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9B18N021

Qantas Airways: financial modelling and dividend policy[[1]](#footnote-1)

Angelo Aspris wrote this case solely to provide material for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The author may have disguised certain names and other identifying information to protect confidentiality.

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If you want to be a millionaire, start with a billion dollars and launch a new airline.

Richard Branson[[2]](#footnote-2)

For Australia’s national airline, Qantas Airways Limited (Qantas), known affectionately as “the flying kangaroo,” 2014 was one of the most difficult years. Following a loss of AU$2.8 billion,[[3]](#footnote-3) the airline’s chief executive officer (CEO), Allan Joyce, asserted that government intervention was necessary. He wanted the Australian government to publicly guarantee the airline’s debt, which would secure its credit rating and provide relief in challenging circumstances. His efforts were unsuccessful. Qantas instead embarked on a structural review and company transformation, seeking to repair its balance sheet and improve free cash flow. On August 23, 2016, having completed one of Australia’s largest and most public corporate turnarounds, Qantas announced a $1.53 billion underlying profit. Contributing to this result was a favourable economic environment, characterized by low fuel costs, a falling Australian dollar, and strong economic growth, combined with greater fiscal discipline and an improved operating strategy. Inevitably, questions arose as to how Qantas would reward long-suffering shareholders, with many thinking back to the fateful words of former chairman Leigh Clifford in 2009: “Under the present circumstances, the board considers it prudent not to pay a final dividend, and future dividends will be assessed against ongoing earnings performance and capital requirements.”[[4]](#footnote-4) Having overcome trying financial problems, Qantas was facing a different challenge: whether, and how, to return cash to shareholders, having not paid a dividend for seven years.[[5]](#footnote-5)

Company Background*[[6]](#footnote-6)*

Qantas was founded in 1920, having originally operated as the Queensland and Northern Territory Aerial Service. As the world’s second oldest airline and Australia’s largest domestic and international airline group, Qantas had historically provided regional, domestic, and international services, employing more than 30,000 people across the globe. The group also engaged in the sale of international and domestic holiday tours and provided service worldwide to Asia, North and South America, Africa, and Europe.

Having rationalized its business over several years, Qantas’s core business segments were divided into five main groups: Qantas International was the premium full-service international airline, accounting for nearly 32 per cent of revenue. Its major routes were between Australia, New Zealand, Asia, the Americas, and Europe. In fiscal year (FY) 2014, Qantas transported nearly six million passengers on more than 550 routes. Domestic travel was divided between a premium and a low-cost offering. Qantas Domestic was the domestic arm of the Qantas premium brand. The main markets serviced were Australia’s capital cities and various regional hubs.Jetstar Group was the Qantas low-fare airline, with service across Australia, New Zealand, and the Asia Pacific regions. Jetstar’s Australian operation was wholly owned by Qantas, but it was managed separately and operated independently of the Qantas premium brand. In the most recent FY, more than half of Qantas revenues came from its domestic premium and low-fare brands (see Exhibit 1). Qantas Loyalty was its frequent-flyer business, which featured hundreds of points-earning partners and more than 10 million members. In FY 2014, it delivered more than $1.3 billion in revenue, with more than four million award seats redeemed throughout the year. Qantas Freight was the independent air freight service business. Freight services included airport-to-airport line haul and ground handling services, including customs clearance (see Exhibits 1 and 2).

Industry Analysis

Warren Buffet once suggested that investors should avoid businesses that had grown rapidly, required significant capital to grow, and had earned little to no money.[[7]](#footnote-7) The airline industry was often used as a case study to demonstrate how the economics of such an industry—with high fixed costs, strong labour unions, and vulnerability to commodity cycles—could produce few winners over the long term. The apparent preponderance of state-owned airlines testified to the unusual challenges faced by the industry. Despite numerous cautionary tales, investors continued to pour money into the sector. They may have been attracted both by the prospect of growth, which was closely related to favourable economic conditions (e.g., fuel costs, gross domestic product growth, and favourable foreign exchange rates) and by an opportunity for financial management. The established view of the airline industry was that any renaissance was generally short-lived, driven more by luck than discipline. Airlines were generally resiliently popular with investors. However, the pronounced uncertainty of their future performance and their dependence on benign economic conditions made it difficult for management to offer stability and surety of future returns to investors. Having already discontinued dividend payments once before, Qantas needed to be confident before reinstating regular distributions. In a share market obsessed with income, investors were unlikely to tolerate a second hiatus from dividends.

