



QANTAS Airways Ltd. (ASX:QAN)

Emerged from turbulence, Australia's phoenix is soaring to new heights

BUY

18.3% Upside

12 Month Price Target: \$7.76

Last Close: \$6.53

1 Month VWAP: \$6.56



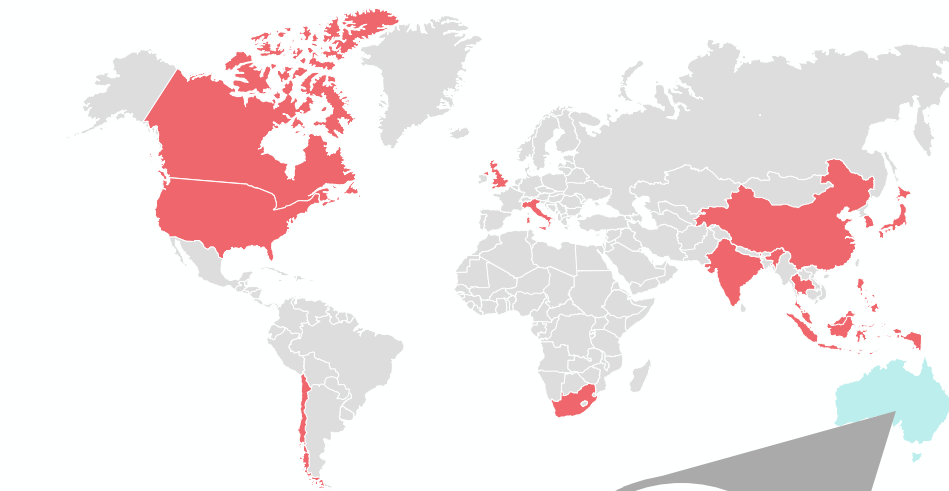
SYDNEY UNIVERSITY
RESEARCH GROUP

Andre Thomas | Jason Shi
Moniq Wever | Patrick
Mahony | Rachel Wang

Business overview

QAN is Australia's travel provider of choice

The only Australian airlines with extensive international flights...



21m

passengers in FY22



49

international destinations

116

domestic routes

...renowned for its safety and quality

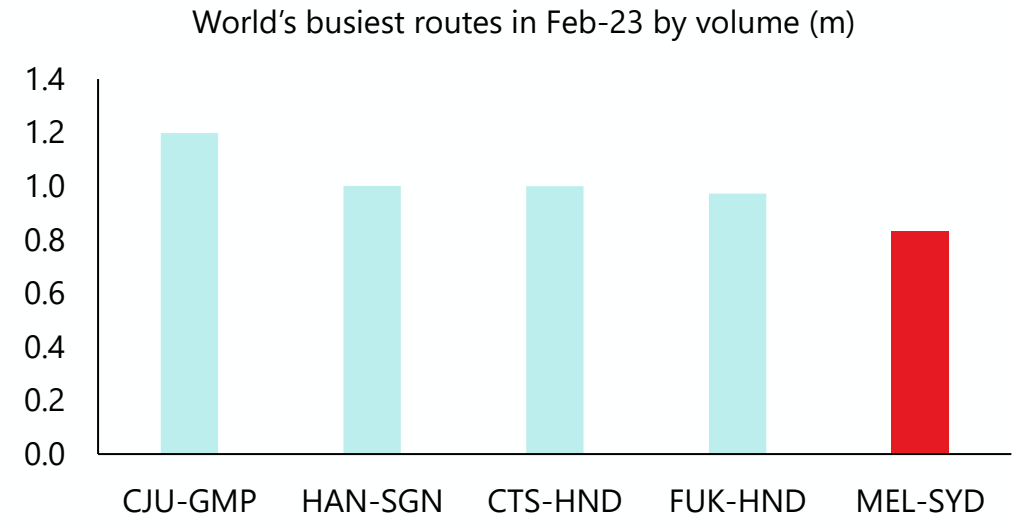
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Jet airliner fatalities and hull losses

