do in Esperance and Albany, let us say with three or four aircraft, we would not be able to make that service sustainable because of the high cost of operations.

When we looked at Western Australia, we obviously had to study it very carefully. I guess one of the benefits of having a licensing submission process is that we had to look at it, understand the cost environment, see if we could factor in a small operator margin to make it profitable and worthwhile for us to undertake that commercial risk and then put in a submission, and, thankfully, we were successful with that submission. We did notice the high operating cost. We obviously look at it from an interesting perspective with more than 50 routes and we can sit down and analyse the cost variances line by line amongst all the different routes that we operate. I think we clearly outlined in our submission that the airport costs were significantly higher in Western Australia.

We also encountered other entrenched costs that I think had evolved over many years. An example is our ground handling costs whereby the incumbent ground handler was significantly more expensive in Esperance and Albany than we were used to. I guess under a licensing arrangement, it is difficult to negotiate airport charges and ground handling arrangements because you can do only a certain amount of negotiation prior to being awarded a tender, and then once you are awarded the tender, a common response is, "You knew what our charges were before you put in the tender and if you can't make it viable, why complain about it now?" We believe that we are only making a very modest return on our Albany and Esperance services. The airport costs are significantly higher and we included in our submission that for a one-way ticket between Perth–Esperance or Perth–Albany, the airport costs are in the vicinity of \$50 on a one-way ticket. In our traditional network, which is vast, that equates to around \$15 per ticket, so there is a very big gap there. We had to include that in all our modelling, knowing that that was our starting point.

We then had to come up with a fare structure and fare schedules in order to make that work, and we are only able to achieve a small operating margin on those services because of our vast efficiencies in terms of what we operate elsewhere and our vast network. If those airport charges would have been lower, we would have modelled a different fare structure. The fares could have been cheaper because under a competitive tender process, it is up to us as the airline to go into that process with our most effective tender, because if you do not do that, you risk not being selected. I think one of the real positives about having a competitive licence tender submission process is that it puts a call out to the marketplace to put your best foot forward. Even under a single operator like Rex in Albany and Esperance, we are able to do some things because we know what the market size is, we know what our frequency is—we have a set capacity and no competitive influences that are going to come in and put an oversupply of capacity in the marketplace—and with around a 70 per cent load factor, for us there is less onus on the average ticket price or the actual price points in the marketplace because for us it is about making sure that we maximise our revenue per departure.

We included in our submission that we have actually done some quite creative things in Albany and Esperance, such as the community fare, and we entered into agreements with the regional councils—the City of Albany, the Shire of Esperance—and also Perth Airport, and it was really about us getting certainty with regard to future airport charges, but also trying to grow the market. As we grow the market and increase passenger numbers, the airport revenue, for example in Albany and Esperance, is locked in. We have an agreement that for FY18, FY19 and FY20, the airport's revenue is set and we have agreed to increases in CPI. Now if we can increase passenger numbers by 10 per cent, the cost per passenger will reduce and that will provide us with an inbuilt incentive for us to grow the market. That benefits us because we are getting increased revenue on our flights but it also brings a tremendous benefit to the regional communities and the council. The councils run the airports but it is the councils that have the true obligation to do what is best in their regional community.

We are not ashamed of the fact that we are a publicly listed company, and we look for work to make a return on that; that is our business. But we believe that we can have shared goals with the council, providing that the council understands the value that we are bringing to the table. We are doing quite a bit of the heavy lifting in those ports in terms of \$129 airfares. We take on the risk with that because if we do not grow the market, we risk fewer passengers or the same number of passengers travelling at a lower fare and our revenue could go backwards. We take a significant risk with that type of program, whereas the airport has it quite good. It can set its budgets for the next three years. It has locked in airport revenue, and that is what the airports should be thinking like. It should be about what revenue they need, not about a per passenger head tax.

Quite often, local government will treat a head tax, like the airport head tax, no different from a lot of other council charges, like the tip charges, for example. Everything goes through a local government process and charges are increased by CPI but if an airline can deliver 10 per cent passenger growth through to the airport, the CPI to the head tax is quite irrelevant. We would rather deliver increased airport revenue through growing the passenger numbers rather than just having quite myopic CPI increases with regard to their airport charges. We have only been here for 18 months. We have not had much ability to be able to lower airport charges. We have had an ability to keep control of where they are now and where they will be into the future, but I think it is very clear that if the airport charges were much lower, that would have a fundamental impact on driving ticket prices further down.