**The Australian Market for Travellers**

Australia’s position in the airline industry was more of an end-of-line destination, rather than a travel (or transit) hub. That fact undermined Qantas’s future certainty, as the company was more exposed to the economic conditions within Australia than other airlines, such as those operating out of Asia and the Middle East, for example. Australians took only 0.4 air trips per capita per year, despite having one of the highest gross domestic product rates per capita globally.[[8]](#footnote-8) Swedes, in comparison, took more than 1.6 air trips per year. The reluctance of Australians to travel internationally was due to several factors, including the cost of a trip relative to disposable income levels, which was a function of the domestic economy; movements in the Australian dollar relative to other currencies; and the competitive standing of airlines, which drove the price of air fares. Clearly, these concerns were largely outside Qantas’s control. Traditionally, domestic travel was less sensitive to the business cycle. However, a significant proportion of travel was driven by fly-in, fly-out arrangements in the resources sector, which were, in turn, linked to international economic conditions, particularly those of China.[[9]](#footnote-9)

Company Analysis

Tracing the Woes

Despite its enviable safety record, Qantas performed poorly in terms of capital returns over the previous decade, as did most airlines. In 2012–13, the airline reached a critical period in its corporate existence after it ran into debt problems amid soaring oil prices and heightened competition from other premier carriers, many of whom benefited from state funding. Qantas, in contrast, was publicly traded. Its ownership requirements limited the amount of foreign capital it could raise, making it largely dependent on increasingly disgruntled domestic investors. Even before the development of these problems, Qantas faced a major disruption to its business from new entrants into domestic routes, where it had been traditionally dominant. It also faced new competition internationally, which proved particularly detrimental to Qantas’s global financial performance between 2010 and 2014 (see Exhibit 3).

The Transformation Plan

In FY 2014, Qantas announced its largest ever corporate loss of $2.84 billion. Despite the enormity of the loss, the airline expressed cautious optimism that a turnaround was imminent. The loss included a $2.56 billion write-down to the value of its fleet. The write-down was expected to be around $750 million,[[10]](#footnote-10) but the company took a significantly higher depreciation charge, with many arguing that it was figuratively “taking a bath,” andengineering an accounting low point for the company. Joyce, the company’s CEO, suggested at the time that the company would “emerge as a leaner, more focused, sustainable Qantas.”[[11]](#footnote-11)

Behind these words of optimism lay the Qantas Transformation Plan, which targeted $2 billion worth of cost reductions by FY 2017. The Transformation Plan placed firm targets on performance and structure, which were publicly and explicitly provided in a bid to demonstrate accountability and transparency in the organization. Among the principal targets were the reduction of at least 1,000 employment positions within 12 months, a freeze on pay for the CEO and board members, a review of the top 100 suppliers to Qantas, and proposed network and fleet optimization improvements. The strategic objectives aimed to also reduce group fuel expenditure by more than 10 per cent, control Qantas’s international unit costs to a level comparable to other international airlines, maintain Jetstar’s lowest seat cost and yield advantage, and improve customer experience.[[12]](#footnote-12)

On February 26, 2015, following these strategic rationalizations, Qantas reported its half-yearly earnings for FY 2015, which featured underlying profit before tax of $367 million and a statutory profit after tax of $206 million. These underlying earnings were Qantas’s best first-half performance since 2010, representing an improvement of $619 million (approximately 245 per cent) on the previous comparable period, as well as a material outperformance of the $300 million guidance. Qantas identified the main factors underlying the improvement as $374 million in Qantas Transformation Plan benefits, $208 million in reduced depreciation, $162 million in increased revenue per available seat kilometre,[[13]](#footnote-13) $59 million from the repeal of the carbon tax, and $33 million from lower fuel prices (see Exhibit 4). Buoyed by the delivery of these positive results, some key analysts became bullish on Qantas’s performance. For example, Macquarie Group issued an outperform recommendation, noting that the profit outperformance was due not only to cost cutting, but also to yield growth in both the domestic and international divisions. Deutsche Bank similarly moved to a buy recommendation, outlining a more favourable operating environment and moderated capacity growth going forward.[[14]](#footnote-14) The Qantas share price, over the five years from 2010 to 2015, showed growth in comparison to the Australian Securities Exchange’s ASX 200 (see Exhibit 5).