5th

2022 World Airline Awards ranking

...and dominates the world's 5th busiest route



Source: Company data, SURG analysis

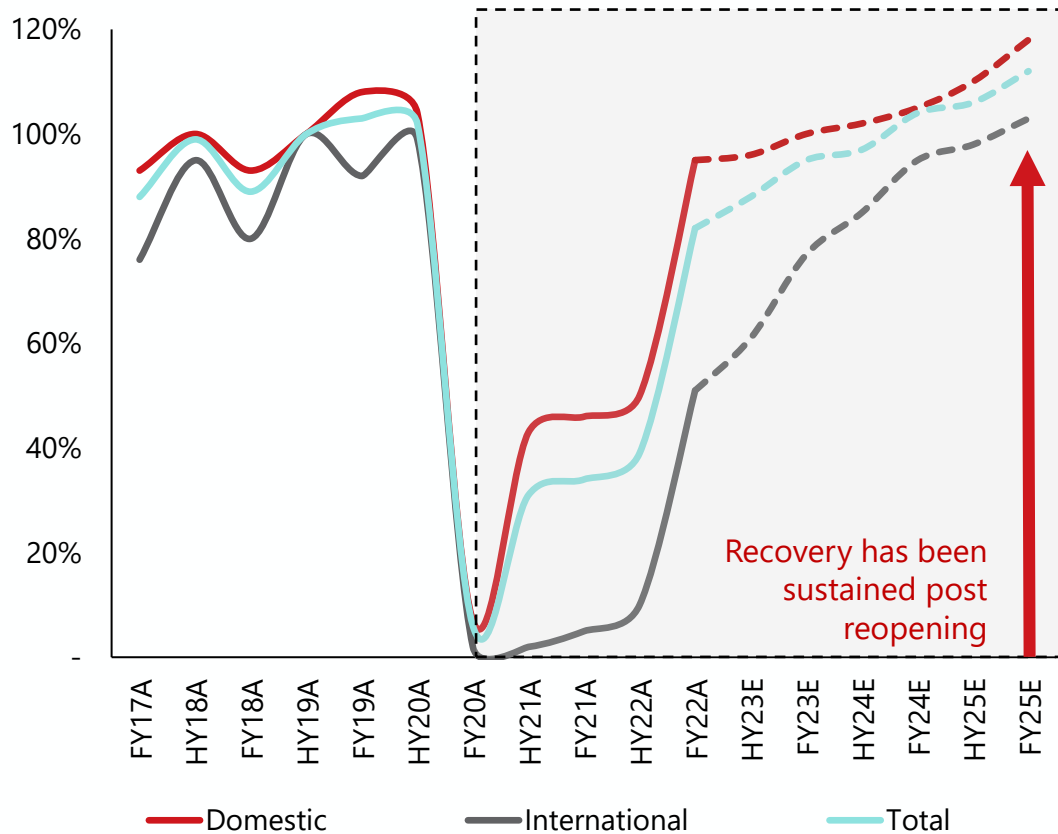
Industry and market overview

QAN holds steady course in a favourable domestic market

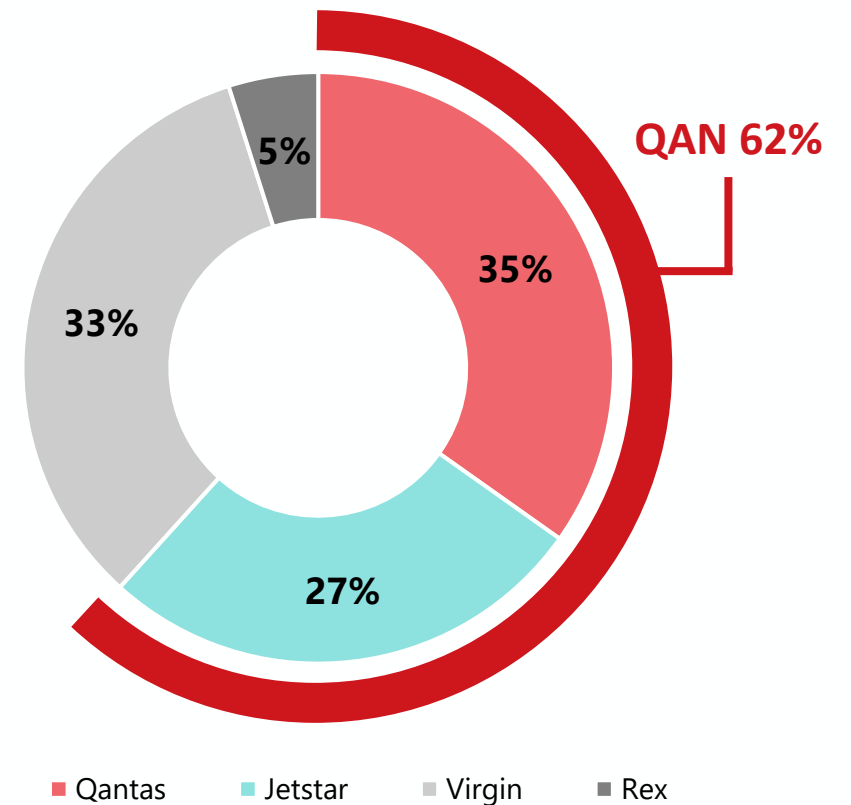
Travel demand continues to recover to pre-COVID levels...