[10.30 am]

The CHAIR: I guess the flipside to that is that airports also need to remain financially viable themselves and need to be able to pay for their ongoing operating costs and for the replenishment of assets as they age. The airport charges argument is one that has been really explored in quite some detail. Your submission does go into some detail as well about it and I accept there has been quite a bit of evidence on airport charges, so I would just like to park that for the moment and explore in more detail the actual airline component of airfares, because we have heard, as I say, a lot of information about airport charges.

Mr LODGE: Can I just make one comment?

The CHAIR: Of course.

Mr LODGE: Just to close off in regard to the airport charges, I think there are two distinct differences. The regional councils, who are the owners of the airport, have an obligation to service their community, and it is an important piece of infrastructure, just like roads and bridges and a whole lot of other infrastructure. I think councils need to make a decision that that becomes like a user-pays service and not everything under a council environment becomes like a user-pays service. There are people who use council-owned roads who profit from using those roads, but there is no toll on those roads and bridges that those parties use. With regard to the regional councils, it is very different. There are two distinct things. There are the airports that are owned by the regional councils but then there is also Perth Airport, and Perth Airport is obviously a different arrangement where it is also generating returns for its shareholders. The airport charges at Perth Airport, just as an example, we pay \$20 per passenger to use terminal 2. We pay \$4.50 in Sydney; the apples for apples charge in Sydney is \$4.50, so it is considerably different. I know that there have been some pushes to say that Perth Airport should consider having international domestic and regional charging, and we would support that in terms of the benefits that these regional air services are not only bringing to Perth Airport in terms of connecting traffic on domestic and international services, but they are also having an economic impact on the state.

In listening to the previous hearing from the AAA, they mentioned the ACCC monitoring of Perth Airport. The ACCC monitoring of Perth Airport only relates to the service delivery; it does not relate to airport charges. The only capital city airport in Australia that has regulated airport pricing is Sydney Airport. Sydney Airport is a declared airport and under federal government legislation, they have to seek approval before they increase their charges. I think that that is a big reason why we are paying \$4.50 for regional air services in Sydney and we are paying \$20 for the same service at Perth. I am sorry to sort of back up on the airport charges, but they were just a couple of points that I wanted to mention.

The CHAIR: It is a really complicated issue because there are significant differences even in WA between the regional airports and the sorts of traffic that goes through them. A very high proportion of FIFO workers, for example, puts really great demands on the airports, but it is not serving the community as such. Therefore, if the community were to somehow underwrite that airport in the same way that they do roads—but there is no link. It is a very complicated issue but I do want to park it because I am conscious of the time we have available. I want to move on from airport charges to specifically look at airlines.

You talked about the fact that the regulatory process facilitated Rex's entry into the WA market. Could you tell us what was it about the regulatory process that facilitated your entry and give us a bit of an overview of your experience through the tender process and, I guess, the components to the degree that you are able, of the way you prepared your tender and interface with the Department of Transport? Can you give us a bit more of a sense of that?

Mr LODGE: I guess looking at the Esperance and Albany routes, Esperance to Perth is around 49 000 passengers a year and Albany is around 56 000 passengers a year. There was a licensing arrangement prior to Rex and that was operated by VARA with the Fokker 50 aircraft. That licensing and submission process enabled us to have a look at that as a serious submission. If those routes had not been licensed and they had been operated by VARA, which could have been the case, VARA would have continued to a point whereby it may not have been viable—it was an inappropriate aircraft choice or aircraft type—and they may have just decided to exit. For us as a carrier operating a vast operation in the eastern states, we may not have been able to respond quickly enough to fill the void from a carrier that was existing in Western Australia. The regulatory process gave us the timing to be able to study the route and put in a submission, and we could very quickly understand the costs of doing business on those routes because as a dedicated regional airline, we understood the costs, apart from the local costs. Once we understood the local costs, we thought that we could make it viable and we put in the tender.

The CHAIR: So when the tender pack was issued, were you provided with some assumptions upon which you could form your tender? Obviously, in a tender, when you are going into assessment mode, you are trying to compare apples with apples. Did the department say that you could assume X number of passengers and X number of flights so that you could then go and reasonably develop a business case, or was it just "put a price to us and we'll see how we go"?

