

OPENING REMARKS BY GEOFF DIXON

CEO QANTAS AIRWAYS LTD

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INTRODUCTION

THANK YOU MADAM CHAIR AND COMMISSIONERS.

AS YOU MAY BE AWARE, WE HAVE A MAJOR BOARD MEETING AND OUR ANNUAL RESULTS ANNOUNCEMENT THIS WEEK AND THIS COMMITMENT PREVENTS ME FROM APPEARING BEFORE YOU IN PERSON.

I NEVERTHELESS WELCOME THIS OPPORTUNITY TO FOLLOW RALPH IN OFFERING SOME INTRODUCTORY REMARKS IN SUPPORT OF THE APPLICATION BY QANTAS AND AIR NEW ZEALAND – AN APPLICATION THAT I BELIEVE IS VITAL FOR THE FUTURE OF BOTH AIRLINES. WHEN I AM FINISHED, I WILL BE PLEASED TO RESPOND TO QUESTIONS.

WHAT I WOULD LIKE TO DO IN THE TIME AVAILABLE IS TO RESTATE THE FACTORS THAT LED QANTAS TO PURSUE AN ALLIANCE WITH AIR NEW ZEALAND IN THE FIRST PLACE, AND TO OUTLINE WHY IT REMAINS OF SUCH IMPORTANCE TO US.

INDUSTRY IN CRISIS

THE FIRST POINT I WANT TO MAKE – AND NO ONE CAN ESCAPE THIS FACT – IS THAT THE AIRLINE INDUSTRY GLOBALLY IS IN CRISIS. THIS SITUATION RESULTS FROM A COMBINATION OF FACTORS AND IS STRUCTURALLY INDUCED AS WELL AS CYCLICAL. IT IS ENDEMIC, AND APPLIES AS MUCH TO OUR PART OF THE WORLD AS ANYWHERE ELSE.

IN REALITY THE INDUSTRY HAS BEEN IN POOR SHAPE FOR MORE THAN A DECADE. PEOPLE COULD SEE A CRISIS DEVELOPING BUT NOT EVERYONE SAW WHAT WAS NEEDED TO CORRECT THE SITUATION. QANTAS WAS AMONG THOSE WHO SAW THE PROBLEMS AND ACTED, BUT TOO MANY OTHER AIRLINES CONTINUED TO STRUGGLE WITH INSUFFICIENT RETURNS, AND TOO MUCH CAPACITY, ON TOO MANY ROUTES.

THROUGHOUT THIS PERIOD, RISING EXTERNAL COSTS, CHANGES IN CONSUMER PREFERENCES, AND THE GROWTH OF LOW-COST CARRIERS PLACED ENORMOUS PRESSURES ON FULL SERVICE AIRLINES.

DEREGULATION AND MARKET ACCESS LIBERALISATION CONTINUED APACE, CREATING FURTHER INCENTIVE FOR AIRLINES TO ADD CAPACITY AND OPEN UP ROUTES. AUSTRALIA AND NEW ZEALAND WERE AT THE FOREFRONT OF THIS PROCESS.

WHILE NONE OF THIS IS ANY SECRET, IT IS IMPORTANT TO RECOGNISE THAT THE PROBLEMS CONFRONTING THE INDUSTRY WERE, AND REMAIN, LONG TERM AND STRUCTURAL. THEY DEMAND LONG TERM SOLUTIONS AND CANNOT BE ADDRESSED WITH A FEW COSMETIC CHANGES.

THE FORMER DIRECTOR GENERAL OF IATA, GAVE EMPHASIS TO THIS CHALLENGE IN APRIL 2001 WHEN HE SAID:

"IN OUR GLOBALISING WORLD ECONOMY, THE LIMITS TO SIZE, THE ACHIEVEMENT OF CRITICAL MASS IN MARKETING, SERVICE PROVISION, COST CONTROL, AIRCRAFT AND OTHER EQUIPMENT ORDERING ARE BEING RE-WRITTEN. THE DRIVE TO FURTHER COST REDUCTION SUGGESTS THAT OUR INDUSTRY SHOULD BECOME MUCH MORE CONSOLIDATED....."