...and QAN is well positioned to capture this demand

Australian Passenger Volumes (% of 2019)



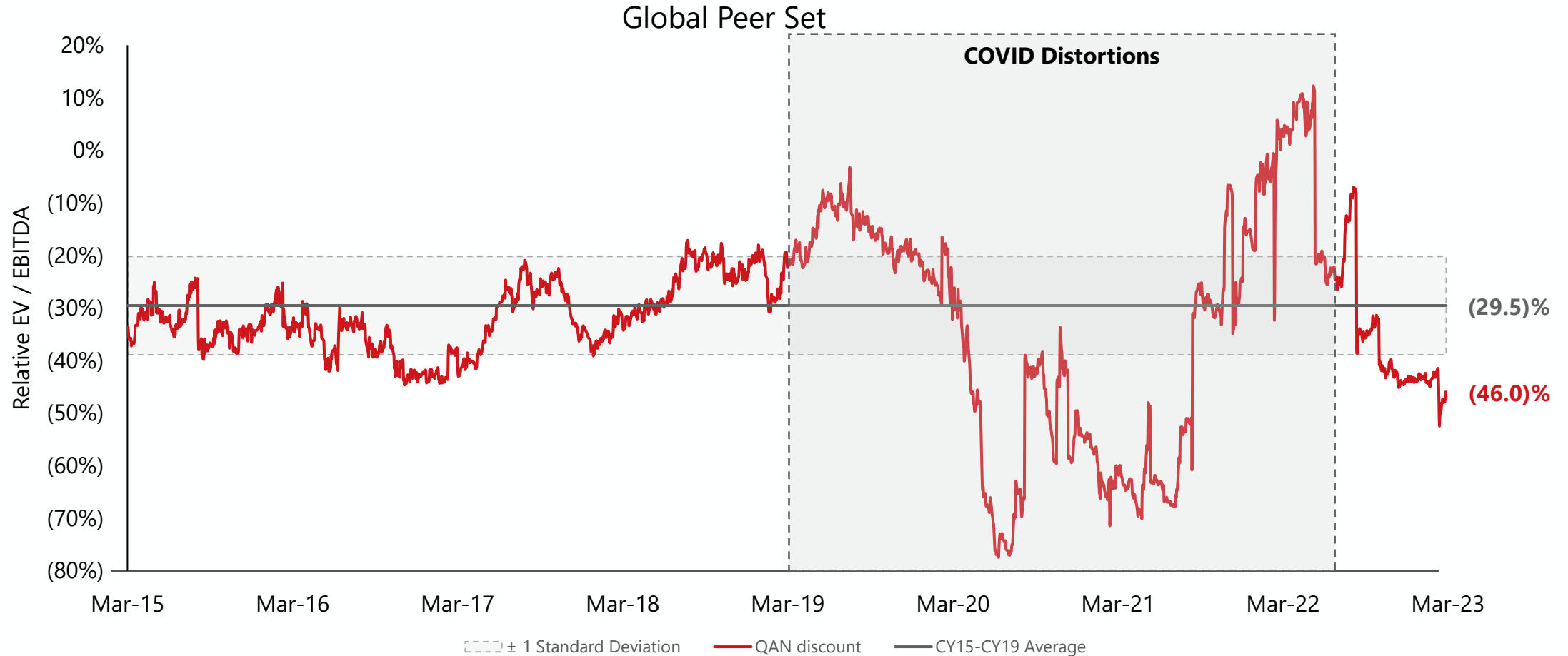
Australian Domestic Airline Market Share



Share price

Despite structural improvements, QAN still flies below peers

QAN's discount to global peers is 1.9 standard deviations below pre-COVID averages...



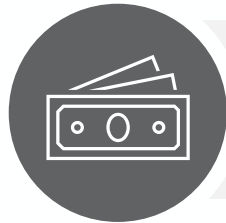
Executive summary

QAN is set to soar after experiencing turbulence

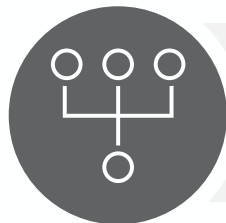
We issue a **BUY** recommendation, with a 12-month target price of **\$7.76**, a **18.3%** premium on the 1-month VWAP



QAN's domestic market advantage is underappreciated



Cost discipline and accretive CAPEX enhance profitability



Diversified portfolio reduces cash flow risk

BUY RECOMMENDATION



1. An underappreciated domestic market

Taking off globally: Virgin's IPO roadshow will drive awareness on the advantages of Australian aviation