Mr LODGE: There was an information pack that was put out which included things like passenger numbers and the current service levels by the incumbent operator. It was up to us to do a lot of research with regard to what the incumbent operator was charging in terms of airfares and to do a lot of research and a lot of discussions to determine local factors. But the timing—I believe it was closed in September 2015 with the services starting on 28 February 2016. The submissions closed in the middle of September and the government made a decision with regard to the successful tendering in the middle of December 2015, and we then started those services on 28 February 2016. It was a pretty tight 10-week time frame from when the government announced that we were

successful to when we commenced the services. About 18 months prior to that, we had started flying to 16 new airports in Queensland on 1 January 2015.

The CHAIR: So busy days.

Mr LODGE: We knew that we were capable of being able to do that within a certain time frame. It services the three airports with two routes. We had the experience to be able to do it within that time frame so I think without that staged regulatory process which gave us certainty with regards to the timing, we would not have been able to embark on that. If, for example, it was not a regulated route, and VARA put up their hands saying “We are exiting, effective next week”, which could have been possible—the process allowed VARA to continue operating up until the end of their previous five-year licence term and for us to start.

The CHAIR: So was there an option in there for you to place nonconforming bids or were the tender requirements quite specific?

Mr LODGE: The tender requirements were reasonably specific in terms of the number of services. We obviously went into it with a different aircraft type so we knew that with a slightly smaller aircraft we could provide more capacity and more frequency into the route and definitely meet the requirements of not only the submission but what the marketplace wanted.

Mr S.J. PRICE: Mr Lodge, was it one tender or two tenders?

Mr LODGE: It was a single tender for both routes. There were other routes that were called for tender at the same time as well, but we only tendered for the Albany and Esperance component.

The CHAIR: Why was that?

Mr LODGE: It was largely due to understanding the time frame and wanting to make sure that we could deliver on what we promised and be able to do it well. We did not want to embark on a whole range of different activity right from day one. We wanted to make sure that we could do it in a rational and practical way so that we could work with the communities and work with the Department of Transport—let us make that work, let us make that be a success and then look at future opportunities after that.

[10.40 am]

The CHAIR: So participating in a big bang tender for the whole of regional WA would not necessarily be something that anyone other than, say, a Qantas or a Virgin could do?

Mr LODGE: I guess it is a unique question to the type of operator. That, for us, was a reason at the time just because of making sure that we were able to deliver on what we did. Now that we are set up in Western Australia, we are in a lot better position to be able to respond to a much broader tender.

Mr Y. MUBARAKAI: So Mr Lodge, what is your strategy now? Now that we look at the information in your submission, you talk about how regional airfare routes are 300 per cent more expensive than the equivalent airfares of a larger jet on similar routes. We look at your submission on page 5 where we see that the WA load factors are about 76 per cent; that is really significant. The first question I have is: will Rex be looking at flying larger aircraft in the shorter distant future to these regional destinations?

Mr LODGE: Taking on larger aircraft might be something that we would not rule out. If there was a specific tender that called for a larger aircraft, we have no objections in terms of taking on a larger aircraft type to do something, particularly under a licensed environment where you have certainty into the future. I will answer the question another way. With regard to what we are doing in Albany and Esperance, the higher load factors that we are achieving is giving us the ability to run frequency.

It is giving us the ability to offer lower fares because for us it is about having a higher revenue on the aircraft. Through the community consultation group meetings in Albany and Esperance, and we run a slightly higher load factor in Esperance than we do in Albany, there has been some commentary, as always happens, that when the loads start getting high, people say, "Are you going to put on more flights? Are you going to get a bigger aircraft?" We say to them, "We think that we've got the model right; don't complain about the high load factors, because it is the high load factor that is actually giving us the ability to be able to generate these community fares for you", in an environment where we are only running with a 50 per cent load factor.

In some markets where there is an inability to grow traffic and stimulate traffic through lower pricing, you end up in an environment where you are forced to charge fewer passengers more because the airline's costs are no different. If we run three return services, a lot of our costs are going to be exactly the same whether we have 50 per cent load factor or a 70 per cent load factor. We think that the Saab 340 aircraft is the right model for us and our initial plans would be to try to expand that Saab 340 operation to improve not only our network's efficiencies, but also, importantly, our efficiencies here in WA. We would have never embarked on just doing Perth—Albany and Perth—Esperance if there was not a desire to expand because whilst we are able to achieve what we are doing, it is difficult operating only a very small base. We need to build up those economies of scale. If we can add another route or another two routes, we then maximise our flight crew and we maximise our airport agents that can be checking in more flights without necessarily putting more cost into our business.

