HD Sydney: Qantas Group Financial Result

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Sydney: Qantas Group Financial Result. Highlights:

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Underlying Loss Before Tax: $646 million

Non-cash fleet writedown post-structural review: $2.6 billion

Statutory Loss After Tax: $2.8 billion

Underlying fuel costs: $4.5 billion, up $253 million

Qantas Transformation benefits: $440 million

Operating cash flow: $1.1 billion

Group comparable unit costs down 3 per cent

Liquidity: $3.6 billion

Underlying Profit Before Tax expected in first half FY15

No final dividend

Qantas today announced an Underlying Loss Before Tax of $646 million and a Statutory Loss After Tax of $2.8 billion for the 12 months ended 30 June 2014.

The Underlying PBT result was driven by the cumulative impact of two years of industry capacity growth ahead of demand, leading to a $566 million decline in FY14 revenue, and by record Australian dollar fuel costs of $4.5 billion - up $253 million from FY13.

In response, Qantas is driving an earnings recovery and de-leveraging the Group's balance sheet to shape a profitable future and build long-term shareholder value.

The $2 billion accelerated Qantas Transformation program announced in February is permanently reducing costs and laying the foundations for sustainable growth in earnings.

Transformation benefits totalled $440 million in FY14, including $204 million of second-half benefits from the accelerated Qantas Transformation program.

A further $900 million of accelerated transformation projects are in the implementation phase, with more than $600 million of benefits from these projects to be realised in FY15.

To date, projects equivalent to more than half the $2 billion target have been delivered or are underway.

Unit costs were reduced by 3 per cent over the year, accelerating from a 2 per cent reduction in the first half to a 4 per cent reduction in the second half.

Qantas CEO Alan Joyce said the underlying result had been foreshadowed at the Group's half-year announcement in February.

'There is no doubt today's numbers are confronting, but they represent the year that is past,' Mr Joyce said.

'We have now come through the worst. With our accelerated Qantas Transformation program we are already emerging as a leaner, more focused and more sustainable Qantas Group.

'There is a clear and significant easing of both international and domestic capacity growth, which will stabilise the revenue environment.

'We expect a rapid improvement in the Group's financial performance - and a return to Underlying PBT profit in the first half of FY15, subject to factors outside our control.'

Significant one-off costs associated with Qantas Transformation are recognised in the statutory result, including restructuring and redundancies ($428 **million**) and primarily non-cash costs relating to early aircraft retirements ($394 **million**). Of the 5,000 redundancies announced in February, 2,500 have been implemented as at 28 August.

At the same time as delivering cost reduction, the Group has taken action to adjust its capacity and network in response to shifts in demand and the competitive environment - while retaining flexibility to make further adjustments if required.

International competitor capacity growth is expected to be 2.4 per cent in the first half of FY15 and domestic market capacity growth is expected to be around 1 per cent, significantly below recent trends for both markets.

Financial Position

Group liquidity at 30 June was $3.6 **billion**, comprising $3 **billion** in cash - up around $600 **million** from the half-year - and $630 **million** in undrawn committed facilities. With operating cash flow of $1.1 **billion**, the Group was net free cash flow neutral in FY14.

The Group significantly extended its debt maturity profile through two landmark bond issuances totalling $700 **million**, with no major unsecured refinancing required before April 2016. Net debt including operating lease liability was reduced by $96 **million**.

Overall capital investment has been reduced to maximise net free cash flow for debt reduction, while the Group has maintained targeted investment in fleet, product and service to sustain brand and yield premiums for Qantas and Jetstar.

Capital investment was $874m in FY14. Planned capital investment in FY15 has been reduced from $800 **million** to $700 **million**, with a forecast of $800m in FY16.

The Group's average fleet age remains at a 20-year low of 7.7 years, with 35 per cent of the fleet debt-free. Thirty-one new debt-free aircraft have been added since FY10, including seven in FY14.

Outcome of Structural Review

Qantas today also announced the outcomes of the structural review that commenced in December 2013.

The Group has identified, valued and will continue to assess opportunities to sell non-core assets such as airport terminals, property and land holdings. Any proceeds from such sales will be used to repay debt.

After detailed strategic and structural assessment of Qantas Loyalty, the decision has been made to retain this highly valuable business within the existing Group structure. It was determined that there was insufficient justification for a partial **sale**. Qantas Loyalty continues to offer major profitable growth opportunities.

No new Jetstar ventures will be established while the Group is focused on transformation. Substantial value exists across the Jetstar Group airlines, to be realised over time.