FOR MANY OF THE WORLD'S AIRLINES WITH A SMALL DOMESTIC MARKET BASE AND UNABLE TO ACHIEVE CRITICAL MASS THROUGH BILATERAL TREATY LIMITATIONS AND FOREIGN OWNERSHIP RULES, THEIR LONG TERM CHANCES OF SURVIVAL IN TODAY'S GLOBAL MARKET IS LIKELY TO BECOME INCREASINGLY DIMINISHED."

IT IS IMPORTANT TO NOTE THAT THE DIRECTOR GENERAL'S ASSESSMENT WAS DELIVERED BEFORE THE SEPTEMBER 11 TERRORIST ATTACKS. SINCE THEN, WE HAVE ALSO SEEN THE ECONOMIC DOWNTURN IN THE US, THE WAR IN IRAQ, AND SARS – EVENTS THAT FURTHER AGGRAVATED THE INDUSTRY'S POOR SITUATION AND OUTLOOK.

IN NORMAL CIRCUMSTANCES, THE INDUSTRY MIGHT BE EXPECTED TO BOUNCE BACK QUICKLY FROM THESE SORTS OF EVENTS. BUT THIS ASSUMES A SATISFACTORY STARTING POINT, FREE OF STRUCTURAL IMPEDIMENTS. NEITHER QANTAS NOR AIR NEW ZEALAND IS IN THAT POSITION.

THE LOCAL AVIATION INDUSTRY HAS BEEN IMPACTED FAR MORE HEAVILY THAN ANYONE COULD HAVE ANTICIPATED BY THE UNDERLYING CHALLENGES AND PRESSURES FOR CHANGE. THIS RESULTED IN THE COLLAPSE OF ANSETT IN AUSTRALIA AND THE NEED FOR THE NEW ZEALAND GOVERNMENT TO COME TO THE AID OF AIR NEW ZEALAND.

GLOBALLY, THE INDUSTRY HAS RESPONDED TO THE LATEST CRISIS BY SHEDDING OVER 400,000 JOBS. FULL SERVICE AIRLINES HAVE CANCELLED OR DEFERRED AIRCRAFT ORDERS, AND NEW INVESTMENT HAS BEEN DRAMATICALLY CURTAILED.

IT REALLY DOES NOT MATTER WHERE YOU LOOK FOR EXAMPLES. IN THE US, EUROPE, LATIN AMERICA, ASIA, OR CLOSER TO HOME, THE SITUATION IS THE SAME.

THE LESSON WE NEED TO TAKE FROM ALL THIS IS THAT WITH THE RAZOR THIN MARGINS THAT EXIST IN THIS INDUSTRY, EXTERNAL FACTORS CAN PUSH OTHERWISE HEALTHY AIRLINES INTO LOSS MAKING SITUATIONS VERY QUICKLY. EVEN PROFITABLE, EFFICIENT AND WELL-ESTABLISHED AIRLINES HAVE BEEN FORCED TO SLASH CAPACITY, EARNINGS FORECASTS, SALARIES, AND OTHER COSTS.

WHILE THE EFFECTS OF THE RECENT SHOCKS ARE BEGINNING TO MOVE INTO THE BACKGROUND AS CARRIERS REBUILD CAPACITY AND THEIR SHORT TERM FINANCIAL RESULTS IMPROVE, THE PRESSURES ON YIELDS WILL BE FELT FOR SOME TIME. AND THERE REMAINS A NEED TO ADDRESS THE UNDERLYING STRUCTURAL CHALLENGES FACING THE INDUSTRY.

GOVERNMENTS ARE PREVENTING INDUSTRY RATIONALISATION

GOVERNMENTS GENERALLY HAVE BEEN SLOW TO RECOGNISE WHAT IS GOING ON AND, WHEN THEY HAVE, MANY HAVE REACHED FOR THEIR CHEQUE BOOKS. TOO MANY AIRLINES WHICH SHOULD HAVE EXITED OR CONSOLIDATED REMAIN PROTECTED SPECIES.

