FIIG | Factsheet

Qantas Airways Ltd

5 November 2021

Sector: Corporate
Sub-sector: Transportation
Country: Australia
Ownership: Public

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Issuer Outline

Qantas Airways Limited (Qantas) is Australia's largest domestic and international airline, underpinned by a dominant position in Australia's duopoly-like domestic aviation market, where the airline's dual brands comprise about 70% of domestic capacity.

Qantas' main business is providing regional, domestic, and international air transportation under the Qantas and low cost subsidiary Jetstar Airways brands. The group also operates subsidiary businesses, including other airlines, loyalty and freight services.

Qantas is listed on the ASX and had a market capitalisation of ~AUD10.7bn as at November 2021.

Key Financials (AUDm)

LTM (30 Jun)	2021
Revenue	5,934
Underlying EBITDA	410
Net Interest Expense	279
Total Assets	17,880
Debt	8,229
Cash	2,221
Net Debt/EBITDA	14.7x
EBITDA/Interest Expense	1.5x

Source: S&P Capital IQ, Company, FIIG estimates

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3CB0220929	AUD 300m	Snr Unsec.	7.75%	Semi	N/A	19 May 2022
AU3CB0240059	AUD 250m	Snr Unsec.	4.40%	Semi	N/A	10 Oct 2023
AU3CB0240109	AUD 175m	Snr Unsec.	4.75%	Semi	N/A	12 Oct 2026
AU3CB0283182	AUD 500m	Snr Unsec.	3.15%	Semi	27 Jun 2028	27 Sep 2028
AU3CB0268357	AUD 425m	Snr Unsec	2.95%	Semi	27 Aug 2029	27 Nov 2029
AU3CB0274280	AUD 500m	Snr Unsec.	5.25%	Semi	9 June 2030	9 Sep 2030

[1]Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call

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Strengths

- **Dominant market position, supported by relatively high barriers to entry:** Qantas retains a dominant position in the Australian domestic airline sector with a market share of ~70% across both its Qantas and Jetstar brands. Barriers to entry are high, while a lack of suitable alternatives between Sydney and Melbourne--one of the world's busiest air routes--and to a lesser extent, Sydney and Brisbane, ensures a relatively dominant position in the normal course of business.

  Qantas has benefited from Virgin Australia's repositioning as a mid-market carrier following its re-emergence from voluntary administration (but in a much more limited capacity); with Virgin now owned by private equity, the focus on profitability and the need to generate an adequate return should ensure that competition in the domestic market remains rational with respect to both capacity and pricing. Qantas is now the only airline with a full-service and low-cost offerings in Australia, and is well-positioned to leverage the recovery in travel demand as vaccine rollout progresses and meet the expected increase in domestic travel (in particular) as lockdowns subside.

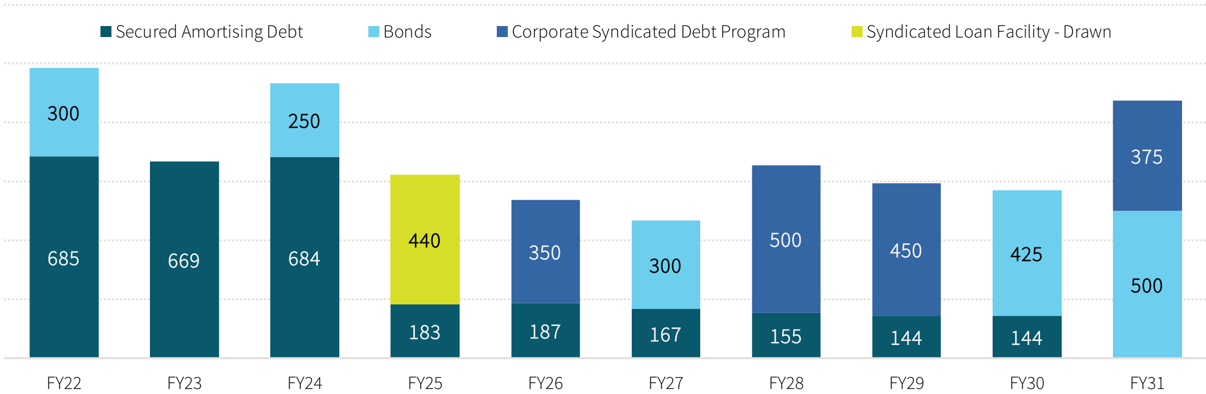
- **Dual brand strategy captures multiple customer sets:** The successful differentiation between the Qantas and Jetstar brands allows Qantas to hold the largest market share in business, premium and low cost segments of the Australian market simultaneously. This dual brand strategy enables the Group to allocate aircraft capacity based on targeted customer segments, which typically results in the Qantas brand on routes with high business traffic and the Jetstar brand for routes primarily servicing tourism destinations.