Since 2012, Qantas' international and domestic airlines have reported their financial performance as separate segments, to strengthen accountability and performance. Following the partial repeal of the Qantas**Sale** Act, the Group will establish a new holding structure and corporate entity for Qantas International. This decision will create the long term option for Qantas International to attract external investment and participate in partnership opportunities in the international aviation market, with a view to achieving efficiencies and improved returns to shareholders.

Fleet Writedown

Under accounting standards, the decision to establish a new holding structure and corporate entity for Qantas International requires a change to Qantas' Cash Generating Units (CGUs) for impairment testing. The previous 'Qantas Brands' CGU has been split into four separate CGUs: Qantas International, Qantas Domestic, Qantas Loyalty and Qantas Freight.

The CGUs for Qantas Domestic, Qantas Loyalty and Qantas Freight all have strong surpluses.

After being tested on a standalone basis for the first time, the Qantas International CGU requires a writedown of $2.6 **billion**. The size of the writedown is largely due to the historic cost of aircraft purchased with an average exchange rate from Australian dollars to U.S. dollars of $0.68.

This writedown is a non-cash charge, recognised in the statutory result, with no cash impact on the Group's or Qantas International's **operations**. It is a writedown to the carrying value of aircraft that Qantas has no intention to sell and intends to retain in its fleet.

Following the writedown, the carrying value of Qantas International aircraft will be more reflective of the current market value of the fleet, and future depreciation expense will be approximately $200 **million** per year lower as a result of this change.

CEO Comment

Mr Joyce said the Group's priority now was to push forward with the accelerated Qantas Transformation program after a positive start.

'After an extremely difficult period, we are focused on building momentum with our turnaround in FY15,' Mr Joyce said.

'Our cash balance and liquidity position is strong, and the Group's overall financial performance is rapidly improving. We are removing costs to drive earnings growth. And the work we've done over recent years to renew our fleet and improve service has been recognised with a string of awards and record customer satisfaction.

'In February we made a deliberate choice to continue investing in core initiatives for customers in order to hold our competitive position, keep our brands strong and maintain a yield premium in a challenging market. As we transform our business at pace, our airlines are providing better service than ever.

'The structural decisions we announce today give the Group maximum scope to attract capital in a fiercely competitive international aviation market. Standing still while the world changes around us is not an option.

'With our structural review complete, we can move forward with certainty.'

Breakdown of Results

Qantas Domestic

Qantas Domestic reported Underlying EBIT of $30 **million**, down from $365 **million** in FY13.

Group Underlying EBIT, including Qantas Domestic and Jetstar's domestic **operations**, was just below $50 **million**.

The earnings deterioration in FY14 was a result of market capacity increases ahead of demand, weaker demand in the resources and government sectors, price pressure in all industries, unrecovered carbon tax costs and an unfavourable fuel cost of $68 **million**.

In this volatile market, Qantas Domestic's strategy of maintaining a capacity, frequency and product advantage over the competition saw it remain Australia's premium carrier of choice.

The airline held an 80 per cent share of the domestic corporate travel market by revenue, including 48 new accounts, eight accounts won back from the competition, 10 accounts lost and 182 accounts renewed.

Comparable unit costs were reduced by 3 per cent as Qantas Transformation benefits began to flow, helping close the cost gap with the competition.

Both customer satisfaction and customer advocacy were at record levels in FY14, helped by Qantas Domestic's consistently superior on-time performance.

Qantas Domestic was Australia's most punctual major domestic airline every month in FY14 and, as at June 2014, had led the competition for 18 straight months - a key factor in winning and retaining corporate accounts.

Qantas International

Qantas International reported an Underlying EBIT loss of $497 million, compared with a loss of $246 million in FY13.

The business delivered another strong year of cost reduction, cutting comparable unit costs by 4 per cent, and has now realised more than $400 million of transformation benefits over the past two financial years. However, these benefits were offset in FY14 by competitor capacity growth of 9.5 per cent - well above demand - and record fuel costs.

Fuel price and foreign exchange movements hit Qantas International hardest of any of the Group's businesses, with an impact of $142 million.

Between FY09 and FY14, competitor capacity growth in the Australian international market was 44 per cent, compared with global growth of 29 per cent. Importantly for the Group's outlook, capacity expansion is now slowing, with expectations for competitor growth of 2.4 per cent in the first half of FY15.

By optimising its network and fleet, including the retirement of older Boeing 747s, Qantas International is cutting unit costs while improving the travel experience for customers. Retiming the QF9/10 services to Dubai and London, for example, has freed up an A380 to operate on the popular Dallas/Fort Worth route and will lead to a significant increase in asset utilisation.