CAPITAL MANAGEMENT

Finding itself in a considerably stronger operating position, the Qantas management was able to focus on improving its financial position. On December 6, 2013, Qantas was downgraded by the rating agency Standard & Poor’s to BB+, with outlook negative, which was the level of junk grade stock. Therefore, numerous domestic funds, with mandates requiring investment grade holdings, were no longer be able to invest in Qantas’s debt. In FY 2014, net debt (including off-balance sheet leases) totalled more than $4.7 billion, with a weighted average debt maturity of five years (see Exhibits 6 and 7). Qantas’s fleet was also aging, and its rate of funds from operations relative to net debt had fallen below 15 per cent.

Qantas’s aim to return to investment grade status could be achieved through three strategic actions. First, the company had to raise its funds from operations to net debt ratio to above 45 per cent through the cycle. Second, it had to diversify its funding profile, while retaining short-term liquidity, to reduce refinancing pressure. Third, the company had to distribute surplus cash to refinance high cost, maturing operating leases. The capital requirements of these initiatives, while helping to stabilize Qantas’s financial position, were clearly contrary to any immediate resumption of capital returns and particularly to sustained dividend payments.

Following the success of the Transformation Plan and favourable environmental conditions, several key highlights emerged from Qantas’s FY 2015 results. Qantas’s operating cash flow doubled to $2 billion, allowing the company to reduce debt by $1 billion. This led to an improvement in Qantas’s ratio of debt to earnings before interest, taxes, depreciation, and amortization (EBITDA), from 5.1 in FY 2013 to 2.9 in FY 2015, while funds from operations and net debt improved from 17 per cent to 46 per cent. Additionally, the rate of fleet that was unencumbered rose to more than 40 per cent, with an estimated market value exceeding $3 billion. Finally, Qantas’s liquidity position improved significantly, with $2.9 billion in cash and $1 billion in undrawn facilities (from $410 million in FY 2014). Overall, Qantas was able to reduce funding pressure by increasing its debt maturity profile and simultaneously to reduce funding costs by lowering gearing.

The firm was able to identify a key factor. A significantly lower level of cash was needed in the future with its optimal capital structure in place. This change provided an opportunity to use cash for other purposes in the future.[[15]](#footnote-15) Based on this result, an important question emerged for Qantas’s senior management: how much capacity did Qantas have for shareholder returns? The company had eclipsed its target of 10 per cent return on invested capital by reaching 16 per cent in FY 2015, thereby aligning its debt levels to their optimal capital structure and returning its credit rating to investment grade status. Qantas then had a decision to make about how to enhance shareholder value with an appropriate mix of growth and shareholder distributions (dividends or share buybacks).

A Choice to Be Made

In a discussion between the Qantas board chair Leigh Clifford and the investor Jack Tilburn, Clifford stated, “We recognize that this has been a difficult period for shareholders . . . We remain committed to resumption of dividends at the earliest opportunity.” Tilburn interrupted, “And I’ll end up on that matter of dividends. We want them. We should get them. You've got $4 billion in cash that’s our money. We should get a dividend next year.”[[16]](#footnote-16)

This exchange, which occurred during a Qantas annual general meeting, exemplified the expectations that were placed on Qantas by the investing public. Australian investors were biased toward dividends, which attracted valuable franking credits.[[17]](#footnote-17) Therefore, the Qantas management faced strong pressure to reinstate regular payments, regardless of other considerations.

Historically, Qantas, like most Australian companies, favoured dividend payments over share buybacks, in accordance with investor preference. The company conducted one large on-market buyback of approximately $500 million during its heyday period of 2007–08 and one small on-market buyback of approximately $91 million in 2012–13. In contrast, regular dividend payments were made from FY 2005 to FY 2009, when only an interim payment was made and future payments were suspended (see Exhibit 8).

The significance of the dividend payment was clear, as was the investor dissatisfaction at the cessation of payments. Nonetheless, Qantas suddenly found itself in markedly different operating and financial circumstances. Its financial returns significantly increased following the Transformation Plan. Return on invested capital had lingered below 5 per cent between FY 2010 and FY 2013, but jumped to 11.73 per cent in FY 2014 and 16.99 per cent in FY 2015.[[18]](#footnote-18) However, the company’s financial leverage remained well above the historically benign levels, during which Qantas distributed large dividend payments (see Exhibit 9).