- **Strong balance sheet provides financial flexibility:** Prior to the pandemic, Qantas had a strong balance sheet with net debt/EBITDA of around 1.4x for the twelve months ended 30 June 2019 (as measured by Moody's rating methodology), significantly below its rating threshold of 2.5x. Although net debt/EBITDA has easily exceeded this threshold during fiscal 2021, it is expected the company will revert toward pre-pandemic levels through a combination of debt reduction (see below) and more normalised earnings.

  In the interim, Qantas continues to retain significant flexibility in its financial position, funding strategies and fleet plan which has allowed it to continue to raise funds and generate liquidity in the face of changing market conditions.

  Total liquidity sits at AUD3,976m as at 30 June 2021--with Qantas benefiting from the issue of long-dated term debt during the pandemic--while the company's debt maturity more broadly is well-staggered (see below), with both factors contributing to minimal refinancing risk.

  Figure 1: Debt maturity profile as at 30 June 2021



- **Commitment to maintaining investment grade credit rating:** Qantas' publicly articulated financial framework triggers pre-emptive actions to fortify its balance sheet in the event of significant operational weakness. Since the start of the pandemic, Qantas has suspended shareholder distributions, reduced capital expenditure and raised equity, all of which have helped to preserve cash. Although its leverage metrics are above the threshold for its current rating, Qantas' publicly announced balance sheet repair initiatives to reduce net debt, headlined by the sale of Mascot land more recently, has been sufficient to maintain its investment grade credit rating.

- Asset rich business: Qantas is an asset rich business, with a number of significant entities and opportunities to reduce debt levels through asset sales if needed. A recent example of this was the Mascot land sale for gross proceeds of AUD802m, which should assist the company in returning its level of net debt toward its target range of AUD4.5bn - AUD5.6bn (from a peak of AUD6.4bn in February 2021).

  Unencumbered assets (prior to the sale of Mascot) were at AUD2.5bn, including 41% of the Qantas fleet, land, spare engines and other assets. Maturing secured debt facilities in FY22 to FY24 (see Figure 1 above) will further unencumber mid-life aircraft.

Risks

- Exposure to highly cyclical and confidence-sensitive industry: The nature of the airline industry presents a risk for bond holders due to it being cyclical, capital intensive, exposed to ‘force majeure’ events such as terrorism and global pandemics as well as the cost of jet fuel which fluctuates with movements in the underlying commodity. While the current pandemic has reached something of an inflection point as the first round of vaccine rollouts progress globally, material uncertainty around the depth and duration of the pandemic remain, particularly as the efficacy of vaccinations diminish and the need for further measures to limit the spread of the virus are sought.

  Qantas has the ability to defer significant capital expenditure which can provide further cash or liquidity to meet short-term liquidity needs in response to cyclical factors. Increasing contribution from loyalty and freight services, which are likely to be less-susceptible to cyclical factors, should also provide an increasing proportion of earning with recurring characteristics.