Mr S.K. L'ESTRANGE: Mr Lodge, you mentioned the possibility of expanding with your Saab 340s. The air routes from Perth—Esperance and Perth—Albany are around about an hour. Some of the airports to our north are considerable further than that. Does that mean you would have to be stopping to refuel or would the Saab 340 be able to take on routes like Kununurra or Broome?

Mr LODGE: I think the routes like Kununurra and Broome are too long for the Saab 340 aircraft, but there are routes like Geraldton that would be workable for the Saab 340. We have operated, and we have mentioned this in our submission, services between Adelaide and Port Lincoln. We were the sole operator prior to QantasLink entering that market. We operated 10 return flights a day and, as the sole operator, carried 150 000 people with 10 return frequencies. The Port Lincoln community loved it because there was a service every hour and a half, and—similarly to what we were just talking about with the cost of airfares when the load factor drops—when Qantas commenced, we had to go back to six or seven return flights. Qantas had their am and pm services, as they do. There was then a big hole in the middle of the day that everyone now complains about and we ended up with both Qantas and Rex struggling to achieve a 50 per cent load factor and Qantas and Rex having to push up the average ticket price to try and make those services viable.

Mr S.K. L'ESTRANGE: So that case example you just gave then is probably an argument for regulating a route and having one provider.

Mr LODGE: Definitely, and I hear what Qantas and Virgin are saying with regards to services to Broome and Kununurra and those services that are quite directional. We all understand the impact that the resources industry has had on that. I have not studied those routes in intense detail but I can see an environment where, because of the lower load factors, those carriers are actually struggling to be able to provide a lower price point for the price-sensitive carriers because there is too much risk of their higher price passengers falling back down into those lower fare categories. There is a big risk in that environment and that is why we do not do community fares in Port Lincoln. If we do community fares in Port Lincoln, we would probably have our competitor following suit and we end up in a bit of a race to the bottom. It is also where, in reality, if you looked at the average

load factor, there are probably some competitive routes where commercial reality would say that capacity needs to be taken out of that market to correct that imbalance, but neither of the two major airlines want to do that because they will be playing into the hands of their competitor.

The CHAIR: I noted with interest that in your opening statement you said licensing larger routes and placing them out to tender could be viable and could drop fares by up to 25 per cent if the tenders were constructed correctly with the right safeguards in place. What structural improvements to the tender process would you suggest and what sorts of safeguards are you talking about in that statement?

Mr LODGE: I think, firstly, we have delivered around that 25 per cent improvement in Albany and Esperance with regards to ticket prices. There are already measures within that regulatory process whereby we actually transparently report every single fare sold to the Department of Transport. The average ticket price is monitored. Our fare structure is part of the deed. We can only increase our fares by CPI under that deed of agreement. As part of the arrangements, we attend community consultation group meetings twice a year. I personally attend those meetings in Albany and Esperance. I stand in front of all the regular users of the air service and report what our average ticket price is. That is not a hard and fast contractual requirement, what our average ticket price is; we actually included an indicative average ticket price as part of our tender process. But if the Department of Transport and the local community are not happy with the average ticket price that we are delivering, it can get to the point whereby the Department of Transport can say we no longer want Regional Express to operate that deed, and they can terminate the deed.

There is a fair bit of incentive there for the airlines to do the right thing under that level of transparency. We believe that the arrangements that are in place on Esperance and Albany can work to deliver lower airfares. Even on the larger routes we think there is nothing wrong with a single operator being awarded a larger route if that single operator has put forward a very efficient submission in delivering benefits for the local community. As the single operator, there is a fair bit of incentive for them to put forward a bid on a high volume route to make a fair level of return, but still being able to deliver things that the local community want and have that level of transparency as well.

[10.50 am]

The CHAIR: One of the arguments that is often advanced against regulation is the cost of compliance and regulatory burden. Could you talk a little more to the point made in your submission about the costs of compliance and what the information disclosure obligations are?