The situation was not unique to Qantas. Air New-Zealand, a close competitor supported by majority government ownership, also saw a similar increase in leverage, with net gearing rising from 18.32 per cent in FY 2009 (i.e., a positive cash balance) to 50.94 per cent in FY 2015. Given the continued pressure of gearing, and Qantas’s focus on returning to investment grade status, a significant, one-off return of cash in the form of a share buyback or special dividend could place untenable pressure on the balance sheet, given that the company’s gearing was largely underpinned by a significant cash balance, exemplified by the sustained gap between gross and net gearing.

Conversely, years of sustained losses had left Qantas with a depleted franking credit balance of only $84 million at FY 2015. Companies normally accrued franking credits, which they distributed to shareholders, by paying corporate taxes. With 2.192 billion shares outstanding, this level of franking credits would support a total dividend of $196 million, or less than $0.01 per share, against a share price of $3.16. Unfranked dividends were significantly less attractive in the Australian market and were a rarity among major corporations. Consequently, even gradual capital returns through dividend payments, alleviating pressure on leverage, seemed less than appealing. Still more problematic was the fact that Qantas had $972 million in accumulated tax losses at FY 2015, which could be offset against future earnings. Of these tax losses, $117 million were used that year, $548 million were total deferred tax assets, and $221 million were used in FY 2015. In short, Qantas’s poor, past performance could limit its future tax obligations, even if it had achieved sustained profitability. Therefore, there was little chance of new franking credits for some time. Further, favourable accounting treatment of depreciation and other expenses could afford Qantas, with an extremely large fixed-asset base, additional opportunities to minimize its tax liabilities and, resultantly, the generation of new franking credits.

Having embarked on a remarkable turnaround, the Qantas management found itself in an unusual position, having no clear way forward to reward shareholders for the company’s financial success.

The author would like to thank Levi Romanov for his generous assistance with research for this case.

Exhibit 1: Qantas Airways Limited REVENUE SEGMENTATION, 2013 and 2014   
(in AU$ million)

|  |  |  |  |
| --- | --- | --- | --- |
| **Division** | **Metric** | **2014** | **2013** |
| **Qantas Domestic** | Revenue | 5,848 | 6,218 |
| Underlying EBIT | 30 | 365 |
| **Qantas International** | Revenue | 5,297 | 5,496 |
| Underlying EBIT | −497 | −246 |
| **Jetstar** | Revenue | 3,222 | 3,288 |
| Underlying EBIT | −116 | 138 |
| **Qantas Loyalty** | Revenue | 1,307 | 1,205 |
| Underlying EBIT | 286 | 260 |
| **Qantas Freight** | Revenue | 1,084 | 1,056 |
| Underlying EBIT | 24 | 36 |

Note: EBIT = earnings before interest and taxes.

Source: Created by the author using data from Qantas Airways Limited, *Shaping our Future: Qantas* *Annual Report 2014*, September 4, 2014, accessed March 1, 2015, http://investor.qantas.com/FormBuilder/\_Resource/\_module/doLLG5ufYkCyEPjF1tpgyw/file/

annual-reports/2014AnnualReport.pdf.

