

By Namini Wijedasa

Suren Ratwatte recently completed one year as Chief Executive Officer of SriLankan Airlines. Here, in an exclusive interview with the Sunday Times, he speaks of turning around a company that is deeply in the red.

TST: What is your reason for soliciting this interview?

There are so many theories and so much speculation out there, I wanted to give you some idea of where we are coming from, where I am hoping to take the company and the journey we have done in the last year, the major milestones, what we have achieved and what is left to be achieved. I'll try to clear up some of the misconceptions that are out there. The only thing I can't discuss with you is financial issues because all of these are covered with non-disclosure agreements. And, anyway, every possible number has been discussed publicly and stridently so you can take your pick of which number you want to believe. Really doesn't matter in the scheme of things. Since we are a public company, eventually we publish an annual report and you all can work out exactly what the costs were.

TST: Where does one start?

A background of where I think the airline business is right now in this region. The problem with the airline business is that everybody is an expert, but most people know nothing about it. The biggest problem with the airline business is that your return on capital is disgraceful. If this was a business you were starting out with, you would never start out with it. But the funny thing about it is that it is absolutely essential to the world economy. You cannot imagine the world economy without airlines. Yet, everybody makes money but the airlines. The manufacturer makes money, the engine manufacturer makes money, the maintenance guys make money, the travel agents make a fortune, the leasing companies make a fortune, the general distribution systems-- like Amadeus, Travelport--they make money. The frequent flyer programmes make money but the core air transport business itself, with a few exceptions, just doesn't make money. So it's really a contradiction. How can you have something that's practically the bedrock of society and where everybody, all the peripheral businesses are profitable, but the core business is struggling? There's really nothing like it in the world but there we are. That's what we are stuck with.

TST: What are the regional issues?

Regionally, we have two, or three, very different types of companies. You've got the traditional carriers-- like Air India, Thai International and, to some extent, Garuda--that have really been around for a long time. They have really high costs but are funded by the State and keep trundling along. Then you have the upstarts, like the Gulf carriers and, to some extent, the Chinese carrier, who have access to capital at rates that we can't even achieve, who have Governments who are, for all practical purposes, totalitarian, who dictate the national agenda and have all sections, including the media, falling in line and doing what they are told. So, to compete with airlines like that, which are cash-rich, which are part of their Governments' agendas for progress, is challenging. Then you have the low cost carriers, like Indigo, which is a fantastic company, Air Asia, and Cathay Pacific, which has reinvented itself and is a

superb airline, and Singapore Airlines, which is a full service carrier but funded in a free market manner and is competing with the best. We are caught in the middle of all that. We are geographically in the middle, as well, because if you look at a map we are surrounded by these guys, trying to survive in a world in which they really hold the cards. We have very few cards and we have no stakes to play with.

TST: What are those cards?

The principal card they hold is access to capital.

TST: I meant what does SriLankan hold?

We hold almost none. We have a geographical position which we can parlay to some extent. Unfortunately, south of here, there's nothing. In an ideal world you want to be located like Ireland, where there is a lot of east-west traffic. They live on the trans-Atlantic traffic plus the European traffic. They are one of the models I would use to move this forward. But on the other extreme, you have New Zealand; a very isolated country, which has used that isolation to its advantage and has a great brand and are able to run a profitable airline. So there is a niche for airlines like us. It's not a very large niche. It's a niche we will have to fight really hard to maintain. But I do think there is a future.

TST: What are the biggest challenges for SriLankan?

The big issues we face--the biggest of all--of course, is access to capital. We just don't have capital and because of that, our hands are tied, and it makes doing business very, very difficult. There's a whole bunch of other problems but let's not go into that right now. From an airline economic point of view, your biggest cost is fuel. That's a no-brainer. Fuel prices right now are okay and they roughly account for 25 percent of our cost.

TST: Are they still among the highest in the world?

They are non competitive. India is cheaper. The only places on our network where fuel is more expensive than Colombo is Male--which obviously should be so because of their geographical location--and Dhaka.

TST: Why is that?

Because the CPC (Ceylon Petroleum Corporation) has monopoly! And it's a monopoly they are using to an unfair advantage. Fuel pricing is based on a regional benchmark price and a value added premium. What we use is something called MOPS (Mean of Platts Singapore, with Platts being the pricing agency). When Emirates took over SriLankan all those years ago, one of the specified criteria in the agreement was that fuel would be supplied at MOPS plus 10 US cents a gallon.

TST: When did that change?

When Emirates went away, they immediately abrogated that agreement. Right now we are paying MOPS plus 30 US cents per gallon, which is crazy. I have a document called 'Fuel Price Impact on Aviation in Sri Lanka' that we commissioned, which was done by a gentleman called Cyril Suduwela who

was a previous General Manager of CPC. It looked at the CPC's costs and he calculated that CPC's actual price is MOPS plus 15 US cents.

TST: Is that without the tax component?