Mr LODGE: We did not put any criticisms in there about the cost of compliance. We felt that it was a fairly simple reporting structure and a fairly practical regime to work within under the licensing arrangements. We simply report all our reporting to the Department of Transport once a year. We do that internal reporting anyway. That data is just forwarded to the Department of Transport within 10 days of the end of the month. We do exactly the same on all our Queensland routes with the Department of Transport and Main Roads in Queensland, so it is not an onerous process with costs involved.

With regard to the attendance at the CCG meetings twice a year by myself and other members of our sales team, it is not a big burden to be visiting regional communities that we fly to twice a year. We actually visit them more than that outside of the CCG meetings anyway. Our next CCG meetings in Esperance and Albany are in November and we tie that in with meetings with the local chamber of commerce. We do business after-hours events with the local chamber of commerce while we are there. We are already out in the marketplace and to have a few hours of meetings as part of our CCG obligations is not a big cost or a business burden by any means.

The CHAIR: Are you working with the local communities to see how you can grow the pie?

Mr LODGE: The community fare is the number one initiative that we have been undertaking to do. In the last 12 months we have sold more than 8 000 community fares. I mentioned earlier that Esperance is around 49 000 passengers a year and Albany is around 56 000, so in the vicinity of 15 per cent of the market are travelling on those community fares. It is early days and we have not grown the market by 15 per cent, but at the last CCG meeting in Esperance, we were able to report that the passenger numbers in Esperance in the 12 months prior to that meeting were at the highest levels in the last 10 years. That is why we enter into these long-term agreements with the council because we know that these types of things are not going to be an overnight success. But we do not want to put all that investment into a really low fare, going through the investment phase whereby our revenue only increases marginally, if at all, when the passenger numbers are increasing, because there is a reduction in the average ticket price. We may actually see the benefits not until year 2 or year 3, and if they do not lock in the airport charges, the risk for us is that we get to year 3, the airport charges continue to go up by CPI, and the airport is actually benefiting through all the passenger growth plus the CPI and it creates an environment whereby it is not workable.

These partnership agreements are about really taking a long-term approach. Let us not work together on a short-term thing because we can as easily take a commercial approach as the airports can, but that is really going to be an initial 12-month thing. We can both benefit from it, but then will we see passenger numbers fall? Will we see ticket prices go up? Will we see people not being able to afford to travel? We would rather take a long-term view and gradually get to that point. We actually think that if the councils or the airport owners and the airlines can work together, in three, four or five years' time we can be both as profitable as we would have been in year one if we just had a short-term goal. However, the problem with the short term is that you only get that short term in year one, and then it all starts to go backwards after that.

Mr S.K. L'ESTRANGE: You just mentioned airport charges. In your submission you say that airport charges in WA are 300 to 350 per cent higher than in other jurisdictions; that is a big number. Are you able to give us some data, if not today, give us some anecdotal evidence today but maybe also on notice can you provide us with some data to support that?

Mr LODGE: Yes, we can. We provided data in our submission. Obviously, we touched on it earlier with the \$15 on a one-way ticket that was the average across the rest of our network.

The CHAIR: Yes, we spent the first part of the session discussing that.

Mr S.J. PRICE: Just with that, Mr Lodge, if you are comparing Albany or Esperance airport charges to somewhere in Queensland, is that figure based on airport throughput, so to speak? If you have 49 000 people going on an, let us say, Esperance flight, you have limited capacity going through the airport. But is that an equivalent airport in Queensland with the same number of —

Mr LODGE: It is probably not necessarily Queensland, but —

Mr S.J. PRICE: Or somewhere. If it is like for like, it is not 50 000 versus 250 000, if that makes sense.

Mr LODGE: I think the cost to the airport of accepting our services mainly comes down to how many flights we do a day. If we do three return flights a day to a port and we carry 20 000 passengers on those three returns, the cost to that airport is not going to be vastly different if we do three returns to that airport and we do 50 000 passengers. There are more people walking through the terminal but I do not think the cost is really any different. I met with a regional council in New South Wales only two weeks ago and they were wanting to increase their airport charges. The service was a loss-making service for Rex, and on those three return services, we only carry 18 000 passengers with a

\$7 head tax, so that airport in total for those three return Saab services generates revenue of about \$120 000. In Esperance, three return services generate over \$1 million; it is a very big difference.

