Liberalisation of Air Transport in Asia Pacific

Shifting models and competitive responses from the full service carriers.

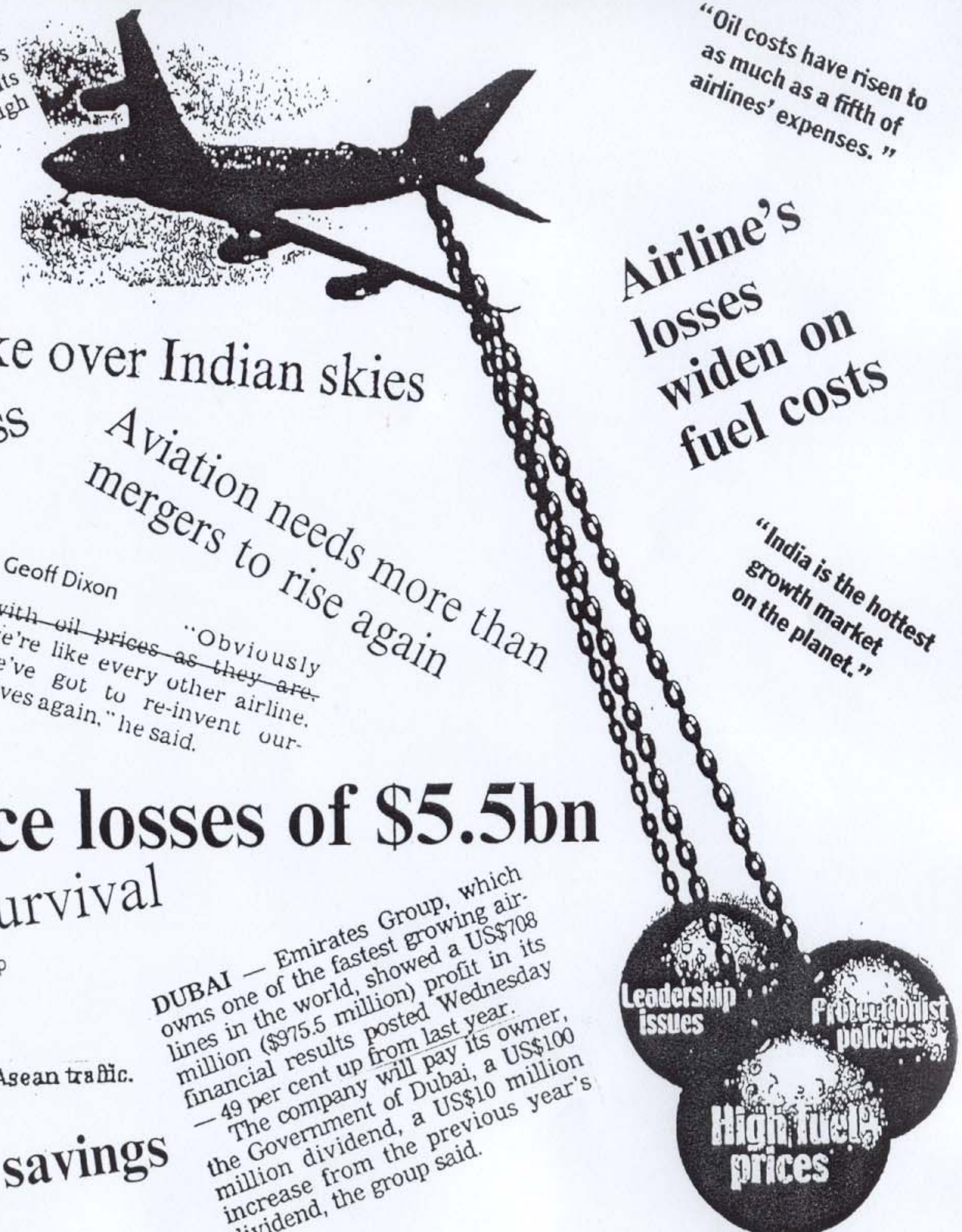
David Hawes, Head of Government and International Relations,

Qantas Airways.

Fuel price hits Singapore's profit

Competition from rival discount airlines stops costs being passed on to travellers

The third largest carrier in the United States, Delta Air Lines, faces bankruptcy unless it sells part of its fleet, as the industry reels from high fuel costs and low ticket prices.



"Oil costs have risen to as much as a fifth of airlines' expenses."