Aviation fuel doesn't pay tax. But we reckoned that if CPC priced fuel at MOPS plus 20 US cents which gives them a 5 cent margin, and their infrastructure is already paid for, they would increase turnover in Colombo by US\$50 million a year. That's US\$50 million of income in cash because most airlines, especially the big boys like Emirates, Qatar, Cathay Pacific and Singapore Airlines, bring in their own fuel. The bigger the airplane, the more fuel you can carry with you for the return journey. They don't buy fuel here. But if fuel was priced rationally, then they would buy it here, because there's a cost involved with bringing the fuel across.

TST: Have you spoken to CPC about it?

Many times! They're not interested. They don't even want to talk about it.

TST: Aren't the handling charges which are levied by SriLankan also among the highest?

Now this is something a lot of the other airlines complain about. We have a monopoly on ground handling in Colombo, as do Emirates in Dubai, as do Qatar Airways in Qatar, as do Saudia in Riyadh, for example. And if you take a cost of ground handling as a percentage of your direct operating cost, it's tiny anywhere. That's not a big cost. Your big costs are fuel, the aircraft ownership charges...

TST: But we are talking about monopolies and SriLankan holds that monopoly.

Yes, but what we pay in the Middle East is actually a lot more than what the Middle East airlines pay here. And the big Middle East carriers--for example, Emirates, which operates here five times a day, and Qatar, which has four flights a day--they get volume discounts. Most of the screaming and shouting is coming from one actual airline, or their representatives here, that operates a few times a week and want the same price as the guys that operate five times a day. India has liberalised ground handling. There is competition and that has led to lower charges. It is true, I accept that. The problem is that everybody refers back to the Emirates time as when the airline was profitable. Actually, that is not so. Emirates did not make money when they ran SriLankan. But because they had a ground handling monopoly, a catering monopoly, and fuel priced at market rates, they were able to break even at group level and make a small profit some years. But at air transport level, Emirates lost money every year that they ran SriLankan.

TST: Can you substantiate that with statistics?

We are talking about group profit and air transportation profit. Emirates took over in 1998-99. They lost money at air transport level in 1998-99. They made a small profit in 1999-00. They lost money in 2000-01 and 2001-02. In 2002-03, they made a small profit; in 2003-04, they made a profit; and in 2004-05, 2005-06, 2006-07, 2007-08, they lost money. Their cumulative loss at air transport level was Rs 32 billion. But ground handling made a profit, SriLankan Catering made a profit and at group level over the

entire period the company made a profit. Actually, the group level profit primarily came, and you can quote me on this, from the insurance payout when the LTTE destroyed those airplanes on the ramp. They made US\$100 million--paid out in 2002 I think it was--which was an enormous sum of money. And they ran on that basis the rest of the time.

TST: What was their aircraft replacement cost?

They didn't replace the airplanes that were destroyed. They took the money. They then rationalised the staff, reducing it by 30 percent through a very generous VRS (voluntary retirement scheme), and brought the company down to a level that was sustainable. Then, they ran with the money that they had, using the profits from ground handling and catering to subsidise air transport level. Right at the end, we had aircraft on what we call finance leases, where you pay every month and in the end you own the asset. The airline ended up owning those airplanes. Emirates then did what you call a sale-and-leaseback. They sold them to a leasing company and they leased them back and made a cash profit on that transaction. That is what put them in the black for the period. They ran it very efficiently by the standards of running a profitable company. You do what you have to do. You use your assets effectively. But to say there was some magic, and they ran the company profitably when nobody else was able to, is actually incorrect.

TST: Apart from the high fuel costs, what other issues are impacting on SriLankan's finances?

The other thing we really have issues with is what we pay for aircraft. This is a complicated subject that everybody in this country seems to be an expert on. There's essentially two ways in which you get aircraft. You buy them direct from the manufacturer, and that is the simplest and most effective way of doing it. But that requires you to have cash because you have to make down payments. And it requires a long lead time. There's about a five to six year delivery time before the aircraft is actually sitting on your ramp.

The second method is to lease them. There are two types of leases. There are finance leases where you actually wound up owning the airplane. That lease structure has fallen into disfavour now and most airlines run on what they call operating leases: the leasing company owns the asset, they lease it to you for a fixed period of time for a certain monthly fee, and at the end of that time, they own the asset and you return it to them. After that, they either find another customer or they dispose of the aircraft in some other way.

What most airlines do is to buy the airplanes direct from the manufacturer with this long lead time and the deposit, which is in round numbers 15 percent of the cost. And when the aircraft is delivered, they do a sale-and-leaseback. They then technically own the asset, sell it immediately to a leasing company and lease it back for a fixed period of time. If you do this correctly, you make a profit as the manufacturer gives the airlines a substantial discount when they buy the aircraft because there's a risk involved.