Exhibit 2: Qantas Airways Limited VARIOUS METRICS (2012–2014)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Qantas Metric** | **Scale** | **2012** | **2013** | **2014** |
| **Passenger Related Key Figures** |  |  |  |  |
|  |  |  |  |  |
| Number of Destinations (Including Codeshare)1 | Unit | 233 | 255 | 260 |
| Number of Destinations (Excluding Codeshare) | Unit | 106 | 112 | 98 |
| Countries (Excluding Codeshare) | Unit | 22 | 22 | 22 |
| Number of Passengers | Thousand | 46,708 | 48,276 | 48,776 |
| Revenue Passenger Kilometres | Million | 111,692 | 110,905 | 109,659 |
| Available Seat Kilometre | Million | 139,423 | 139,909 | 141,715 |
| Passenger Load Factor | % | 80.1 | 79.3 | 77.4 |
| Net Passenger Revenue/Revenue Passenger Kilometre | Cents | 12.2 | 12.3 | 12.1 |
| Yield (Excluding Foreign Exchange) | Cents | 11.0 | 10.3 | 10.0 |
| Yield Variance to Prior Year (Excluding Foreign Exchange Variances) | % | 2.6 | −2.4 | −2.6 |
| Weight Related Cargo Key Figures2 |  |  |  |  |
| Available Freight Tonne Kilometre | Million | 4,137 | 3,701 | 3,385 |
| Terminal Handling Tonnes | Million | 538 | 552 | 639 |
|  |  |  |  |  |
| **Aircraft Related** |  |  |  |  |
|  |  |  |  |  |
| Number of Aircraft (Including Network Aviation, Freighters, And Jetstar Asia) | Unit | 308 | 312 | 308 |
| Average Age of Scheduled Passenger Aircraft | Years | 8.3 | 7.9 | 7.7 |
|  |  |  |  |  |
| **Fuel and Efficiency Key Figures** |  |  |  |  |
|  |  |  |  |  |
| Average West Texas Intermediate Crude Oil | USD | 95 | 92 | 101 |
| Average Brent Crude Oil | USD | 112 | 109 | 109 |
| Average Singapore Jet Fuel | USD | 126 | 124 | 122 |
| Average AU$ per US$ | $ | 1.03 | 1.03 | 0.92 |
| Consumption of Jet Fuel (in Barrels) | Thousand | 32,449 | 32,005 | 31,500 |
| Qantas Domestic On-Time Domestic Departures | % | 84.4 | 84.7 | 87.5 |
| Qantaslink On-Time Domestic Departures | % | 77.7 | 78.7 | 82.3 |
| Jetstar Domestic On-Time Domestic Departures | % | 76.6 | 75.6 | 78.8 |
|  |  |  |  |  |
| **Other Key Figures** |  |  |  |  |
|  |  |  |  |  |
| Number of Frequent Flyer Members | Million | 8.6 | 9.4 | 10.1 |
| Number of Meals Prepared | Million | 37 | 38 | 36 |
| Visits at www.qantas.com | Million | 116 | 113 | 134 |
|  |  |  |  |  |
| Macroeconomic Data |  |  |  |  |
|  |  |  |  |  |
| Australia Population | Million | 22.7 | 23.0 | 23.3 |
| Australian GDP (Constant 2005 Prices) | AU$ Billion | 889.5 | 911.7 | 938.0 |
| Australian GDP (Current Prices) | AU$ Billion | 1,555.9 | 1,505.8 | 1,558.7 |
| Inflation | % | 1.8 | 2.4 | 2.7 |
| Consumer Price Index (Absolute, 2005 = 100) |  | 121.8 | 124.8 | 128.1 |
| Unemployment Rate | % | 5.4 | 5.8 | 6.1 |
| Reserve Bank of Australia Cash Rate | % | 3.00 | 2.50 | 2.50 |
| US$/AU$ | $ | 0.9660 | 1.0360 | 1.0360 |

Note: 1 Includes Jetstar Asia/Valuair; 2 Refers only to international freight; GDP = gross domestic product.

Source: Created by the author using data from Qantas Airways Limited, *Qantas Data Book 2014*, October 1, 2014, accessed March 2, 2015, http://investor.qantas.com/FormBuilder/\_Resource/\_module/doLLG5ufYkCyEPjF1tpgyw/file/data-book/2014

qantasdatabook.pdf; “Qantas Airways Ltd., Macroeconomic Data,” Bloomberg LP, database, accessed March 2, 2015, www.bloomberg.com/quote/QAN:AU.

