NOUMEA PECC ROUNDTABLE

"Connecting the Pacific Islands to enhance Growth & Development"

John Campbell

Chairman
Association of South Pacific Airlines

Managing Director & CEO
Air Pacific Limited

November 2002

- This address comes from two perspectives :
  - ➢ CEO of the largest airline within the South Pacific.
  - ➢ Chairman of ASPA, an association of 16 South Pacific Airlines.
- Assumption is that air services between island nations in the South Pacific will/can be improved.
- There are certainly shortfalls.
- Sadly, these shortfalls will not change in the near future.

Why ?

A number of contributory factors.

- Ignorance is not one of them.
- Airlines understand the low frequency and often inadequate range of airline services within the South Pacific.
- We, too, are frustrated in our endeavors to transverse the Pacific and often have to fly via New Zealand or Australia to move between two island countries separated by only a few hundred miles of ocean.

Traffic rights are generally not an issue.

- Most Governments are delighted to facilitate improved links and will readily approve A.S.A.'s code shares, new aircraft types and entrants.

- Airline co-operation is generally not an issue.

  - The first code share in the world was operated in the South Pacific between Qantas and Air Pacific in 1980;

- Nearly all flights operate with co-operative code share partnerships e.g.

FJ	with	IE/NF/WR/QF/AA/PH
WR	with	FJ/NZ/PH
IE	with	FJ/NF/QF
NF	with	QF/FJ/IE/NZ
PH	with	QF/FJ/WR

The primary issues are :

- The “missions” of the airlines
- The economics of growth
- Aircraft type/size as growth inhibitors
- The financial standing of South Pacific airlines
- Market size and viability
- Traffic “quality” to drive growth
- Infrastructure
  - Aviation
  - Ground Plant
- Freight Homogeneity

- Most South Pacific airlines have, as the primary mission, flights between their home country and major tourism/business/ VFR source markets.
    - Typical routes are more North-South than East-West e.g.

      FJ - Australia/NZ/Japan/USA and Fiji

      NF - NZ/Australia and Port Vila

      SB - NZ/Australia/Japan and NOU

      PH - Australia/NZ/HNL and APW
- Major Intercontinental airlines typically have long range jets designed to operate non-stop between Pacific Rim countries. Intra Pacific flights would be loss making and they typically “partner” with South Pacific airlines to provide network fees - they will not consider intra-Pacific flying.

- South Pacific airlines primarily deliver tourists to meet tourism infrastructure and national earnings needs.

- A major requirement can also be links for VFR and overseas local workers - the source of substantial repatriated income.

- Most of the airlines are [substantially] Government owned and fulfill the directives of Government first and foremost.

- Most markets are small and slow growing which works against economic airline growth.
  - In 2001 only three destinations achieved more than 100,000 tourist arrivals

Fiji	348,000
Tahiti	228,000
Noumea	100,000

  - Average long term growth rates are between 3 and 5% p.a.
  - Demand is often highly seasonal and generally the same peaks apply in all source market, so few discretionary capacity allocation opportunities exist.
  - Tourism airfares are generally low, requiring high seat factors for breakeven - typically around 70% year round.

- Most airlines operate only 1 or 2 jet aircraft, typically Boeing 737 or Airbus A320.
- These provide 120 - 156 seats.

  To add only one aircraft represents an increment of 50% [min] and usually 100% i.e. doubling the fleet.

  This is indigestible growth for small airlines.

- Modern narrow-bodied aircraft are not small - they are the size of yesterdays Boeing 707’s and DC8’s.

- These aircraft are primarily obtained to fly missions between major metropolitan source markets and the “home” tourism destination.

- Intra Pacific flying is a secondary consideration.

- Modern aircraft are expensive to lease or purchase.
  - Most SWP airlines currently lose money
  - Most SWP airlines earn in weaker and spend in stronger currencies, typically USD’s
  - Aircraft leases / spares / maintenance contracts / insurance and interest / pilot training are in USD’s.
  - No South Pacific Airline can fully maintain it’s fleet :- all major maintenance is contracted out to major metropolitan airlines.
- Most airlines cannot afford more than one type of jet aircraft.
  - Spare costs, engineering licensing, pilot training and regulatory costs are crippling for small multi aircraft-type fleet.

- Most South Pacific airlines lose money [fully allocated costs] or manage small profits, typically 2.5% - 3.5% of turnover.
- Investment funds are limited and Government owners typically cannot fund large capital outlays.
- There are no small costs in airlines
  - Typical lease costs for a new B737 over a 60 month lease are a fixed 270,000 USD p/m, plus overhaul reserve of USD 260/hr for a typical 4000 hours p.a. A total cost of USD 4.24 million p.a.
  - Without DOC’s of fuel; catering; ground handling; enroute and air navigation fees; landing and airport terminal charges; freight handling; insurance; crew salaries and expenses etc, etc, etc….

    Docs at least double lease and maintenance costs.

- Governments and shareholders will only fund growth which :
  - Meets national objectives
  - Grows tourism and freight
  - Has a chance of economic return
- Small airlines and nations cannot be risk takers.
- Chronically unprofitable Airlines are capable of seriously damaging small nations economies.