Customer satisfaction reached record levels in FY14 and customer advocacy was a record for the year. New lounges were opened in Singapore, Hong Kong and Los Angeles, while new and expanded codeshare agreements were struck with China Southern, LAN and Bangkok Airways.

These agreements complement the ground-breaking Qantas-Emirates partnership launched in FY13. The Dubai route continues to receive the highest customer satisfaction anywhere on the Qantas International network, with more than 2 millionQantas customers having already travelled through the hub since the partnership was launched.

Qantas International now offers its biggest ever global network, with 1,200 destinations available with Qantas and its partner airlines.

Jetstar

The Jetstar Group reported an Underlying EBIT loss of $116 million, down from Underlying EBIT of $138 million in FY13.

Controllable unit costs were reduced by 2 per cent. However, these gains were offset by an unfavourable fuel cost of $86 million, a yield decline of $113 million across the highly competitive South East Asian and Australian markets and an increase in associate start-up losses of $20 million. Total associate start-up losses in Asia were $70 million due primarily to the rapid expansion of Jetstar Japan as it consolidates its leading LCC position in the Japanese domestic market.

Jetstar's domestic business in Australia remained profitable - as it has been every year since launch in 2004 - and continued to play its part in the Group's successful two-brand strategy.

Customer satisfaction remains at record levels in Jetstar Airways' domestic and international operations, helped by continued improvement in on-time-performance and the introduction of the Dreamliner on key international routes, including Bali, Phuket and Bangkok.

The Jetstar Group airlines in Asia, in which Qantas is a minority investor, remain focused on distinct market priorities:

Growth at Jetstar Asia has been suspended in a very challenging Singapore market that saw capacity expand by 23 per cent in FY14, but the business made productivity gains, holds a substantial yield premium to its LCC competitors, and is ranked the nation's leading LCC. Its performance is expected to improve as capacity growth moderates, with market correction already underway.

Jetstar Japan is Japan's largest and fastest growing LCC, having carried over 5 million passengers since launch and opened a second domestic base in Osaka. The launch of operations from the second base is improving unit cost performance, as a result of increased asset utilisation from the 24-hour airport in Osaka. With LCCs still holding just 6 per cent of the Japanese domestic market, the business has significant growth potential.

Vietnam's Jetstar Pacific cut unit costs and increased customer advocacy in a high-growth market. The business has completed its recapitalisation, has begun international services and will expand its fleet from 7 to 10 aircraft by December 2014.

The Board and management of Jetstar **Hong Kong** continue to work with local regulators towards gaining approval to begin **operations**.

Qantas Loyalty

Qantas Loyalty reported record Underlying EBIT of $286 **million** - up from $260 **million** in FY13 - after a fifth straight year of double-digit earnings growth.

The business continued to perform strongly in FY14, reaching 10.1 **million**Qantas Frequent Flyer members by 30 June 2014, and award redemptions rose 11 per cent to 6.2 **million**.

Qantas Frequent Flyer billings increased by 8 per cent. Fourteen new program partners were added during the year, increasing options for members to earn points.

Alongside the continued success of Qantas Frequent Flyer, the broader Qantas Loyalty business expanded into new ventures through the successful launch of the Aquire loyalty program for SMEs and the Qantas Cash travel money card.

More than 35,000 businesses have signed up to Aquire and there have been more than 300,000 Qantas Cash activations since the product's launch, with $500 **million** in cash loaded onto the card. Qantas Cash was also awarded the maximum five-star rating in its category by CANSTAR.

A new digital channel, Qantaspoints.com, provides a dedicated one-stop resource for Qantas Frequent Flyer and Aquire members.

Qantas Freight

Qantas Freight reported Underlying EBIT of $24 **million**, compared with $36 **million** in FY13.

Earnings were lower as a result of the **sale** of Star Track Express in FY13, while global air cargo markets remained challenging. However, the integration of Australian air Express with Qantas Freight is now complete and full run-rate benefits began to flow in the second half of FY14.

Outlook

The Group expects a return to an Underlying Profit Before Tax in the first half of FY15, subject to factors outside its control.

This is based on the following expectations:

A target of $300 **million** of Qantas Transformation benefits to be realised in the first half.

A stabilising operating environment, as market capacity growth subsides.

First half fuel costs in line with the first half of FY14.

The repeal of the carbon tax.

Reduced depreciation costs compared with the first half of FY14.

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