Airline's losses widen on fuel costs

Budget airlines set to take over Indian skies

Jetstar Asia 3rd budget carrier to fly to Philippines

Lufthansa swoops on Swiss

Aviation needs more than mergers to rise again

Geoff Dixon

~~with oil prices as they are,~~ "Obviously we're like every other airline, we've got to re-invent ourselves again," he said.

"India is the hottest growth market on the planet."

'Green light' for Air NZ-Qantas alliance

Bumpy ride for S'pore budget carriers

Airlines face losses of $5.5bn

US airlines turn to mergers for survival

Critics liken the proposed US Airways and America West marriage to two one-legged men propping each other up

In South-east Asia, LCCs control about 10 to 15 per cent of intra-Asean traffic. And half a dozen are starting up in India and China.

DUBAI — Emirates Group, which owns one of the fastest growing airlines in the world, showed a US$708 million ($975.5 million) profit in its financial results posted Wednesday — 49 per cent up from last year.

The company will pay its owner, the Government of Dubai, a US$100 million dividend, a US$10 million increase from the previous year's dividend, the group said.

Air France-KLM ahead on savings

Agenda

- Full Service Carriers
- Liberalisation
- Other Pressures for Change
- Impact of Pressures
- How Have FSCs Reacted?
- Impediments to Change
- Qantas Case Study
- Conclusion

Full Service Carriers

Typical features:

- Large and well established.
- Operate over broad networks.
- Offer premium product.
- Complex and cumbersome systems.
- Legacy cost base.
- Vertically integrated businesses.

Now include newly established airlines - benefit from a modern and flexible operational environment.

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Liberalisation

- Increasing trend towards liberalisation and deregulation over the past decade - however pace and extent uneven.
- Two major impacts:
  - Opening markets - FSCs competing with each other on more routes.
  - Multiple designation - recent rise of LCCs.

    "The effect of low cost carriers has been quite profound, and will continue to impact travel trends for many years to come." (Asia Pacific Airline Daily)

- LCCs now capture 12% of schedules flown worldwide.
- Now 21 LCCs operating internationally in the Asia Pacific region, an increase of 12 since 2000.
- Also new entrants in domestic markets.

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Other Pressures for Change

In recent times FSCs have felt the impact of:

- External shocks such as 9/11 and SARS.
- Increasing external costs eg. fuel and airport charges.

"Due to rising fuel costs, profits are expected to dwindle despite an expected growth in revenue."
(Japan Airlines)

- Aspirations of national agenda airlines.
- Surplus capacity globally, driving fares and yield down.