COMPETITION AND OTHER GOVERNMENT POLICIES HAVE CLASHED WITH SOUND INDUSTRY POLICY, WITH THE RESULT THAT OVER SUPPLY OF AIRLINE SERVICES HAS BEEN ALLOWED TO CONTINUE. INDEED IT HAS BEEN ENCOURAGED. THIS IS NOT SUSTAINABLE AND AIRLINE CONSOLIDATION HAS TO OCCUR.

ALTHOUGH A FEW ESTABLISHED CARRIERS HAVE BEEN ALLOWED TO FAIL, THE RESPONSE OF MANY GOVERNMENTS HAS BEEN TO PROVIDE FINANCIAL ASSISTANCE TO THEIR AIRLINES, EITHER OVERTLY OR COVERTLY.

WHILE SOMETIMES THE REASON FOR THIS CAN BE FOUND IN THE NEED TO MAINTAIN BASIC AND ESSENTIAL DOMESTIC SERVICES (AS IN NEW ZEALAND) JUST AS OFTEN GOVERNMENT SUPPORT HAS DONE NOTHING OTHER THAN PROP UP AILING AIRLINES FOR NATIONALISTIC REASONS. HAND IN HAND WITH THIS IS THE FACT THAT MANY FLAG CARRIERS WERE ALREADY OWNED BY THEIR GOVERNMENTS, BEING USED AS INSTRUMENTS OF NATIONAL POLICY, AND NOT SUBJECT TO THE SAME COMMERCIAL DISCIPLINES AND RETURN ON INVESTMENT REQUIREMENTS AS QANTAS AND AIR NEW ZEALAND.

THIS IS A DAMAGING MARKET DISTORTION, PURE AND SIMPLE. IT TILTS THE PLAYING FIELD AND MAKES THE TASK FOR AIRLINES SEEKING EFFICIENCIES ALL THE HARDER. IT STRENGTHENS THE CASE FOR CONSOLIDATION.

LOW COST CARRIERS

COMPOUNDING THESE PROBLEMS ARE THE PRESSURES PLACED ON THE TRADITIONAL BUSINESS MODEL OF AIRLINES LIKE QANTAS AND AIR NEW ZEALAND BY THE GROWTH OF LOW COST CARRIERS. THERE IS NOTHING UNFAIR ABOUT THIS PER SE, BUT WE MUST BE ALLOWED TO RESPOND IN A RATIONAL ECONOMIC MANNER.

HAVING OPERATED WITH MIXED SUCCESS OVER MANY YEARS, THE LOW COST, "NO FRILLS" AIRLINE MODEL REALLY BEGAN TO TAKE HOLD IN THE MID 1990'S. IT HAS PERMANENTLY CHANGED THE NATURE OF AIRLINE COMPETITION. WITH THEIR COST ADVANTAGES, THESE AIRLINES DO NOT SIMPLY OPERATE ON THE LOW END OF THE EXISTING COST CURVE BUT HAVE MOVED THE COST CURVE FOR THE WHOLE INDUSTRY. AS A RESULT, FULL SERVICE, NETWORK AIRLINES LIKE QANTAS AND AIR NEW ZEALAND HAVE TO POSITION THEMSELVES ON THAT NEW CURVE OR FACE BEING UNCOMPETITIVE AND, ULTIMATELY, UNSUSTAINABLE.

THIS DOES NOT OBLIGE US TO MATCH LOW COST CARRIERS IN EVERYTHING THEY DO, OR BECOME LOW SERVICE AIRLINES IN OUR OWN RIGHT. THIS IS NOT OUR INTENTION, AND TO SEEK TO DO SO WOULD CLEARLY BE A MISTAKE FOR BOTH QANTAS AND AIR NEW ZEALAND.

EQUALLY, I DO NOT THINK THIS IS WHAT CONSUMERS - PARTICULARLY LONG HAUL INTERNATIONAL PASSENGERS, WHO ARE USED TO THE BENEFITS OF THE INTERLINE SYSTEM, ALLIANCE MEMBERSHIP, AND SEAMLESS TRAVEL – EITHER WANT OR EXPECT.