- Airlines plan using ave pax per week as the core measurement of demand.

  e.g. An annual market of 50,000 arrivals = 961 pax pw @ 70% SF = 1373 seats per week

  Requires 9 B737-800 services p.w. This equates to 1 aircraft.

- At 5% annual growth 1 additional flight pw is required each 2.3 years.
  - At this rate an extra aircraft is needed every 14.5 years.

- It follows if major N-S tourism markets are targeted, E-W cross Pacific flows are secondary and will receive low frequency and often poorly timed flights.
  - Prime markets obtain prime timings.
  - Curfews in some major markets require daylight flights, leaving “odd hour” E-W cross Pacific flights.

- Cross Pacific E-W markets are small and slow growing e.g.

NAN/APW	130 pw	2002/03 [est.]
	107pw	1994/95
NAN/VLI	70 pw	2002/03 [est]
	60 pw	1982/83
NAN/TBU	200 pw	2002/03 [est.]
	161 pw	1993/94

- Most markets can only justify 1 or 2 B737/A320 services p.w.
- Capacity increments are “large and lumpy” at 120-150 seats per additional flight.

- Extra stops on flights destroy route economics e.g. a POM-HIR-VLI-NAN vv service has a breakeven 125% seat factor, even when shared between 4 airlines [PZ, IE, NF, FJ]

  Fuel, crew costs, aircraft wear and tear, ground handling and landing / terminal fees are crippling for multistop flights.

- Multi stop flights are not a viable solution.

- Small aircraft giving higher frequency are costly to operate; lack comfort, lack range and payload and most airlines do not operate turbo prop aircraft, except domestically.
- Most airlines are restricted to one jet aircraft type. Multi-type cost are large.
- Regional jets [70-90 seat size] are not operated by any SWP Airline as they are :
  - Costly to obtain and operate.
  - Not suitable for major market operations.
  - Often not suited for domestic operations to rugged and remote airways.
  - Not supported with spares, training and maintenance by any major airline on most of our networks.

For growth in services to occur, both volume and "quality" are critical.

- Cross Pacific point to point local traffic is small in volume but high in quality i.e. average fares are high.
- Cross Pacific multi stop business travel is medium volume and medium quality i.e. the fare whilst high in total is shared between several airlines and each receives a small amount.
- "Air Pass" and tourism type tickets are low in volume and price [yield].

Which market segments are likely to grow?

- Local point to point markets only a little.
  - Even if fares reduced, not much elasticity.

- Intra regional business traffic, only a little.
  - Already price elastic but frequency / volume inelastic as regional business is slow growing.

- Australia, New Zealand and Japan origin “Multi Destination” tourism ?

  No

  These are primarily mono-destination tourists who perceive South Pacific countries as much the same as each other.

- UK / Europe and USA origin travelers.

  Yes

  But the fares are very low and will not support economic growth in services.

Therefore

Driver for growth is local point to point and intra regional business traffic – and these segments are slow growth

There are some infrastructure issues

1. Aviation

- Modern jets are quite large and heavy.

  - Many island runways are small, old and do not have a “depth” of concrete on thresholds.

  -Runways “break up” with modern jet landing impacts.

- Many terminals struggle with a full aircraft load and security is poor.
- Navigation aids are often deficient or faulty.
- Some airports have night curfew or closed on Sundays.
- Some airports lack lighting for night landings.
- Some airports do not have reliable, high quality jet A1 fuel.

1. Tourism

- Hotel bed supply and categories can be patchy.
- Quality issues [food/room facilities/access] in smaller markets..
- “Value for money” is sometimes an issue.
- Tourist transportation and tours / rental cars can be expensive and local public transport unsuitable or inefficient.
- Small destinations lack promotional / marketing funds to drive demand and growth.

It’s a Catch 22!!

Investment in Infrastructure and Tourism Plant will not improve or grow without flights.

And V.V.

AIRFREIGHT

- Generally not a reason to add flights.

  - Passenger carriage is the driver.

- Intra-Pacific airfreight is homogenous.

  - Generally perishable, often seafood.

  - Secondary products are fruit and root crops.

  - Third level is spare parts; courier, diplomatic and post office mail.

- Most island states produce and seek to export similar perishable products to the same Pacific Rim markets.
  - Generally the few “intercontinental” airlines can fill their aircraft from home markets with the same export products – and are under pressure in “The National interest” to do so.
  - There is no premium available for preference to smaller nations and no reason to mount flights for freight carriage.
  - Small jets operating Intra Pacific are not equipped for container loading, required for Intercontinental jets.
- Passenger aircraft typically charge around 50% of freighter aircraft per kg fees for perishable product.
- Freighters are not affordable for perishable exports.

CONCLUSION

- Sadly, there is no imminent change or growth in air services between South Pacific nations.
  - The economics do not support individual airline risk taking.
  - The markets are slow growing.
  - Current aircraft are too large to allow high frequency services.
  - Regional jets are not yet affordable for individual airlines.
  - Turbo props are unsuitable for extended over water flights.