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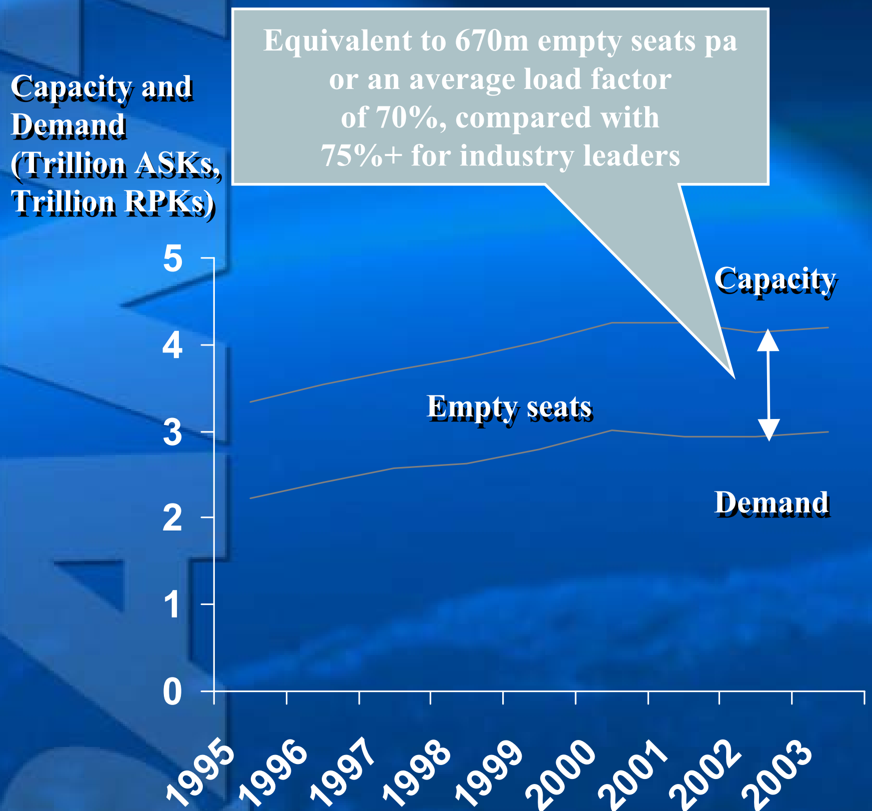
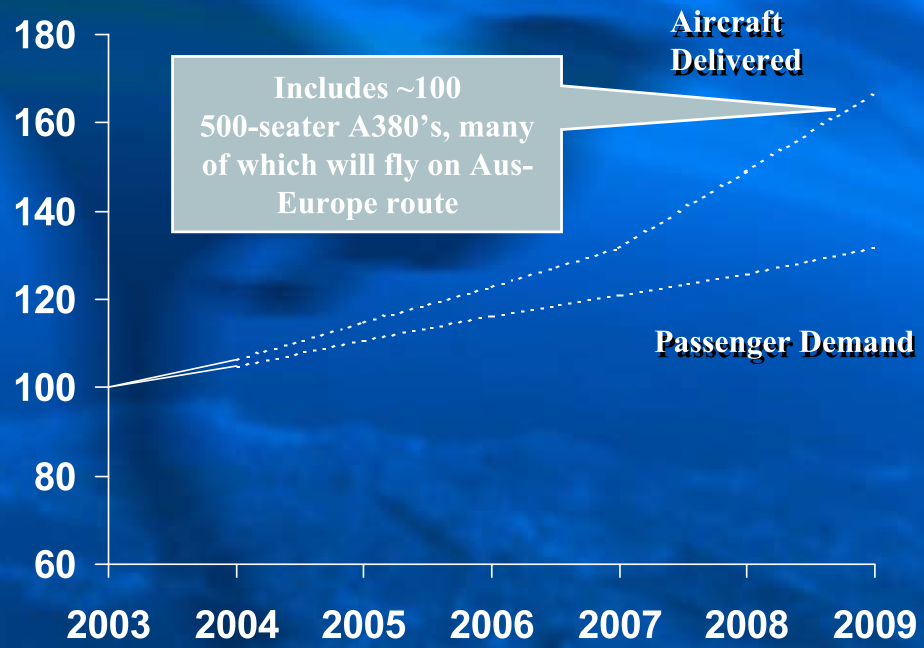
Industry Is Subject To Chronic Over-Capacity

Global Airline Capacity, Demand 1996–2003



Deliveries Of New Aircraft Indicate That This Trend Will Continue Over The Next 5 Years

Worldwide Deliveries Of Aircraft Versus Passenger Demand - 2003 to 2009



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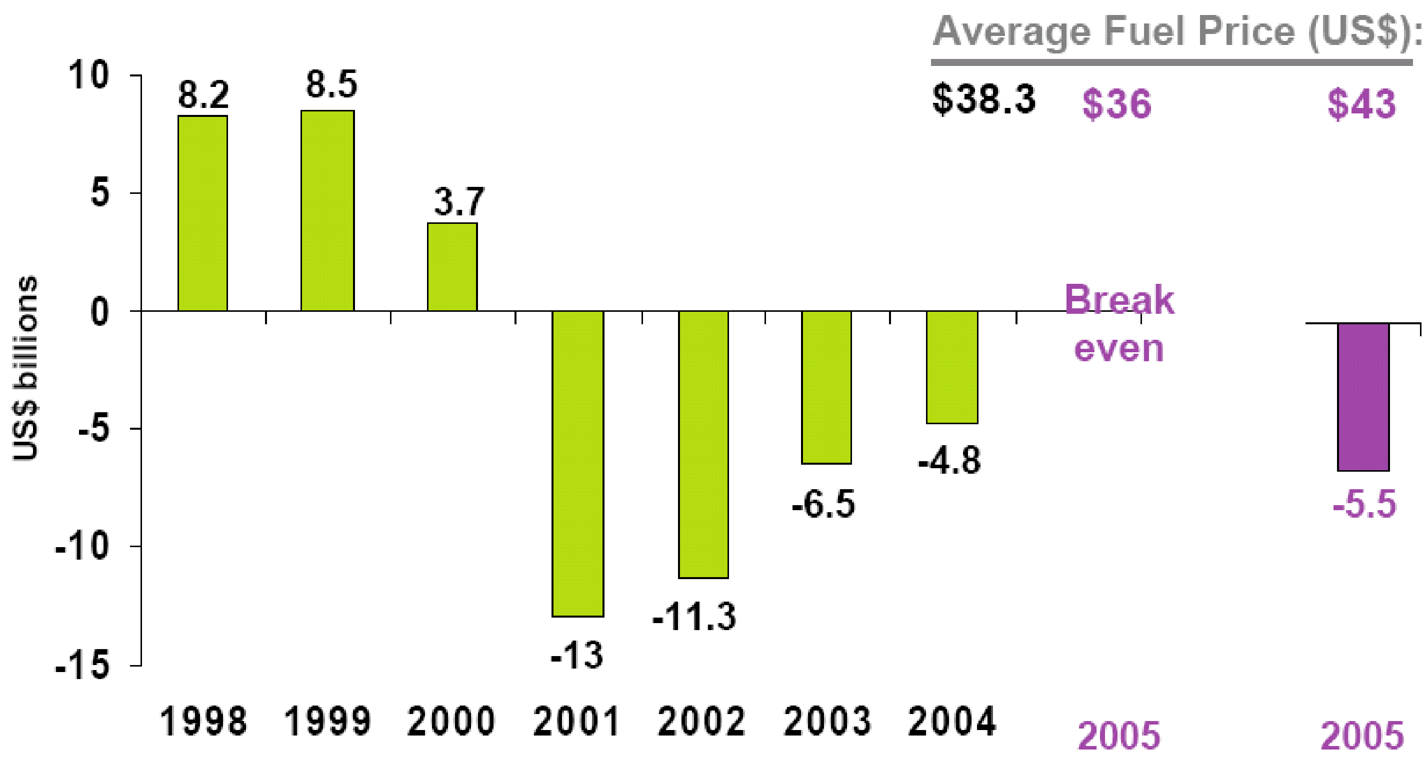
The airline industry is not profitable at current oil prices