FOR QANTAS, THE CORRECT RESPONSE IS ABOUT REDUCING COSTS AND GENERATING NETWORK EFFICIENCIES. AND THIS LIES BEHIND THE ALLIANCE WE ENVISAGE WITH AIR NEW ZEALAND.

QANTAS IS ALSO CONCENTRATING ON THE NEED TO TAKE THE COMPLEXITY OUT OF WHAT WE DO WITHOUT LOSING THE ESSENTIAL ATTRIBUTES OF, AND BENEFITS FROM, BEING A COMPETITIVELY FOCUSED, NETWORK BASED, AIRLINE.

SOME OF THE RESPONSE IS WITHIN OUR OWN PROVINCE TO ACHIEVE. WE ARE FOCUSING ON THIS AND HAVE A RANGE OF STRATEGIES IN PLACE TO TAKE \$1 BILLION OF COSTS OUT OF THE BUSINESS OVER THE NEXT TWO YEARS.

EARLIER IN MY REMARKS, I QUITE DELIBERATELY LABELLED THE RISE OF LOW COST CARRIERS AS A STRUCTURAL ISSUE. AS WE LOOK AROUND THE WORLD, WE SEE MANY EXAMPLES OF FULL SERVICE AIRLINES SPAWNING OFF LOW COST MODELS. THEY ARE NOT SOME SORT OF TEMPORARY PHENOMENON AND WILL REQUIRE A LONG TERM COMPETITIVE RESPONSE FROM AIRLINES LIKE QANTAS.

IT IS NOW CLEAR THAT AT LEAST ONE LOW COST CARRIER, WITH AN ALREADY PROVEN BUSINESS RECORD, VIRGIN BLUE, WILL EXTEND ITS OPERATIONS TO TASMAN AND DOMESTIC NEW ZEALAND ROUTES WITH OR WITHOUT THE PROPOSED ALLIANCE.

AND IT IS ALSO UNQUESTIONABLE THAT WITHOUT THE LEGACY COSTS OF QANTAS AND AIR NEW ZEALAND, AND WITH THE ABILITY TO "CHERRY PICK" PROFITABLE ROUTES, VIRGIN BLUE WILL GROW THE MARKET, AS THEY HAVE DONE IN AUSTRALIA.

STRONG LOCAL INDUSTRY

THE LOGICAL PLACE TO START ADDRESSING THE CHALLENGES WHICH CONFRONT QANTAS AND AIR NEW ZEALAND IS IN OUR HOME MARKET OF AUSTRALIA/NEW ZEALAND, WHICH SUCCESSIVE GOVERNMENTS HAVE ENCOURAGED US TO THINK OF AS ONE, AND WHICH ARE THE MOST OPEN IN THE WORLD FOR FOREIGN SERVICE PROVIDERS.

UNLESS WE STRENGTHEN OUR BUSINESSES AT HOME, WE HAVE NO HOPE OF REMAINING GLOBALLY COMPETITIVE.

BOTH AIRLINES REQUIRE A STABLE BUT GROWING HOME BASE. THIS IS CRITICAL FOR ANY AIRLINE BUT IS ESPECIALLY IMPORTANT FOR TWO NETWORK CARRIERS GEOGRAPHICALLY SITUATED, AS WE ARE, FAR FROM OUR INTERNATIONAL OPPORTUNITIES.

WE CANNOT AFFORD TO BE PICKED OFF IN OUR HOME MARKET THAT, APART FROM BEING IMPORTANT IN ITS OWN RIGHT, FEEDS OUR INTERNATIONAL OPERATIONS.

A STRONG LOCAL INDUSTRY IS, OF COURSE, ALSO VITAL FOR AVIATION DEPENDENT INDUSTRIES, TOURISM BEING THE MOST PROMINENT OF THESE.

SHOULD THE ALLIANCE NOT BE AUTHORISED, QANTAS WILL HAVE NO OTHER CHOICE THAN TO CONTINUE GROWING ITS HOME MARKET. THIS GROWTH WILL BE REQUIRED TO PROVIDE A SUSTAINABLE BASE, AND THE LEVEL OF SERVICES DESIRED BY OUR CUSTOMERS.