- International business exposed to strong competitive dynamics: Qantas’ international business has underperformed financially in recent years due in large part to the increase in competition which has come with the deregulation of routes and heightened competition from state-sponsored competitors, who are unlikely to have the same financial hurdle rates compared with Qantas.

  An output of Qantas' three-year recovery plan (see below for more details) has been a significant improvement in Qantas’ cost base and unit cost performance--particularly within its domestic and international segments--which has improved Qantas’ competitive position and yield premium compared with its competitors. While the COVID-19 pandemic is also likely to see the international segment underperform Qantas’ domestic operations for some time, as international travel gradually resumes, stronger returns from the international segment should emerge.

- Exposure to fuel and foreign exchange risks: Qantas, as is the case for all airlines, has a high exposure to oil price and foreign exchange. This is because fuel costs represent a material portion of total costs and these costs, together with aircraft purchases and aircraft leases, are typically denominated in US dollars.

  To mitigate these risks to the greatest extent manageable, Qantas has historically maintained significant level of hedging.

- High level of execution risk associated with its recovery plan and balance sheet repair initiatives: In response to the grounding of substantially all off the Qantas’ fleet in March 2020 as a result of the COVID-19 pandemic, Qantas announced a three-year plan for recovery, looking to produce AUD15bn in cost savings by 2023, along with AUD1bn in annual (structural) cost savings from 2023. This included a reduction in its workforce of ~6,000 personnel. An inability to deliver the cost reductions as planned, or longer than expected border closures (noting international travel, including freight, accounts for 40% of pre-COVID revenues), could materially negatively impact Qantas’ earnings over the coming years.

  We note that progress to-date is ahead of target (Qantas has delivered structural savings of AUD650m and is on track for at least AUD1bn from 2023). While there is uncertainty over the timing of the deleveraging process (the recent sale of Mascot land has accelerated its balance sheet repair initiative), Qantas is committed to restoring its credit profile, and has the liquidity to mitigate any timing risk.

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Summary Financials

The financial summary below represents the consolidated operations of Qantas Airways Ltd (AUDm, FYE 30 June).

Income Statement	FY17	FY18	FY19	FY20	FY21
Revenue	16,057	17,128	17,966	14,257	5,934
Underlying EBITDA	2,752	3,062	3,115	2,437	410
Net Interest Expense	(159)	(150)	(250)	(242)	(279)
Depreciation & amortisation	(1,382)	(1,528)	(1,996)	(2,045)	(1,929)
Exceptional Items	(48)	(43)	(65)	(1,805)	(568)
Net income	852	953	840	(1,964)	(1,728)
Balance Sheet	FY17	FY18	FY19	FY20	FY21
Cash	1,775	1,694	2,157	3,520	2,221
Goodwill & intangibles	1,025	1,113	1,225	1,050	849
Net property, plant, and equipment	11,501	12,186	13,412	12,404	10,888
Total assets	17,221	18,647	20,535	20,026	17,880
Total debt	4,838	4,748	6,889	8,535	8,229
Total equity	3,540	3,955	3,014	1,526	516
Cash Flow Statement	FY17	FY18	FY19	FY20	FY21
Cash flow from operating activities	2,704	3,413	3,164	1,083	(386)
Cash flow from investing activities	(2,046)	(2,201)	(1,563)	(1,571)	(722)
Debt Issued / (Repaid)	(34)	(134)	(52)	1,163	(239)
Equity Issued / (Repurchased)	(564)	(913)	(735)	894	58
Credit Metrics	FY17	FY18	FY19	FY20	FY21
Net Debt/EBITDA	1.1x	1.0x	1.5x	2.1x	14.7x
EBITDA/Net Interest Expense	17.3x	20.4x	12.5x	10.1x	1.5x
Debt / (Debt + Equity)	58%	55%	70%	85%	94%

Source: S&P Capital IQ, Company, FIIG estimates.

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