Exhibit 3: Qantas Airways Limited Profit and Loss, Balance Sheet (2010–2014)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | | **Historical** | | | | |
| **(AU$ Million, June Year End)** | | **FY 2010** | **FY 2011** | **FY 2012** | **FY 2013** | **FY 2014** |
|  | **Income Statement** |  |  |  |  |  |
|  | Operating Revenue | 13,312 | 14,367 | 14,913 | 15,902 | 15,155 |
| Other Revenue | 460 | 527 | 811 | 0 | 197 |
| Total Revenue | 13,772 | 14,894 | 15,724 | 15,902 | 15,352 |
| Operating Expenses | −12,261 | −13,197 | −14,069 | −14,031 | −14,372 |
| EBITDA | 1,511 | 1,697 | 1,655 | 1,871 | 980 |
| Depreciation | −1,199 | −1,249 | −1,325 | −1,450 | −1,351 |
| EBIT | 312 | 448 | 271 | 421 | −442 |
| Interest Revenue | 181 | 192 | 181 | 109 | 82 |
| Interest Expense | −256 | −305 | −357 | −296 | −286 |
| Pre-tax Profit | 237 | 335 | 95 | 234 | −646 |
| Tax Expense | −62 | −74 | 105 | −11 | 1,133 |
| Net Profit after Tax before Abnormals | 175 | 261 | 200 | 223 | 487 |
| Abnormals | −59 | −12 | −444 | −217 | −3,330 |
| **Reported Net Profit after Tax** | **112** | **250** | −**245** | **5** | −**2,843** |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Balance Sheet** | |  |  |  |  |  |
|  | **Current Assets** |  |  |  |  |  |
| Cash | 3,704 | 3,496 | 3,398 | 2,829 | 3,001 |
| Receivables | 1,088 | 1,027 | 1,111 | 1,436 | 1,196 |
| Prepaid Expenses | 138 | 148 | 107 | 102 | 0 |
| Inventories | 319 | 372 | 376 | 364 | 317 |
| Investments | 233 | 318 | 88 | 180 | 172 |
| Other | 259 | 260 | 307 | 292 | 112 |
| Total Current Assets | 5,832 | 5,641 | 5,460 | 5,245 | 4,932 |
| **Non-Current Assets** |  |  |  |  |  |
| Receivables | 407 | 423 | 472 | 174 | 158 |
| Investments | 483 | 546 | 474 | 217 | 177 |
| PP&E | 12,516 | 13,652 | 14,139 | 13,827 | 10,500 |
| Intangibles (excluding Goodwill) | 449 | 429 | 464 | 517 | 546 |
| Goodwill | 219 | 164 | 146 | 197 | 195 |
| Future Tax Benefit | 0 | 0 | 0 | 0 | 548 |
| Total Non-Current Assets | 14,078 | 15,217 | 15,718 | 14,955 | 12,386 |
| Total Assets | 19,910 | 20,858 | 21,178 | 20,200 | 17,318 |
| **Current Liabilities** |  |  |  |  |  |
| Account Payable | 1,750 | 1,738 | 1,876 | 1,859 | 1,851 |
| Short-Term Debt | 619 | 577 | 1,119 | 835 | 1,210 |
| Provisions | 448 | 456 | 939 | 644 | 876 |
| Other | 3,420 | 3,464 | 3,172 | 3,032 | 3,588 |
| Total Current. Liabilities | 6,241 | 6,235 | 7,118 | 6,370 | 7,525 |
| **Non-Current Liabilities** |  |  |  |  |  |
| Long-Term Debt | 5,099 | 5,454 | 5,430 | 5,245 | 5,273 |
| Provisions | 1,275 | 1,414 | 1,605 | 1,445 | 405 |
| Other | 1,314 | 1,604 | 1,136 | 1,186 | 1,249 |
| Total Non-Current Liabilities | 7,688 | 8,472 | 8,171 | 7,876 | 6,927 |
| Total Liabilities | 13,929 | 14,707 | 15,289 | 14,246 | 14,452 |
| **Shareholders’ Equity** |  |  |  |  |  |
| Share Capital | 4,675 | 4,657 | 4,687 | 4,650 | 4,614 |
| Reserves | 109 | 85 | 36 | 128 | −81 |
| Retained Earnings | 1,155 | 1,405 | 1,162 | 1,171 | −1,671 |
| Total Equity | 5,981 | 6,151 | 5,889 | 5,954 | 2,866 |

Note: EBIT = earnings before interest and taxes; EBITDA = earnings before interest, taxes, depreciation, and amortization; Exhibit data also available in Qantas Student Spreadsheet file (7B18N021); Totals subject to minor rounding errors.

Source: Created by the author with data from “Qantas Airways Ltd.,” Bloomberg LP, accessed March 2, 2015, www.bloomberg.com/quote/QAN:AU.

Exhibit 4: Qantas Airways Limited INITIATIVE SCORECARD

|  |  |  |
| --- | --- | --- |
| **Metric** | **Timeframe** | **Progress as at FY 2014** |
| AU$2 billion gross benefits; more than 10% ex-fuel expenditure reduction1 | FY 2017 | 2H14 realized benefits = AU$204 million  Initiatives in implementation phase = AU$900 million |
| 5,000 FTE reduction | FY 2017 | 2,500 FTEs actioned2 |
| More than AU$1 billion debt reduction | FY 2015 | AU$96 million reduction in net debt3 achieved in FY 2014 |
| Debt/EBITDA4 less than 4 | FY 2017 | Debt/EBITDA to peak in FY 2014 |
| Positive free cash flow | FY 2015 onwards | FY 2014 free cash flow neutral  FY 2015 and FY 2016 CAPEX5 reduced by $1.3 billion |
| From 11 fleet types to seven | FY 2016 | Two B747 aircraft retired since December 2013  Five B767 aircraft retired since December 2013  All three B734 aircraft retired since December 2013 |
| Customer satisfaction  (six-month rolling average) | Ongoing | Stable at record levels |
| Most on-time domestic carrier (Qantas Domestic) | Ongoing | OTP leader 18 out of 19 months (January 2013 to June 2014) |