QANTAS IS WELL POSITIONED TO FACILITATE THIS EXPANSION. IN MAY 2001, WE ESTABLISHED OUR DOMESTIC NEW ZEALAND SUBSIDIARY, JETCONNECT. THE JETCONNECT FLEET HAS NOW GROWN TO SEVEN 737 AIRCRAFT. NEXT MONTH, JETCONNECT WILL COMMENCE TRANS TASMAN FLIGHTS FROM ITS NEW BASE IN WELLINGTON, FOR WHICH WE HAVE RECRUITED 80 STAFF.

ALLIANCE COSTS AND BENEFITS

IN EXPLAINING THE QANTAS / AIR NEW ZEALAND ALLIANCE, WE HAVE CONFRONTED ALMOST EVERY DAY THE ARGUMENT THAT WE, THE AIRLINES, ARE ONLY OUT TO HELP OURSELVES. THE ARGUMENT UNIVERSALLY GOES THAT 'WE CAN SEE THAT THE TWO AIRLINES WILL BENEFIT, BUT WHAT ABOUT THE TRAVELLING PUBLIC?'

MY UNASHAMED RESPONSE TO THIS IS THAT, WITHIN REASONABLE LIMITS, WHAT IS GOOD FOR THE AIRLINES WILL BENEFIT CONSUMERS. I JUST CANNOT SEPARATE THE TWO.

THE BROAD BENEFITS OF OUR PROPOSAL HAVE BEEN WELL DOCUMENTED. CERTAINLY WE ANTICIPATE PRODUCER SYNERGIES AND COST ADVANTAGES BUT WE ALSO ANTICIPATE:

- INCREASED VISITOR NUMBERS TO BOTH COUNTRIES BY TENS OF THOUSANDS EACH YEAR, THROUGH STRONGER PROMOTIONS AND MORE ATTRACTIVE HOLIDAY PACKAGES. THERE IS NO GAIN SAYING THE FACT THAT LOCAL AIRLINES DEDICATE MORE OF THEIR RESOURCES TO PROMOTING AND DEVELOPING HOME MARKETS THAN ANY OTHERS;
- IMPROVED AIRCRAFT UTILISATION FOR BOTH AIRLINES, ALLOWING THE DEVELOPMENT OF NEW DIRECT TRANS TASMAN ROUTES THAT NEITHER AIRLINE CAN OFFER INDEPENDENTLY;
- IMPROVED SCHEDULE COORDINATION AND CONVENIENCE, BOTH ACROSS THE TASMAN AND WITHIN AUSTRALIA AND NEW ZEALAND;
- INCREASED FREIGHT CAPACITY TO THE BENEFIT OF EXPORTERS AND IMPORTERS; AND
- BENEFITS TO AIRLINE STAFF THROUGH THE PROTECTION AND PROMOTION OF SKILLED EMPLOYMENT INCLUDING UNDERPINNING OF INVESTMENT IN ENGINEERING AND MAINTENANCE FACILITIES.

WITHOUT THE ALLIANCE, OBVIOUSLY THESE BENEFITS WILL NOT FLOW.

THERE ARE DIFFERENCES AMONGST ECONOMISTS, I KNOW, AS TO THE MAGNITUDE OF THE NET BENEFITS.

WHILE THE COMMISSION IS OBLIGED TO QUANTIFY THE OUTCOMES, MODELLING OF THE SORT REQUIRED IS HIGHLY DEPENDENT ON THE ASSUMPTIONS THAT UNDERLY IT. IT IS IMPORTANT THAT THESE ASSUMPTIONS REFLECT A CLEAR APPRECIATION OF MARKET CIRCUMSTANCES AND NORMAL COMMERCIAL BEHAVIOUR OF AIRLINES IN RELATION TO THE ALLOCATION OF CAPACITY, PRICING, YIELD MANAGEMENT AND SO ON. THERE WILL BE MORE DISCUSSION OF THESE ISSUES OVER THE NEXT FEW DAYS.

I HAVE NO DOUBT THAT THE ALLIANCE WILL ACHIEVE SIGNIFICANT AND BROADLY BASED BENEFITS AND THAT THESE WILL CARRY THROUGH INTO THE ECONOMIES OF BOTH COUNTRIES.

