Submission No 10

Inquiry into Australia's Relationship with Malaysia

Organisation: **Qantas**

Contact Person: David Hawes
Group General Manager
Government and International Relations

Address: **Qantas Centre 203**
Coward Street
Mascot NSW 2020

Joint Standing Committee on Foreign Affairs, Defence and Trade
Foreign Affairs Sub-Committee

QANTAS

31 August 2006

Mr John Carter
Secretary
Joint Standing Committee on
Foreign Affairs, Defence and Trade
Parliament House
CANBERRA ACT 2600

Dear Mr Carter

Inquiry into Australia's relationship with Malaysia

In response to your email of 18 August 2006, I am pleased to attach a brief submission covering Australia-Malaysia air services arrangements and an overview of Qantas' activities in the Malaysian market.

We would be pleased to provide any further information if it would assist the Committee.

Yours sincerely

David Hawes

David Hawes
Group General Manager
Government and International Relations

Qantas Airways Limited ABN 16 009 661 901
Qantas Centre 203 Coward Street Mascot NSW 2020 Australia
Telephone 61 (2) 9691 3636

qantas.com

QANTAS AIRWAYS LIMITED

SUBMISSION TO

JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE

INQUIRY INTO

AUSTRALIA'S RELATIONSHIP WITH MALAYSIA

AUGUST 2006

Australia - Malaysia market

Malaysia is Australia's ninth largest market in terms of total origin/destination (O/D) traffic flows. In 2005/06, 6,383 passengers travelled each way each week between the two countries, comprising almost equal proportions of Australian residents and visitors. Approximately 50 percent of passengers were travelling for holiday purposes, 24 percent for business and 20 percent visiting friends and relatives (VFR).

Malaysia Airlines (MAS) carried 69 percent of the O/D traffic, Singapore Airlines (SIA) 14 percent, Qantas/British Airways (BA) eight percent over Singapore, and Royal Brunei Airlines and Lauda Air four percent and three percent respectively.

Malaysia stands out among Australia's top 10 markets in terms of a single carrier capturing such a dominant share of the traffic. MAS' capacity to Australia has grown by around 156 percent over the 10 years to December 2005, at a compound annual growth rate of 10 percent. It currently operates 47 services with almost 15,000 seats per week to Sydney, Melbourne, Brisbane, Adelaide and Perth, using a mix of Boeing 777-200, 747-400 and Airbus A330-300 aircraft.

In 2005/06, only 41 percent of MAS' Australian traffic had an O/D of Malaysia. A significant proportion of MAS' Australian traffic flows to and from points beyond Malaysia, for example, to the UK (16 percent), to Europe (13 percent) and to India (six percent).

Australia - Malaysia air services arrangements

An air services framework between Australia and Malaysia was put in place in 1967. Air services consultations were last held in April 2003, further opening up the already liberal arrangements.

The arrangements provide for the operation of 15,000 seats per week by Malaysian carriers and 20,600 by Australian carriers between points in Malaysia and Sydney, Melbourne, Brisbane and Perth. The larger entitlement for Australian carriers reflects recognition of the sixth freedom opportunities available to Malaysian carriers - the ability to combine point-to-point traffic rights to carry passengers to and from markets on either side of their hubs. Unlimited capacity is available to and from all other Australian ports. There are limited restrictions on routes and traffic rights and liberal code sharing opportunities are available. An open regime dedicated for freighter services is also in place.

Qantas and Malaysia

Qantas maintained a core operation of three Boeing 767 Sydney-Singapore-Kuala Lumpur services throughout the 1990s. In 1997, traffic fell sharply as a result of the Asian currency crisis. In combination with the high costs of the Singapore-Kuala Lumpur flying and the high frequency of service operated by SIA and MAS on this sector, the downturn meant the extensions were unsustainable and were terminated in October 1998. Qantas continued to code share on BA's Australia-Kuala Lumpur flights until these were terminated in April 2000.

Qantas and BA have maintained a total of seven staff based in Malaysia. Qantas is represented on various industry bodies in the market, for example, the Board of Airline Representatives (BAR).

Qantas continues to monitor opportunities in the Malaysian market, however, evaluations continue to indicate heavy losses. Given the market dominance of MAS, the development of low cost vehicles provides the only potential means of profitably re-entering the market.