The regional council in New South Wales that I met with two weeks ago was in a difficult situation because I acknowledged that \$120 000 is not a lot to operate the service. But on the flip side, the service is not making money either and the airport disclosed with us that the airport was losing about \$300 000 a year. I guess I do not understand how an airport can take three return Saab services but is losing \$300 000 a year with a \$100 000 revenue stream. That is telling me that that airport is costing that council, in black and white numbers, around \$400 000 a year, whereas whenever we see airports earning \$1 million or \$1.6 million, there is always still a challenge with regard to it not meeting costs.

In the example here in Western Australia, we have Albany that is somewhere in the vicinity of a \$30 million asset that has to deal with somewhere in the vicinity of \$700 000 worth of depreciation. That is something that has evolved over many years given that regional airports were vested in the councils free of charge many years ago, often with a fair bit of money with that to get the council started. From our perspective, I am not sure that really to have four return Saab services servicing a port warrants a \$30 million asset, and then that depreciation is a really difficult issue because \$700 000 depreciation on an airport with \$50 000, you have more than \$10 per passenger just going into recovering depreciation, and that depreciation is not really covering any of the real nuts and bolts costs of operating the airport.

The CHAIR: But it is covering replacement cost when the assets expire at the end of their economic life.

Mr LODGE: I understand that.

The CHAIR: Those things have to be provided for by someone. The airport charging thing is a complex issue.

Mr LODGE: I will just make one point that the airport charges that we pay in Western Australia amount to \$5.2 million a year. We service only three airports. Our total variable operating costs in terms of servicing those two routes, excluding airport charges, is about \$13 million. Within that \$13 million we are paying fuel, flight crew, engineering, ground handling, all our air services, variable charges et cetera. It does put into context that \$13 million worth of variable costs to operate two routes 52 weeks of the year with a huge amount of cost. That \$5.2 million is material when you consider what is it costing us variably to operate the routes.

Mr S.K. L'ESTRANGE: For me, this is what I want to try to get a better understanding of, because we are hearing from the airlines that airport charges are an issue. You have provided some data to show it is 300 per cent to 350 per cent higher than other jurisdictions. If you think there is any more fidelity to that that you can provide us, I would welcome to see it because I think it comes back to the point that Stephen made to educate us to understand apples and apples. If you have regional airports in other parts of Australia, which are very similar to Albany and Esperance, and the cost is significantly lower, we would love to see that information.

Mr LODGE: We would be more than happy to disclose that information and we have shared some of that information previously with the Department of Transport who were also trying to get their head around the high cost of airport charges in Western Australia.

The CHAIR: Can I just come back to my point I was trying to make earlier about growing the pie. I was not just talking about airports and airlines working together; I was talking about more broadly working with the local government. A lot of evidence to this committee has been put to us about increasing load factors through promoting tourism opportunities and packaging up destinations and

tourism activities at the other end. Also, one of the things that has come up as well is about participation in the global booking system. Has Rex explored those sorts of opportunities of just growing the tourism pie? What would you say to participating in the global booking system as well?

[11.00 am]

Mr LODGE: We are hosted in the global distribution systems, so we are fully across all the GDSs with Sabre, Galileo, Amadeus et cetera. We have agreements in place with major wholesalers, including Australian Outback Travel, Flight Centre and others. We do not confess to be a tourism operator or a holiday wholesaler, but we do provide fares for wholesalers to promote to those destinations. We have had those discussions in Albany and Esperance. In both Albany and Esperance, the three-year agreement that we put into place to deliver the community fares also includes a commitment to be able to work together to grow tourism. We believe that some of that needs to be done on the ground in Albany and Esperance, because sometimes, I think, too much reliance is placed on a regional airline to be the silver bullet to fix tourism.

At the end of the day, we can provide the avenue for tourism, we can provide special fares, we are providing the services, and we have a good mechanism to sort of dovetail into with our community fare. We can do a bit of a hybrid arrangement of the community fare and package and tailor that as a tourism thing. There are also local issues—I am sure that it has been discussed by others in front of the committee—and we do not believe it is going to be something that is significant in numbers, but it can be something that can benefit from having an extremely good service. We have found in some of the ports that it has been a little bit difficult getting traction with promoting tourism. But it does come down to what tourism products are available out in the marketplace, even how many taxis are available and how much accommodation is available out in the regional ports. We are very committed to being a vehicle for that tourism growth in the regional ports.