- √ This year we forecast industry-wide losses to exceed $5 billion assuming an average oil price of $43



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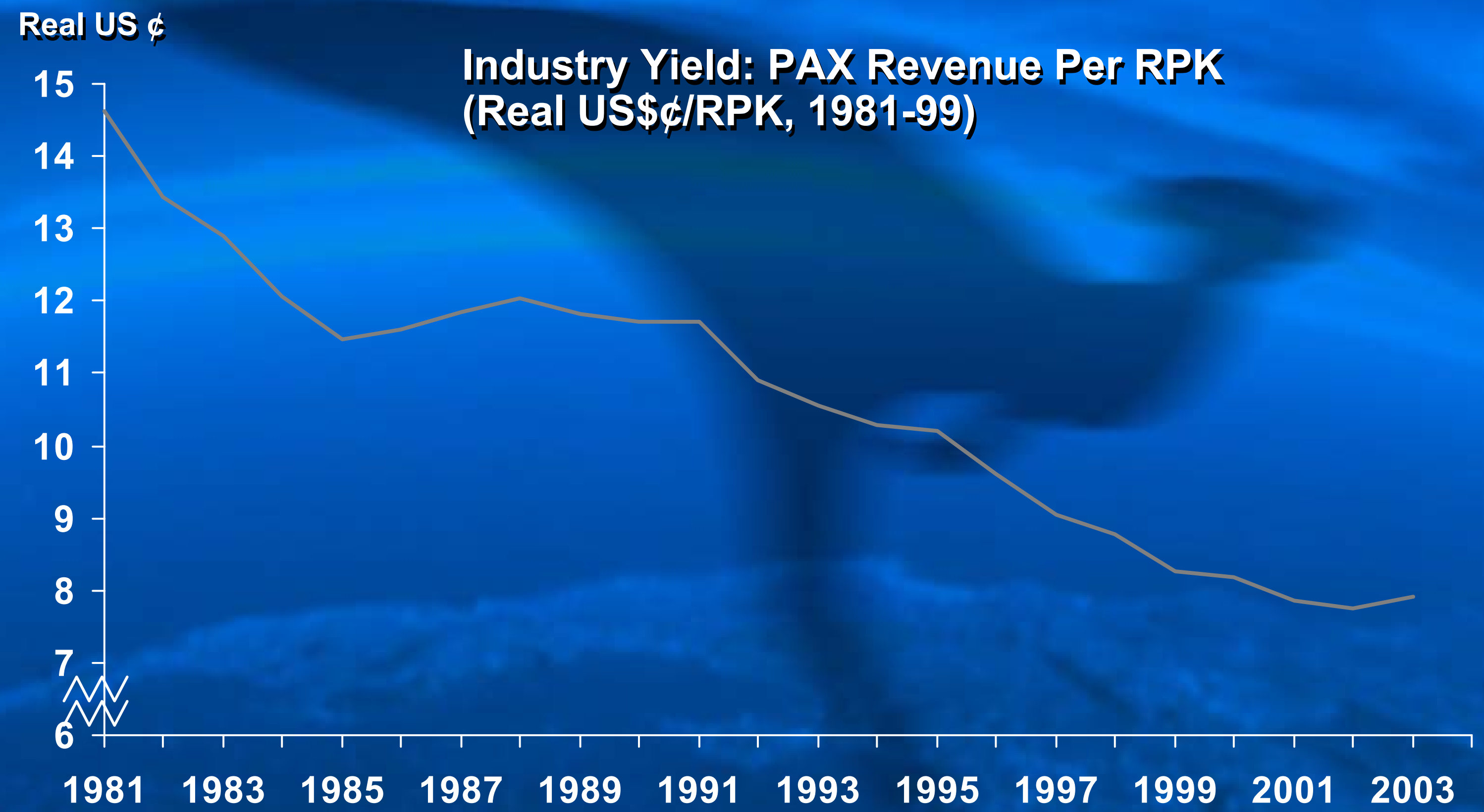
Impact of Pressures