In June 2003, Australian Airlines, a single class leisure subsidiary of the Qantas Group, commenced twice weekly Sydney-Kota Kinabalu-Singapore-Cairns vv services. Although these services grew the size of the Australia-Sabah market, they did not consistently cover variable operating costs and were withdrawn in May 2005.

Jetstar, Qantas' value-based subsidiary airline, is currently investigating a range of potential international destinations, including Malaysia.

Qantas and MAS have a longstanding relationship, with its foundations in the management assistance provided by Qantas in the early development of Malaysia Singapore Airlines (MSA). Although Qantas no longer serves the market directly, it has continued to work with MAS.

Qantas had two teams on site in Kuala Lumpur for approximately two and a half years between 2002 and 2004, assisting MAS with improving business processes in the engineering and maintenance and financial management areas.

In 2002 Qantas contracted MAS to conduct the initial line training of 10 Airbus A330 senior check captains, as MAS had already brought these aircraft into service. This involved simulator training, aircraft base training (take-off and landing training) and training on MAS commercial services.

Malaysia Airlines

MAS is a significant player in the Australian international aviation market. In 2005, MAS carried 5.5 percent of passengers to and from Australia, making it the fifth largest carrier in the market. MAS enjoys a number of structural advantages relative to privately run carriers such as Qantas by virtue of its ownership and support by the Malaysian Government.

MAS was fully privatised in 1985 and operated profitably until 1997 when the Asian economic crisis severely impacted the region. In January 2001, the renationalisation of MAS commenced, and today the Malaysian Government owns almost 90 percent of the airline.

The events of September 11 2001 plunged MAS further into financial difficulty, and the Malaysian Government responded by restructuring the company to separate assets from operations. Termed the Widespread Asset Unbundling (WAU) scheme, this involved the transfer of MAS' aircraft from its balance sheet to a specially created entity owned by the Ministry of Finance. The aircraft were then leased back to MAS.

Since December 2001, MAS has had to compete with the highly successful Malaysian low cost carrier (LCC) Air Asia, which has further diminished its returns. Since 2001, MAS has continually incurred losses, posting its largest loss since 1990 in 2005 – MYR1.3 billion (A$476 million) after tax.

Against this background, the Malaysian Government has decided on a major restructuring plan, which focuses on cutting jobs, revamping routes and selling assets to return MAS to profitability within two years.

In March 2006, the Government of Malaysia announced a domestic route rationalisation strategy which saw most of MAS' domestic routes handed to Air Asia. This took effect in August, with approximately MYR650 million (A$233 million) in compensation paid to MAS. MAS plans to use these funds to pay for its employee mutual separation scheme. MAS had indicated it had hoped to reduce staff by between 3,000 and 5,000 by July 2006. MAS will also receive MYR200 million (A$72 million) directly from the government to cover potential losses from asset sales below book value.

The restructuring is already showing improvement in MAS' bottom line, and MAS is expected to emerge as a substantially stronger and leaner competitor.

Singapore - Kuala Lumpur Route

The Singapore-Kuala Lumpur route is one of the most protected in Asia. The Singapore - Malaysia air services agreement confines the market to services operated by SIA and MAS, at the exclusion of other Singaporean and Malaysian based carriers (a so-called "single designation agreement").

However, the advent of LCCs such as Air Asia and Singapore-based Jetstar Asia, in which Qantas holds a minority shareholding, has put pressure on the Singaporean and Malaysian governments to liberalise the route. However, while Ministers on both sides have acknowledged a need to free up the market, substantive talks are yet to take place.

Although the route is contested by a number of international carriers, and others hold rights to do so, these airlines do not have sufficient capacity or frequency to make a competitive impact on an essentially single dominant player.

Jetstar Asia's cost structure and fleet of Airbus A320 aircraft are well suited to the economics of the Singapore-Kuala Lumpur route, and given a sufficient level of initial access to compete effectively with SIA and MAS, could have a positive impact. Jetstar Asia's presence, supported by cooperative arrangements with Qantas or Jetstar, would also provide a boost to the Qantas Group's competitiveness in the Malaysian market, which is limited by the high cost of Singapore-Kuala Lumpur add-on sectors operated by SIA and MAS.