Airbus publishes a list price which is utter nonsense, nobody ever pays that. That's like the rack rate in a hotel. The list price of an A330-300 is about US\$130 million. The current market value of an A330-300 is

closer to US\$ 100 million. So that's a 30 percent discount that's obvious. But if an airline with a good credit rating goes out there and buys one now for delivery probably in two or three years' time, they'll get that aircraft for about US\$80 million or US\$85 million. Of course, you will have to spend a little money configuring it to the standards they want. But when the aircraft is delivered, it's technically worth about a US\$100 million and your cost is US\$90-92 million. When you do a sale-and-leaseback, you realise the 100 million. You realise the cash profit right there, which usually pays for your deposit so that's written off your books. Now all you have to do is to fly the aircraft sufficiently to return the lease payment on it. This is what the likes of Air Asia, Indigo and Ryan Air do. They buy aircraft by the 100s literally. Then, when the time comes to make a sale-and-leaseback, they make a small profit on each one, which means their costs are all taken care of. Now all they have to do is pay the lease.

TST: How is SriLankan's credit rating?

Not very good.

Now we come to the aircraft. There is a lot of controversy over who did what. And we essentially, under the previous government, contracted to acquire a lot of aircraft. We bought six A330-300s. We ordered them from Airbus.

TST: Did we pay the deposits?

We paid the deposits. We actually didn't have the money to pay the deposits so we had to borrow that money as well.

TST: Was it from the Treasury?

From other leasing companies. (It was) a very complicated financial structure. It was actually quite an innovative leasing structure but, because so few people understand it, it has led to a lot of controversies.

What you must understand about the leasing companies is that they are mostly listed on the New York Stock Exchange and they are completely and absolutely above board. They are terrified of being investigated and will not pay anything.

There are a lot of allegations that this guy made money, that guy made money. When you lease an aircraft from one of the big leasing companies, and we deal with the world's biggest leasing companies, there's no money to be made. They're not going to pay you anything. They might take you to dinner but that's about it. That's all you're going to get.

So we ordered six A330-300s from Airbus and those have all been delivered. We ordered four A350s, all direct orders to Airbus from SriLankan. The A350s are due in 2020 and that is my next problem. Other than that, we ordered one A330-300 for lease because the business plan at the time called for an additional airplane. So they wanted seven A330s and six other A320s, which we call narrow-bodies, on lease.

TST: Who did the business plan?

It was done by the previous government.

TST: Did they hire a consultant?

For some of it. There was a consultant called Seabury (Seabury Aviation Consultant) who analysed it. But the business plan itself was done in-house.

TST: Were they envisaging a long-haul carrier?

They were planning a long-haul carrier, yes. They were planning London, Rome, Paris and Frankfurt and wanted to add Zurich, Amsterdam, Moscow and Melbourne. That is why there were so many long-haul airplanes ordered.

The disconnect between this business plan and reality was that the Gulf carriers have had this price war going on. And what we call the "yield" has lowered so much. Year on year, the yield out of Colombo has gone down by about 30 percent a year. So in two years, the yield has dropped 60 percent and it's longer possible to get the revenues forecast.

TST: The Director General of Civil Aviation (DGCA) recently asked all airlines operating to Colombo to file their fares with the Civil Aviation Authority (CAA) in an effort to stop ongoing price wars and undercutting. What is your opinion of this directive?

All civil aviation authorities do control pricing. The level to which they enforce that pricing is debatable.

The DGCA is actually--how do I put this politely without sounding offensive--the part of the CAA's mandate is to control capacity into the country. And the CAA allows unlimited capacity increases by everybody else. For example, Emirates operates five wide-bodies a day; Qatar operates four wide-bodies a day; flydubai operates four narrow-bodies a day.

TST: Is this not due to the Government's "open skies policy"?

There is no such thing as an open skies policy.

TST: The Government has not backed an open skies policy?

No. This is another word that's bandied about that nobody understands. There is no such thing. When you want to operate into the country, you apply to the regulatory authority for permission. And the regulatory authority is supposed to look at the traffic in and out of the country, what is necessary, and make a decision based on that.

But our regulatory authority has been essentially giving out a blank cheque. So Air Arabia operates here three times a day, flydubai operates here four times a day, Etihad operates here three times a day, Qatar four times a day, Emirates five times a day. There's unlimited capacity out of the country. And this business is a business of controlling capacity.

I'm sure you've read what's happened in the container ship industry recently. It's very similar. They increased capacity without looking at the marketplace and now you can get container space for essentially nothing. So one of the biggest South Korea ship lines went bankrupt and that's what's going to happen to the airline industry and that's what's happened already in the US.

TST: Will the DGCA's directive to file fares with the CAA work?

Probably not, because they don't have the financial muscle to bring the other carriers to heel! For example, one Middle Eastern carrier, because KLM is flying directly to Colombo, they have offered a return fare to Amsterdam, which is KLM's home base, for Rs 33,000! I mean, that's ridiculous.

TST: The filing of fares won't work?

It's an attempt...it won't work.

TST: What do you want, more regulation?

Not really. I'm not a believer in over-regulation. I don't think that's a good thing. What do I want to run the airline efficiently? Was the question?

TST: Not really. What do you want from the DGCA to end the price war? What more can he do?

There's probably very little he can do because it's essentially a free market. And you can't regulate a free market. We understand that. We are not asking to place capacity constraints or to control prices.