Note: FY = fiscal year; 2H14 = first half (six months) of 2014; FTE = full-time equivalent; EBITDA = earnings before interest, taxes, depreciation, and amortization; CAPEX = capital expenditures; OTP = on-time performance; 1 Assumes steady foreign exchange rates, capacity and sector length; 2 Includes FTEs that have exited or received notice; 3 Net debt includes interest-bearing liabilities, operating lease liabilities, and the fair value of hedges related to debt less cash, cash equivalents and aircraft security deposits. Operating lease liability = the present value of minimum lease payments for aircraft operating leases which, in accordance with AASB 117: Leases, was not recognized on balance sheet. This operating lease liability was calculated in accordance with Standard and Poor’s methodology using an assumed interest rate of 7%; 4 Metric calculated based on Moody’s methodology including cash greater than two billion dollars; 5 Equal to investing cash flows.

Source: Created by the author with data from Qantas Airways Limited, *1H15 Results*, February 26, 2015, accessed March 4, 2015, http://investor.qantas.com/FormBuilder/\_Resource/\_module/doLLG5ufYkCyEPjF1tpgyw/file/half-year-results/2014InvestorPresentation.pdf.

Exhibit 5: Qantas Airways Limited SHARE PRICE

Note: A$ = AU$ (Australian dollar); QAN = Qantas; S&P = Standard & Poor’s; ASX = Australia Securities Exchange.

Source: Created by the author with data from “Stock Prices for Qantas Ltd.,” Bloomberg LP, accessed March 2, 2015, www.bloomberg.com/quote/QAN:AU.

Exhibit 6: Qantas Airways Limited DEBT REPAYMENT PROFILE, excluding operating leases, 2015–2025 (in AU$ million)

Note: FY = fiscal year.

Source: Created by the author with data from Qantas Airways Limited, *1H15 Results*, slide presentation, February 26, 2015, accessed March 4, 2015, http://investor.qantas.com/FormBuilder/\_Resource/\_module/doLLG5ufYkCyEPjF1tpgyw/file/half-year-results/2014InvestorPresentation.pdf.

Exhibit 7: Qantas Airways Limited DEBT POSITION (2013 and 2014)

|  |  |  |
| --- | --- | --- |
| **Debt Position and Gearing (AU$ million)** | **FY 2014** | **FY 2013** |
| Net on Balance Sheet Debt | 3,455 | 3,226 |
| Net Debt Including Operating Lease Liability | 4,751 | 4,847 |
| On Balance Sheet Debt Ratio1 | 54:46 | 36:64 |
| Gearing Ratio2 | 62:38 | 46:54 |

Note: FY = fiscal year; 1 Net debt on balance sheet to net debt on balance sheet and equity (excluding hedge reserve); 2 Gearing ratio = net debt including operating lease liability to net debt including operating lease liability and adjusted equity (excluding hedge reserve); Gearing ratio used by management to represent Qantas’s debt obligation, including obligations under operating leases.

Source: Created by the author with data from Qantas Airways Limited, *Annual Report 2014*, September 4, 2014, accessed March 1, 2015, http://investor.qantas.com/FormBuilder/\_Resource/\_module/doLLG5ufYkCyEPjF1tpgyw/file/annual-reports/2014AnnualReport.pdf.

Exhibit 8: Qantas Airways Limited Dividends, Franking, and Share Price (2005–2008)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **FY** | **Dividends** | **Franking** | **Total** | **Share Price** | **Yield** |
| 2008 | $0.35 | $0.15 | $0.50 | $3.04 | 16.45% |
| 2007 | $0.30 | $0.13 | $0.43 | $5.60 | 7.65% |
| 2006 | $0.22 | $0.09 | $0.31 | $2.96 | 10.62% |
| 2005 | $0.20 | $0.09 | $0.29 | $3.37 | 8.48% |

Note: FY = fiscal year.

Source: Created by author with data from “QAN AU Equity,” Bloomberg LP, accessed March 2, 2015.