Mr S.J. PRICE: Mr Lodge, with regards to your obligations under the agreement that you have with the government to provide information back to the department, what information do you currently provide and do you think there is additional information that should be provided? One of the aspects we are looking at is transparency in pricing. If you could give us some understanding about what you have to supply back and is there anything else that maybe should be included?

Mr LODGE: The information we provide is very transparent. We are aware that it is more information that has been provided than under any prior deed. We report every single fare class by direction on a monthly basis for Perth to Albany, Albany back to Perth and the same for Esperance. We report every single fare sold in every fare bucket, and that is reported monthly. That will give the department our average load factor and our average ticket price. We also report our passenger revenue, excluding airport charges and GST. The airport charges are actually a formal part of that reporting process, so we are not only reporting the average ticket price to Rex, but importantly what the average ticket price is to the customer. We also report all our on-time performance for the prior month, which I think has been a standing item in prior deed of arrangements. I think that is important to have that KPI under the arrangement. I guess the broader deed covers our fare structure in that we cannot increase our fares by more than the CPI each year. I do not think that anything else is necessarily required under those arrangements.

The deed of arrangement for our services between Perth–Esperance and Perth–Albany, the lowest fare type that we have to provide under that deed is around \$170 each way. That was our initial offer when we went into the deed. That is as low as we felt that we could go, given the high airport charges. We have actually done these community fare initiatives and the partnership initiatives outside of the deed. I think that has been positive because the department said, “At the end of the

day, we don't want to lock you into something. If you can deliver improvements, it doesn't necessarily then need to be part of the deed."

There are improvements that can be beneficial to the local community and to the airline that we do off to the side. If we find the \$129 community fare successful over the next three years, that should be something that should continue. I think that is the right approach too, because the department does not necessarily want to interfere in those relationships between the airline and the regional communities because they can be delivering some positive things.

The CHAIR: You would much rather see the market participants generate the solutions themselves, and the communities and industry to work together.

Mr LODGE: That is the objective.

The CHAIR: Exactly. That sort of win-win, right?

Mr LODGE: Yes.

The CHAIR: The thing that is striking me is that on the regulated and the unregulated routes, there is something here about scale and about business model. Your business is regionally focused. It is small, you are able to be very agile and responsive and engaged with your communities and you are only operating on two Western Australian routes. Are the outcomes that you have managed to achieve in Western Australia typical across Rex's entire network? Is there something about scale here? Once we get up to the Qantas and Virgin global network scale, whereby they have obviously got very complex pricing mechanisms and complex logistics and networks and cost bases, is there something here about scale and about operating these regional regulated services?

Mr LODGE: There are two parts to the question. Working in partnership with the regional councils and the airport owners is something that is typical of Rex way back to 2002 and 2003. The very first year that Rex operated, we lost \$30 million and we have been working hard every single year over the last 15 years to make our organisation more efficient. Branching into Western Australia and branching into Queensland continues to make us more efficient because we are getting increased scale. The working in partnership is not something new but it is something that we have brought to Western Australia from our past, from our history and from our experience, but doing what we have done with regards to the community fare is something that is brand new; we have never done that before. Charging \$129 for the Esperance and Albany routes, we are largely competing with the road. We do not have any big mathematical formula that says, "These are our operating costs and those operating costs translate into these fares that we know that we need a price point that is attractive that is going to compete with the road." We came up with \$129. We had \$170 as a starting point. We first entered into an agreement with the regional ports and dropped it by \$20. Our first community fare was roughly \$149. We then entered into a broad sort of growth agreement with Perth Airport and we committed to lowering it by another \$20 if we could achieve that. The fact that we operate with higher load factors under a regulated licenced environment gave us the thinking that we could actually afford to do some creative things, particularly within that last day. If you look today for all our flights to Esperance and Albany tomorrow in both directions, it is \$129 until it fills up. I noted that some of the big carriers say that that is not possible because we would see a reduction in average ticket price. They are dealing with some different dynamics, but I think you are right. They are much bigger organisations and it is actually harder to say, "Let's do something creative for these routes only" because that is what that calls for. We are able to do that.