We would like a rational fuel price; we would like competition on fuel price going forward; we would like more terminal capacity, which is not the CAA but the Airport and Aviation Services; we would like them not to close the runway on us but that inevitable now and we have to accept it. We would prefer if a lot of the infrastructure development had happened in Colombo rather than elsewhere but again that's a decision that preceded me and I wasn't a party to it.

But if you want to know what I want moving forward, I want breathing space. I want the ability to reorient the airline from trying to compete on these long-haul routes which are now patently obvious that we cannot, and to concentrate on our strengths. As a regional carrier, we are very, very, competitive.

TST: Let's back up to the acquisition of aircraft again. You were saying there is a lot of controversy about who was responsible. That was never properly answered.

The Board of Directors was responsible. That was answered.

TST: Should there not be any sort of accountability?

Possibly, but that's not my job. My job is to run the airline. If the Government wishes to hold the previous directors or people in charge responsible, there are vehicles to do that. There's the FCID (Financial Crimes Investigation Division), there's the presidential commission (Presidential Commission of Inquiry to Investigate and Inquire into Serious Acts of Fraud, Corruption and Abuse of Power, State

Resources and Privileges), there's COPE (Committee on Public Enterprises), which is extremely powerful. There are plenty of avenues in order to hold them responsible but the individuals who signed off on those decisions are no longer in the airline. We're just dealing with the consequences of those decisions.

TST: Were the aircraft overpriced?

Arguably, yes. Again, there are two lots of airplanes. There were the airplanes directly ordered from Airbus, and there were the airplanes that were leased. Let's talk about the leased airplanes.

The leased airplanes were responses to an RFP (request for proposals). The company advertised, they said they wanted these types of aircrafts on these delivery dates and there were responses. We have all the documentation. And those prices were competitive in the marketplace. The reason we did not want to accept the A350s was not because they were overpriced at the time. At the time the aircraft were in great demand and the RFP was competitive and this was the best price.

Subsequently, the yield degradation I talked about took place and now the aircrafts have dropped in value by about 30 percent. There is no way we could operate those aircraft at the lease price we were contracted to operate them and ever make money.

I can't tell you what we paid to terminate the lease but there is no termination clause in a lease. Once that lease is signed, it's like a marriage contract, that's it. You can't get out of it. If you want to get out of it, just like in a divorce, you pay alimony. So that's what we did. We negotiated, quite strongly I must say, and we came up with a price.

TST: It was widely quoted that you paid a termination fee of US\$98 million.

We never gave a US\$98 million figure.

TST: So it wasn't US\$98 million?

I can't disclose a price. I told you. We've signed a non-disclosure agreement.

TST: There are a lot of numbers around.

There are a lot of numbers around. You pick what you wish. But let me tell you this. That number that we paid was less than what we would have lost in the first year of operation if we had to accept those aircraft.

TST: What if you flew more cargo and passengers per flight?

We don't. The aircraft were bought to operate to those European destinations we talked about. The market has dropped so much that we are pulling out of those destinations. And I can show you the numbers, how much we lost on Frankfurt and Paris alone during the last two years.

TST: Will we lose those European landing slots when we pull out of them?

There's no problem. If we want to go back, they will give us slots. There's no issue. The only slot-constrained airport in our network where we have to buy slots is Heathrow. Frankfurt and Paris have sufficient capacity, we can always go back. We had three flights a week to Paris. Emirates have three 380s a day out of Paris, and five connections here! So there is no way we can compete. It's impossible. And if you're not a market leader or even a contender, you should not compete. It's best to leave that market and go to markets where we are the leader, which is what brings us to the region. In South India and the Maldives, we are the dominant airline.

TST: Returning to the question of aircrafts, were they overpriced?

The leases were not overpriced.

There were four of those. The four A350s, which at current market value are greatly overpriced--which is why we terminated the leases. They were subsequently leased at about 30 percent less than what we would have paid. And part of the termination fee was that difference because, obviously, the leasing company had a contract to make that money and they could have held us to it if we didn't come to an agreement.

We leased one A330-300. It was quite competitively priced actually, not bad at all. We are operating it currently. That one's fine. We also contracted to lease the six A320s coming next year. Again, not bad. Don't forget that, given SriLankan Airlines' history, there is always a premium. We have never made money consistently. Our business models have been looked at by the lessors as unrealistic so they always had a premium when they lease to us. Keeping that in mind, the leases on the aircraft we are picking up next year are actually okay. There's a small premium on market and that is to be expected. So I'm quite happy to take and operate those aircrafts. They're quite good aircraft.

Now, the aircraft we bought direct, did we pay too much for them? Probably. But since no other airline in the world will disclose what they paid at the same time as we bought those aircraft... for example, Singapore Airlines bought a similar aircraft and I'm willing to bet that Singapore Airlines paid a lot less than us. But since I don't know how much they paid, I can't compare.

TST: So to say repeatedly that these aircraft were overpriced is political?