WE ARE SMART ENOUGH TO KNOW, HOWEVER, THAT ALL OF THIS WILL COUNT FOR NOTHING IF CONSUMERS COME TO FACE HIGHER PRICES AND LOWER SERVICE STANDARDS, OR REDUCED FREQUENCY, WITHOUT OPPORTUNITY FOR REDRESS.

IT IS IMPOSSIBLE, IN MY MIND, TO CONCEIVE OF A SITUATION IN PRACTICE WHERE THE COMBINED PRICING DECISIONS OF VIRGIN BLUE AND FIFTH FREEDOM CARRIERS - EMIRATES BEING ONE - WOULD FAIL TO ACT AS A MATERIAL CONSTRAINT ON THE PRICING OF THE ALLIANCE.

DOMESTIC ROUTES IN BOTH COUNTRIES WILL BE UNDER SIGNIFICANT PRICE PRESSURE FROM VIRGIN BLUE'S PRESENCE IRRESPECTIVE OF ALLIANCE ACTIVITY.

COMMITMENT AND UNDERTAKINGS

THE PARTNERSHIP BETWEEN QANTAS AND AIR NEW ZEALAND WILL CREATE AN AIRLINE GROUP WITH THE ECONOMIC AND FINANCIAL SCALE TO COMPETE IN WORLD MARKETS WHILE MAINTAINING TWO SEPARATE, INDEPENDENTLY MANAGED AND LOCALLY BASED AIRLINES, WITH DISTINCTIVE AND POPULAR BRANDS.

WORKING TOGETHER, QANTAS AND AIR NEW ZEALAND WILL BE ABLE TO REALISE SYNERGIES, IDENTIFY THE BASIS FOR MORE EFFICIENT AND SUSTAINABLE GROWTH AND MAXIMISE COST AND OTHER ADVANTAGES ASSOCIATED WITH OPERATIONS AT THEIR RESPECTIVE HUBS.

THE CULTURAL FIT IS PERFECT. AIR NEW ZEALAND IS A HIGH-CLASS AIRLINE WITH A NETWORK AND COMMERCIAL OUTLOOK WHICH DOVETAILS PERFECTLY WITH OUR OWN.

THE ALLIANCE WILL NOT DIMINISH THE UNIQUE CHARACTER OF EITHER AIRLINE OR LEAD TO THE DOMINANCE OF ONE OVER THE OTHER. QANTAS WILL CONTINUE TO GROW ITS OPERATIONS AND THE ALLIANCE WILL CREATE VALUABLE NEW FLYING OPPORTUNITIES FOR AIR NEW ZEALAND.

FINALLY, AS THE COMMISSION WILL BE AWARE, QANTAS AND AIR NEW ZEALAND HAVE PROPOSED A SET OF CONDITIONS UNDER WHICH AUTHORISATION IS SOUGHT. THESE ARE DESIGNED TO FACILITATE SUBSTANTIVE NEW ENTRY ON TASMAN AND DOMESTIC NEW ZEALAND ROUTES, AND TO MATERIALLY REDUCE ANY COMPETITIVE DETRIMENT ARISING FROM THE ALLIANCE. THEY WILL ALSO ENSURE THE DELIVERY OF THE SIGNIFICANT PUBLIC BENEFITS THAT FLOW FROM THE ALLIANCE.

IN REFINING THESE CONDITIONS, THE ALLIANCE PARTNERS HAVE BEEN CONSCIOUS OF THE NEED TO MAKE A SERIOUS EFFORT TO ADDRESS THE CONCERNS OF THE CRITICS OF THIS PROPOSAL.

WE BELIEVE WE HAVE DONE THAT WITHOUT STIFLING OUR OWN ABILITY TO PROVIDE CONSUMERS WITH THE SERVICES AND PRICES THEY SEEK, AND THAT THE MARKETS IN QUESTION WILL REMAIN NOT ONLY VERY ATTRACTIVE TO NEW ENTRANTS, BUT ALSO HIGHLY COMPETITIVE.

RALPH AND I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

THANK YOU.