Exhibit 9: Qantas Airways Limited Gearing Ratio (2005–2015)

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **FY** | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** |
| Gross Gearing | 86% | 95% | 82% | 73% | 95% | 96% | 98% | 111% | 102% | 226% | 161% |
| Net Gearing | 83% | 47% | 28% | 27% | 33% | 34% | 41% | 54% | 55% | 121% | 77% |

Note: FY = fiscal year.

S Source: Created by author with data from “QAN AU Equity,” Bloomberg LP, accessed March 2, 2015.

1. This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Qantas Airways Limited or any of its employees. [↑](#footnote-ref-1)
2. Lara Kolodny, “Cleared for Takeoff: Surf Air Scores FAA Approvals, More Funding,” *Wall Street Journal,* June 3, 2013, accessed August 14, 2018, https://blogs.wsj.com/venturecapital/2013/06/03/cleared-for-takeoff-surf-air-scores-faa-approvals-more-funding/. [↑](#footnote-ref-2)
3. AU$ = Australian dollars; AU$1 = US$0.82 as of December 31, 2014; all currency amounts are in AU$ unless otherwise specified. [↑](#footnote-ref-3)
4. Qantas Airways Limited, “Qantas Announces Profit Result—Year Ended 30 June 2009,” press release, August 14, 2018, accessed August 14, 2018, www.qantas.com/travel/airlines/media-releases/aug-2009/3951/global/en. [↑](#footnote-ref-4)
5. Simon Mitchell and Caitlin Heffernan, “Qantas Airways—What to Do with all the Cash,” Global Research, UBS AG, January 25, 2015, accessed August 14, 2018. [↑](#footnote-ref-5)
6. “About the Qantas Group,” Qantas Airways Limited, accessed March 1, 2015, http://investor.qantas.com/home/?page=About-the-qantas-group. [↑](#footnote-ref-6)
7. Warren E. Buffett, “Letter to Shareholders for Financial Year Ended 31 December 2007,” Berkshire Hathaway Inc., February 20, 2008, accessed March 31, 2017, www.berkshirehathaway.com/letters/2007ltr.pdf. [↑](#footnote-ref-7)
8. Guy Bunce, “Qantas Airways—A Worthwhile Destination,” JP Morgan, July 28, 2016, accessed August 14, 2018. [↑](#footnote-ref-8)
9. Fly-in, fly-out was associated with temporary work in remote locations. Australia’s mining sector used such arrangements for workers and their families. [↑](#footnote-ref-9)
10. Jamie Free and Max Mason. “Qantas Posts ‘Confronting’ $2.8b Loss after Hefty Writedowns,” *The Sydney Morning Herald*, August 28, 2014, accessed May 1, 2017, www.smh.com.au/business/aviation/qantas-posts-confronting-28b-loss-after-hefty-writedowns-20140827-109ba6.html. [↑](#footnote-ref-10)
11. “Qantas Group Financial Result,” Qantas Airways Limited, August 28, 2014, accessed May 5, 2017, www.qantasnewsroom.com.au/media-releases/qantas-group-financial-result. [↑](#footnote-ref-11)
12. Ibid. [↑](#footnote-ref-12)
13. Available seat kilometres, which indicated an airline’s carrying capacity, were calculated based on the number of seats available multiplied by the number of kilometres flown. [↑](#footnote-ref-13)
14. Jamie Freed, “Moody's Lifts Qantas Outlook as it Heads toward $1bn Profit,” *The Sydney Morning Herald,* February 27, 2015, accessed May 2, 2017, www.smh.com.au/business/aviation/moodys-lifts-qantas-outlook-as-it-heads-toward-1bn-profit-20150226-13qc26.html. [↑](#footnote-ref-14)
15. “About the Qantas Group,” op. cit. [↑](#footnote-ref-15)
16. David Taylor, “Qantas Still Struggling for Air a Year after Grounding,” The World Today, Australian Broadcasting Corporation, November 2, 2012, accessed June 3, 2018, www.abc.net.au/worldtoday/content/2012/s3624344.htm. [↑](#footnote-ref-16)
17. Australia operated a dividend imputation system to prevent the double taxation of dividends. Taxation that the company had paid on profit distributed as a dividend was refunded (under most circumstances) to the investor, reducing personal income tax obligation or providing a tax refund. Therefore, a “fully franked” dividend consisted of the dividend payment itself (i.e., $1) and the attached franking credit of $0.4286 (assuming that the company’s tax rate was 30 per cent). [↑](#footnote-ref-17)
18. Data sourced from “ASX:QAN,” Morningstar Analysis, accessed March 4, 2015. [↑](#footnote-ref-18)