To say that the four A350s leases were overpriced compared to the current market is actually correct. At the time the leases were signed, no. The purchased aircraft, were they overpriced? Because there is no clear benchmark to compare it, it is an opinion and not a fact. But my opinion is that they were overpriced, yes, and they were overpriced quite significantly.

TST: How does the merger with Mihin Lanka work?

Mihin was set up for reasons that I'm sure the Sunday Times has discussed at length and I don't want to get into that. But Mihin has never consistently made money. At least SriLankan makes money occasionally but Mihin has never made money. Forty percent of Mihin's passengers travel at least one sector on a SriLankan flight. So, really, there was a great deal of overlap between the two airlines. Mihin

competed directly with SriLankan on two routes--Male and Chennai, which are actually two of our best routes. And why we compete with ourselves nobody has been able to clearly explain to me.

Mihin's other routes suffered greatly because they had so few aircrafts that network connectivity, the ability to come from Indonesia to here and go on to Saudi Arabia, was very limited. They had a limited number of flights and so there were long transit periods, which is not attractive to passengers.

Having said that, Mihin's revenues amounted to somewhere between US\$25-35 million a year but their costs exceeded their revenues by about US\$5-6 million. So they lost money every year. But the challenge is to bring that revenue into SriLankan and strip out most of the associated costs and then we should have a net gain, which is what we are trying to do.

And a perfect example is the Seychelles. Mihin operated to the Seychelles three times a week because they had a lack of aircraft and the timings were not conducive to connections from China. SriLankan is operating to the Seychelles four times a week with two different timings. So one of them connects outbound to Seychelles and the other one connects inbound immediately to Chinese flights. China has a huge market for the Seychelles. SriLankan has that type of flexibility and Mihin doesn't.

TST: Will Mihin still fly under its own name after the merger?

No, Mihin's brand is not as strong as SriLankan's.

TST: So the uniforms, the aircrafts, everything will change?

Yeah, they will be progressively repainted to SriLankan's colours.

TST: What did the invitation for Expressions of Interest (EOI) offer?

That's not handled by us. That's handled by NSB (National Savings Bank) which has put the two airlines up for sale. But when you say airline, we mean AoC or an airline operator certificate. So Mihin has an AoC that remains valid for another year-and-a-half or so. But Mihin, the airline, is also part of the proposal that somebody can invest in if they so wish. But SriLankan, the airline, will have that network that we have absorbed, and two of the aircraft that the leases are still current on, and a good portion of the staff--just over half of the staff.

TST: You're going to take in more staff?

But that's okay. We need pilots and engineers and cabin crew to maintain airplanes.

TST: At any given time, what's your shortage of pilots?

We're ok. We're slightly surplus at the moment but we have retirements coming up so going into next year.

TST: Then why do some pilots fly back to back after the mandatory rest period?

Because it's more efficient that way.

TST: Not because of a shortage?

No, the benchmark is that a pilot should fly about 80-85 hours a month. We are actually slightly below that. So the polite word is "making your assets work harder". The pilots and cabin crew have to fly more than they are now. Not because I'm an unpleasant person and I want them to work harder but because our competition up the road flies their cabin crew 120 hours a month and their pilots 90 hours a month. So, by definition, they are much more efficient. And this business there's two pots. One is the revenue. And controlling your revenue is very hard because of competition. The other is the cost and you have to (do that), in the absence of being able to control your revenue, which is what a top-line CEO would do. I have to concentrate on lowering my costs. So I'm essentially a bottom-line CEO. I really don't have a choice.

TST: You are going for this merger with Mihin before you go into the privatisation.

Yes.

TST: But the EOI does not reflect that fact that Mihin will be merged with SriLankan, does it? When you're offering your assets to the party that's coming in, isn't it only SriLankan assets you are talking about?

It was always one bundle--two AoCs, a ground handling company, an engineering company, a catering company, all one group. Mihin's AoC is available if somebody wishes to acquire it but I don't believe there are any takers.

TST: What are the timelines for the privatisation?

I believe the initial--verify this--I believe next Tuesday, which is the 25th, is when they shortlist the bidders. Then the bidders are allowed to do due diligence. I think they allow up to 120 days for due diligence. Moving forward, it will be some time in February that the due diligence is completed. And then I believe the government will select one from the shortlist.

TST: Who else has bid for the airline?

You'll have to check with NSB.

TST: Why did you go into all this strategising on the verge of a privatisation?

Well, the airline business moves very quickly. You can't stop and wait till this process is complete.

TST: Shedding aircraft, for instance, shouldn't it be up to the incoming party to decide?

Those aircraft will be delivered next week. If I didn't shed them now, I would have to take them. And we made a business decision about six months ago that we would not take and operate these aircraft. So we allocate our resources, which are mainly the pilots, engineers and cabin crew, to our current business plan. If I was forced to accept those aircrafts next week, I couldn't fly them for six months. And the six months that I would have had to park the aircrafts in Toulouse while I trained the support staff,

acquired the spares pools, lease an engine, and build a facility to house the spare engine--the cost of all that would have been US\$75 million.