I actually look after our pricing and our revenue management. I go to the CCG meetings. I put in the submissions to the Department of Transport, so it gives us a very good holistic view of what we need to do. You mentioned it before, but we can be nimble and we can come up with some creative

things. But the community fare initiative is something that is unique to Western Australia and only in the last six months we have actually started rolling it out in New South Wales and our existing ports under similar partnership agreements with the airports because we have seen that it is working. There is a risk that some business travellers will take up a \$129 fare on the day. I have heard other witnesses say, “If that was me, I would probably just chance it and go on the day” and that is a risk for the airline. But getting back to regional air services are essential: a lot of people need to have the commitment and need to book four or five days out in advance or two weeks in advance, and that is the way it is. But if we can provide a price point where discretionary travellers, people who really just need to get there at the last minute—someone who may have been driving for the past five years is now going to jump on board a plane—we see it more as incremental revenue rather than something that erodes our average ticket price, and the average ticket price has become something that we do not focus on as much.

[11.10 am]

The CHAIR: And the benefits, in terms of your reputation with those communities—in Albany, we had no-one turn up to our public forum. We had very positive feedback about the way that Rex is servicing its community. Contrast that with other regions where we had massive turnouts and a lot of disgruntled people. The difference is marked.

Mr LODGE: I made it a point to read, particularly, all the individual submissions, because I thought that that was important. I obviously read the Qantas submission, the Virgin submission, the AAA submission and some of the key submissions, but I thought it was important to read all the individual general public submissions. I do not know whether it was me, but I did not find any complaints with regards to our services to Albany and Esperance. We understand that sometimes someone would want to book three or four days out and they might have to be paying \$350, but we have measures in place that create a good low price point for those who actually need it.

I also noted earlier comments from a previous hearing that the word does get out very quickly. We did a press release in Albany and Esperance to say that we are doing \$129 fares, and we did not need to do a lot of promotion after that for that to become something that everyone in Esperance and Albany know about, which has translated into having 15 per cent of the marketplace now travelling on those lower fare types. Working in partnership is not a new thing and we think that it is an important part of the recipe. Regulation needs to be able to foster that and allow that to happen.

The community fare initiative is something that is quite new. One of the problems with regulation, which we found when we were entering Albany and Esperance, and I touched on it earlier, was that it can be difficult to enter into those discussions whereby you want to work in partnership with someone. If we pick up the phone and speak to the Shire of Esperance or the City of Albany saying, “We are putting in a tender, we would like to do this over the next five years” it is fairly difficult to engage with the councils under that sort of environment. They are more likely to say, “These are our airport charges; you either put in a tender or you don’t.” We have to start from scratch. This is an evolving process that will hopefully continue to evolve as we continue through the deed.

The CHAIR: Great.

Mr S.J. PRICE: Does Rex currently have any port that would do 200 000 pax a year?

Mr LODGE: By ourselves?

Mr S.J. PRICE: Yes.

Mr LODGE: No, we do not. Like I said, we have serviced Adelaide–Port Lincoln with around 150 000 passengers with 10 return flights a day. We do operate in markets with 200 000 passengers,

but generally they are competitive ports. We fly Dubbo–Sydney, Wagga Wagga–Sydney, Albury–Sydney that are all 200 000 passengers or more. Generally, QantasLink and Rex operate those ports. But as we have said publicly before, as we have said to the Queensland government before, and as publicly stated today, we would not shy away from getting a larger aircraft type if it meant there was certainty in regards to a five-year term and we knew what the passenger numbers were. We are an experienced operator, we have a lot of expertise through all the different parts of the business and we certainly would not shy away about putting in a submission with a larger aircraft if that required it. I think there are routes like Geraldton that are obviously within the range of the Saab 340 aircraft. I think that our previous experience in Port Lincoln is a good example that you can deliver a very high frequency with a good load factor, good fares, transparency et cetera. It would be a good model for a route like Geraldton.

The CHAIR: That is great, Mr Lodge. Thank you very much. I will proceed to close today's hearing and thank you for your evidence. A transcript of this hearing will be emailed to you for correction of minor errors. Any such corrections must be made and the transcript returned within seven days of the date of the letter attached to the transcript. If the transcript is not returned within this period, it will be deemed to be correct. New material cannot be added by these corrections and the sense of your evidence cannot be altered. Should you wish to provide additional information or elaborate on particular points, please including a supplementary submission for the committee's consideration when you return your corrected transcript of evidence. Thank you.

Mr LODGE: Thanks very much.

Hearing concluded at 11.15 am