- General effect for FSCs has been:
  - Yields declining more rapidly than ability to drive down costs.
  - Struggling to meet cost of capital.

This Has Led To A Long Run Yield Decline



Note: Data pertains only to scheduled airlines of ICAO Contracting States. Inflation adjusted at US rates. Year refers to calendar year
Source: ICAO; IMF; IATA WATS; Thomson Financial Datastream

Impact on Individual FSCs

Influenced by:

- Geographic location - hub versus end of line operation.
- Government owned and supported versus privately run.
- International versus domestic exposure.
- Age and ability to adapt.

How have FSCs Reacted?

Seeking greater efficiencies through:

- tackling costs;
- process re-engineering;
- rationalisation of operations;
- strengthening of alliances/consolidating; and
- outsourcing and off-shoring.

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How have FSCs Reacted?

- Seeking growth opportunities:
  - new markets; and
  - new technology.
- Segmenting and new business development models eg. 8 LCCs launched by FSCs in the region.
- Diversifying - reducing reliance on core business.

Impediments to Change

- Pressure for rationalisation/restructuring will continue.
- Barriers to exit are high:
  - creditors and leasing companies;
  - government intervention to save failing carriers; and
  - bankruptcy protection.
- Regulatory framework:
  - competition regulation preventing consolidation; and
  - ownership and control requirements.

> "US carriers run the risk of being marginalised and left behind by the global consolidation beginning to take place in the business. US rules that prevent more than 25% foreign ownership of a US carrier makes precious little sense." (Glenn Tilton, CEO - United Airlines)

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Qantas Case Study

- Addressing costs – “Sustainable Future“ program
- Ten stand alone units with transparent accountability for their budgets and responsibility for finding strategic growth opportunities.
- Investments to diversify the Qantas business
  - Qantas’ Freight Division- Star Track Express.
- New business models - Australian Airlines, Jetstar and Jetstar Asia.

Australian Airlines

- Wholly owned Qantas subsidiary.
- International full service all economy class carrier targeting leisure travellers.
- Serving routes Qantas could not operate viably.
- Medium haul routes (4 to 8 hours) using 5 B767-300s with 271 seats.
- Two phases of expansion - inbound and outbound.
- Cost efficiencies from simplified processes.

Jetstar

- Wholly owned Qantas subsidiary.
- Launched in Australian domestic market in May 2004, with 14 B717s flying up to 88 flights daily with one class of travel.
- Now flies over 800 services a week.
- First Australian carrier to operate scheduled services from a secondary airport.
- By 2006, will operate a fleet of 22 A320s.
- 12% market share and further growth expected.
- One of Australia's most recognised brands.
- Recently announced will operate to New Zealand.

Jetstar Asia

- 49% Qantas shareholding with Singaporean majority partners in a new Singapore-based low cost carrier.
- Commenced operations in December 2004.
- Currently serving Hong Kong, Bangkok, Taipei and Manila, using A320 aircraft.
- Start-up and expansion slower than anticipated because of regulatory approvals and traffic rights issues.

Conclusion

- FSCs cannot escape need for change.
- Ongoing liberalisation not the only challenge.
- Pressures from growth of mega-carriers, external shocks, national agenda airlines, LCCs will continue.
- Must continue to reduce costs, increase efficiencies and adapt to the changing environment.
- Efforts will be aided by a flexible and forward looking regulatory framework that assists consolidation and access to capital.

"We need modern rules that will allow us the same freedoms that other global businesses take for granted."
(Giovanni Bisignani)

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