TST: A month?

No, until April. We'd have spent US\$75 million between accepting the aircraft and the first day we could fly it, with no revenue whatsoever. The termination cost was actually very cheap but, in the context of Sri Lanka and the media hype, everybody is an expert, so I just keep my mouth shut.

TST: Is SriLankan's strategy now regional?

Our best markets are all regional because we are the market leader. Your airline of choice, if you are travelling in this region, is SriLankan. For example, for all practical purposes we are the national carrier of the Maldives because we dominate the Maldives. We have great support from the Maldivian Government and the Maldivian people. We're the first international airline into Gan. And Gan is grossly underserved. So we are really positive about that. We think that's going to be a great route for us. Both South India, specifically, and the Maldives is where the bulk of our passengers come from and the bulk of our money is made. And we want to use that as a vehicle for future growth.

The narrow-body strategy, the A320s work for us, going forward. Because, for example, Hong Kong. Currently we do three times a week to Hong Kong via Bangkok. It is not a desirable service for a businessman. And in order to make money in this game, you have to fill the front end of the airplane. You have to fill business class. If you can't fill business class, you're dead.

Cathay Pacific operated a daily wide body from Hong Kong to here. All business traffic goes with them. Even if we had the aircraft and we operated the 300-seater to HK, we can't fill it. But if we operate a 180-seat airplane to Hong Kong, we can fill it and that's what the A320-neos will allow us to do, assuming we can get a slot. We have applied for them. We can get a daily Hong Kong flight. You apply and the airport allocates depending on what they feel is demand. It's not a completely transparent process. But you get there eventually.

So the A320s allow us to offer a single-aisle product, which is a smaller airplane, on long thin routes and, given the nature of where we are located and our population base, long thin routes are of the realities. We can't fill A380s out of Colombo.

TST: What will you do with the A350s that you bought?

The ones arriving in 2020? We are negotiating with Airbus and we'll find a solution. Airbus is willing to (negotiate). They now realise we mean business. Nobody expected us to terminate the A350 leases. The whole world expected us to have those aircrafts sitting on the ramp next month. And--even if I say so myself--it was quite an achievement. Unfortunately, the 23 million airline experts we have in the country disagree with me but there you go.

Have all the debts owed by the previous President's office for using the aircrafts now been settled?

No. There are still some outstanding payments. Generally, that depends on the Treasury. I don't know the exact numbers but they're in our annual report. Dig deep enough and you'll find them. The current Government, I'm pleased to say, buy tickets and fly on normal commercial flights, which I'm very grateful for.

TST: How can Middle East airlines operate to same European destination make profits when their prices are so much lower?

Whether they make money is an open question.

TST: You mean to say they don't?

Emirates do not produce air transport level financial numbers; they provide group level financial numbers. And, at group level, when you have an airport as vast as Dubai with a ground handling monopoly and a catering monopoly, you can make good money. At group level, if I were left alone with a ground handling monopoly and a catering monopoly, I will make reasonable profits. Not spectacular profits but I will make reasonable profits.

TST: The industry norm per aircraft is 175 employees. SriLankan has more than double that.

Yes, we have. In round numbers we have 7,000 people. But ground handling is an integral part of that and so is engineering. We're working towards making those strategic business units. Ground handling alone will take about 2000 people. Engineering will take 900. So that's almost half the company. I do want to have a VRS because in the previous Government, between the time Emirates left and I came in here, the payroll increased by 30 percent.

TST: The payroll increased by 30 percent?

The headcount increased by 30 percent, not the payroll, because there were a lot of people employed and it's very difficult to undo that.

TST: So the office space, utilities, welfare payments, all go up isn't it?

Yeah, and our transport bill is considerable.

TST: How many is that per aircraft? Double?

Again, at group level, yes. But it's incorrect to look at it at group level. At Singapore Airlines, for example, where ground handling and engineering are separate companies, they have 202 people per aircraft. By that benchmark, for our 25 aircraft, it's 5,000. So, yes, we should have about 4,500 people.

TST: Are you giving a VRS?

I would love to. We can fund it ourselves if necessary because we can make it back in about two-and-a-half years, in savings. But that is a political decision that the Government has to make. We have everything in place for a VRS internally, so the decision has to be taken by the Government

TST: Do you think that, rather than reducing the fleet and leasing three aircraft to PIA, the sensible strategy would have been to increase destinations and use the planes?

We are actually not reducing the aircrafts. What we are doing is replacing three very expensive aircrafts with much cheaper aircrafts for a short period of time.

When you lease an airplane, you lease it for twelve years. That is the benchmark. If you are a good customer, you might get away with a six-year lease, but that's about it. PIA has an order book that starts delivering in four years. So they were out there looking for aircraft for four years. Nobody will give it to them. We are willing to give aircraft for three to four years because it's a short-term solution for us. We then use our older aircraft, which we have had from day one and which we have looked after very well. We have them for a little longer. When the PIA leased aircraft are returned we will probably scrap the old aircrafts and revert to the same fleet number.

The difference is that our lease costs have reduced substantially due to the PIA leases and right now it's the cash flows that are worrying me. It is the ability to keep paying my bills. And the PIA is a solution for them and a solution for us. Going forward, we have a very good relationship with them. All that traffic that comes out of Pakistan and goes east and south of here to Australia and Asia--we hope to be able to route through Colombo.

TST: What is the yield per passenger for Frankfurt and Paris? Is it about 6.5 US cents?

Since I'm walking away from those sectors, I'm happy to share the yields. Generally people don't answer questions like that. In 2013-2014, for example, when most of these aircrafts were signed and the acquisitions were decided on, it was in the region of 5 US cents revenue per available seat kilometre. Today, when we stopped, it's just over US\$3. So you can see the revenue degradation we were talking about.

TST: Couldn't you cover that by retrenching staff and managing better?

You could. But what that essentially means is that the per flight deficit on Frankfurt, for example, in 2015-2016 as US\$37,000 per flight. And I had four flights a week, so I lost US\$128,000 every single week operating that. I can't shave US\$128,000 off my costs and the problem is not controlling cost because my cost actually has come down significantly as well. That's mainly dictated by the fuel price.

Remember 25% of our cost is fuel price. 16% is staff and about 18% is aircraft leases. Doesn't matter what I do with the 16%, I can't halve it. It's impossible to halve my staff. The numbers just don't add up. And the longer the sector, the higher your fuel costs and all your fixed costs become. So the long sectors are the ones that are going to kill you. The short sectors you can do stuff with. And why I like the narrow-body, regional network is that I can chop and change.

TST: Was this strategy backed up by a consultant?

Yes, we had two separate consultants, and both of them told us two salient things. One is the A350s do not work for us, regardless of the price of fuel. They just don't work for us. And second was that our

strength is regional. And because we don't necessarily believe one person, we had another set of consultants who essentially told us the same thing.

TST: How many flights are you cancelling as a result of the runway renovation?

Two hundred a month or around seven flights per day. That's 620 for the entire period. But what kills me is that my aircraft utilisation drops. In order to make money, I have to fly an aircraft roughly between 11 and 14 hours a day. And when six hours a day I can't fly my aircraft, my costs don't change, my revenue plummets.

TST: Why not use Mattala Rajapaksa International Airport?

Eighty percent of our routes are less than four hours flight time. Passengers won't drive four hours to fly four hours. They certainly won't drive four hours to fly one hour to Bangalore, which is one of our best routes, or to Chennai, which is another, or to Male.

TST: How many are you rescheduling?

Everything else we reschedule. You take the total schedule, take away the 620 and you can play with the numbers all you want. We are still waiting confirmation on some of the Chinese routes but all of the others we have received confirmation. We are waiting for the timings.

TST: But the runway has to be done, isn't it?

We absolutely accept that the runway has to be done. We would have preferred that the work be done at night. But the agencies doing the work elected to do it during the day, over our objections. So we live with it. But we expect the revenue shortfall alone to be in the region of US\$47 million. Plus, our costs don't change. It's going to cut us.

TST: What is the figure with the costs?

I'll tell you again in April, when I do the numbers.

TST: Give us an estimate?

There are too many variables. For example, once we have confirmation of our slots and we know exactly how many aircraft we need, we are approaching the leasing companies to get a rental holiday on some of them. They have said they are okay with that. So we will have to ground aircrafts and not pay for a month for some of them. And that will substantially reduce the costs. If I could, I would have the VRS in December to reduce my payroll before the runway closure because during the runway closure the flying will drop so much and I'll have all those people.

TST: How many will have to go?

It's voluntary, remember?

TST: Of course, but how many do you think you will have to lose to be efficient?

Well, if 500-600 take it, I would be pleased. And the package we are offering is similar to what was offered in 2002.

TST: Is it under discussion?

The package, we have already decided on. We are just waiting for the decision to be made by the shareholder. And once the shareholder makes the decision, we will discuss with the unions and go ahead with it.

TST: The Minister said US\$900 million has vanished from the airline. I assume some of it is due to the reasons you mentioned above?

I didn't actually read that comment and I don't know exactly what he was referring to. I mean, our accounts are published. We are a public company. Money doesn't disappear. So I don't exactly know what he meant and, without knowing what he meant, I don't think I should comment.

TST: The political support has been good?

Political support has been good. Largely speaking public support has also been good.

TST: Perhaps people don't care apart from the Colombo circles?

No, I think the Colombo circles are the most opinionated but they really don't matter. I think the actual support in the country is tremendous.

TST: How's the relationship with pilots now?

The relationship with pilots has always been very good. We have excellent relations with our pilots, our cabin crew and all the other unions.

TST: You don't meet them, it seems?

That is not correct. I'm actually meeting them next week. I'm a great believer in process. There is a process of communication and that process is not buttonholing me at some social event and trying to talk business. If they want to talk something, they talk to their line manager who will discuss with them, escalate to Human Resources and, if necessary, they'll escalate to the next, higher level--which is me or the chief officers or the board of directors. The perception that you can just walk into the Chairman's office and discuss anything at a drop of a hat, which may have been the case earlier, I discourage because I believe in process. This is a very, very complex business. The people involved, for the most part, work extremely hard and we do have to follow process. In the whole issue with the alleged alcohol incidents, we are following process.

TST: You now have an agreement on the breathalyser tests?

We always had one.

TST: I was told you had a new one?

The pilots' union requested some changes. Don't forget that procedure is set by the CAA, not by us. We merely follow the guidelines as per the CAA. They had some concerns and brought them up to the CAA. The CAA accepted those concerns and asked us our opinion. We had no problem with what they proposed and the procedure was modified and it's being carried out successfully.

TST: Do you test the cabin crew as well?

We randomly test them.

TST: What action was taken on the Weliamuna report?

Right, this is quite controversial I believe. It happened long before I got here. I believe we have addressed most of the issues in the Weliamuna report. There was an issue with one individual cabin crew member. Again, we are following process and the process is not fast enough for the media. But it is important that it be followed.

TST: The issues at SriLankan Airlines were discussed extensively before the presidential election and it was promised that all activities will be investigated and action taken on them. What was the action taken?

There were allegations of people being recruited inappropriately. And we spent a lot of time and resources looking at every single person who was hired in that period. We identified, I believe, 53 people who did not on paper qualify but were taken on direct orders. There were relatively minor issues, for example, not having a credit in English. We then brought those issues up before all the unions and asked them for their opinions. And the absolute consensus of unions was that these individuals could have been recruited inappropriately but that in the period that they had been in the company they had performed well and had no disciplinary issues. The unions requested us not to take punitive action against them. And so the board of directors agreed.

TST: You're talking about small people. I'm talking about big people.

Well, the big people... the allegations are mainly financial and really, we, the company don't have the authority or the resources to prove or disprove those allegations. As I said before, there's COPE, there's the presidential commission, there's FCID. They have the resources to investigate these things.

TST: But you did some transfers and "reassignment of duties"?

There were some management people who were reassigned before I got here. All that happened before my tenure so I'd rather not comment on it. I wasn't involved.

TST: SriLankan has a poor credit rating and a hell of a lot of losses. Basically you're in the red. You have huge management challenges. Why would anybody take it?

You mean the investment. Again, I've nothing to do with this but you have a viable business that requires capital. That's our biggest problem. The airline has been under-capitalised from day one, since

it was founded. Right now, the problem is that we are carrying a lot of debt. If that debt were to be taken away, the airline is actually, right now, marginally profitable. You didn't know that did you?

TST: Is the Government wiping off the debt?

I believe it's one of the issues that can be negotiated. Don't forget, we're paying Libor plus a large number and right now, if you have good access to capital, if you're an investment fund or a bank, you can get money at what Libor is currently running at... I think half a percent. You can get money at one and half to two percent, total.

So what are we paying?

A lot more.

How much?

Go ask the guys who make the money. Ask People's Bank and the Bank of Ceylon. They'll tell you how much I'm paying. Again, I can't disclose it because I signed NDAs on these things.

Under five percent? Over five percent?

I'm not going to play that game. We're paying a lot. Way more than we should be. If the debt were to magically disappear, I'd be profitable. Now, debt doesn't disappear. What we can do is rationalise it and bring the interest rates down to something that's more in line with what our competitors pay, given that given the route rationalisation that we're carrying out. If I can have a head count reduction through the means we discussed, put all that together, once the runway closure is done, going into the 2017-18 financial year, I believe at a group level we can make a small profit. At air transport level, it's very, very hard.

TST: You said you have already made group level profit?

This quarter--that is, July, August, September--at group level, we were profitable.

TST: What changed?

Good management.

TST: Because of the holiday season?

July, August are traditionally our best months. Again, December and January are our best months. January is going to take a hit because of the runway closure. In this business, you have routes that make money nine months of the year. And we have a few of those. Then you have routes like London that will make you money seven months of the year, so you just put up with it. Then you have the routes that will make you money five months of the year and you lose money seven months of the year. So, it's really juggling those and keeping the latter out of the picture, if at all possible. But you have to stay in them. For example, China is a market that is very, very hard for us. We don't fully understand it. Almost all the traffic is from China to here; there's almost no traffic from Colombo to China yet. So we don't make a lot

of money on China but it's such a huge market that we can't not be in it. It's also in the national interest that we stay in it. But on most Indian routes we make money on almost all year round. We have a daily Mumbai flight and a daily flight to Delhi. I'd like to have 10 or 11 flights a week to feed our other network.

TST: What about transit passengers to Europe?

Overcapacity. Emirates, for example, has five A380s a day into Bangkok. So to expect transit traffic to come through Colombo to Bangkok you have to pitch it at a price point so low that it's not worth carrying. We get better yield from our Indian passengers going to Bangkok than we would on a European passenger going to Bangkok. So we'd just go after the Indian passenger.