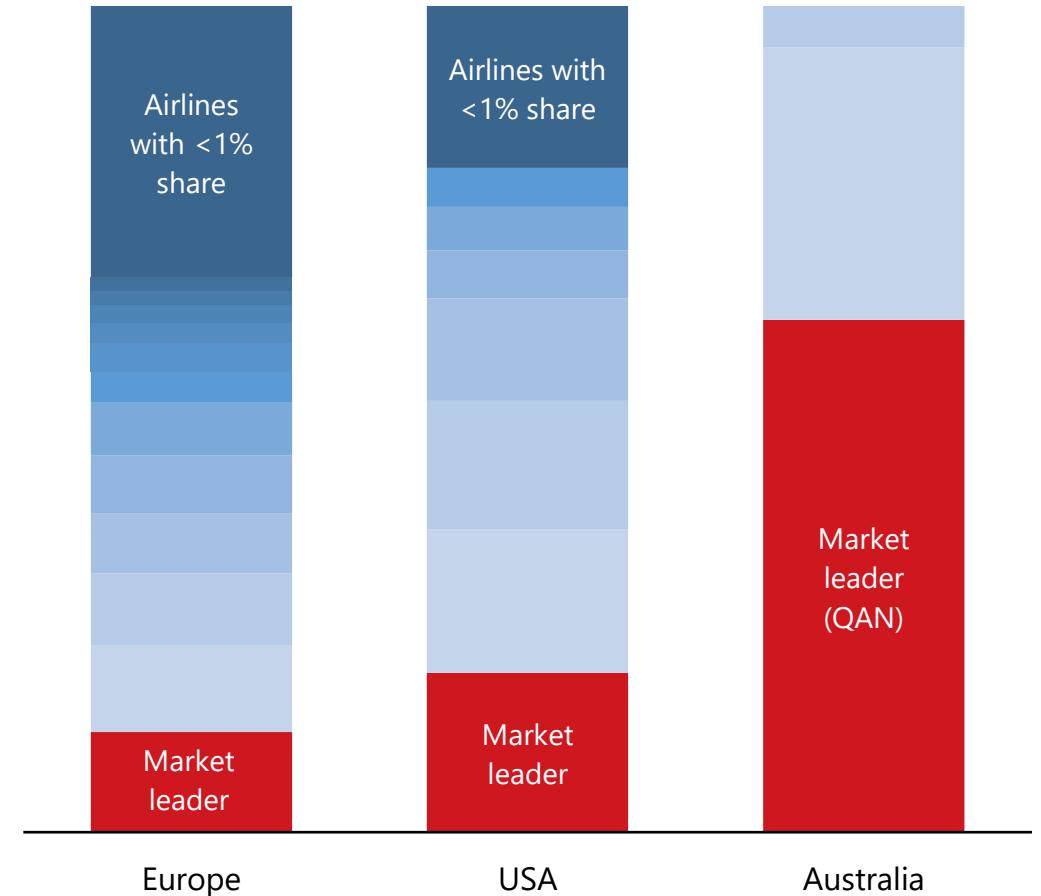
QAN's domestic market

Qantas' domestic market possesses structural advantages

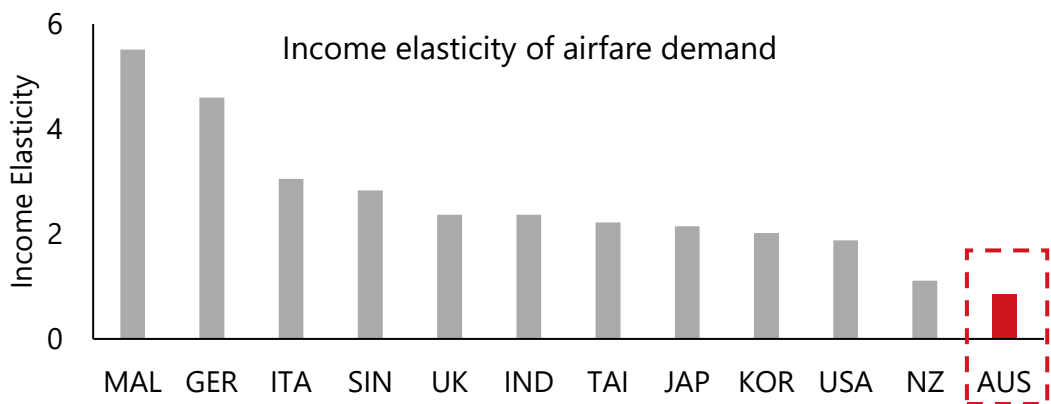
With a dispersed population and no substitute for air travel...

... with Qantas at the helm of a functional monopoly

City pair	Distance	High speed rail alternative
Melbourne - Sydney	900km	⊘
Brisbane - Sydney	900km	⊘
Brisbane - Melbourne	1,800km	⊘
Adelaide - Melbourne	730km	⊘
Melbourne - Perth	3,400km	⊘
Perth - Sydney	3,900km	⊘



... Australia's domestic aviation market is uniquely income inelastic...

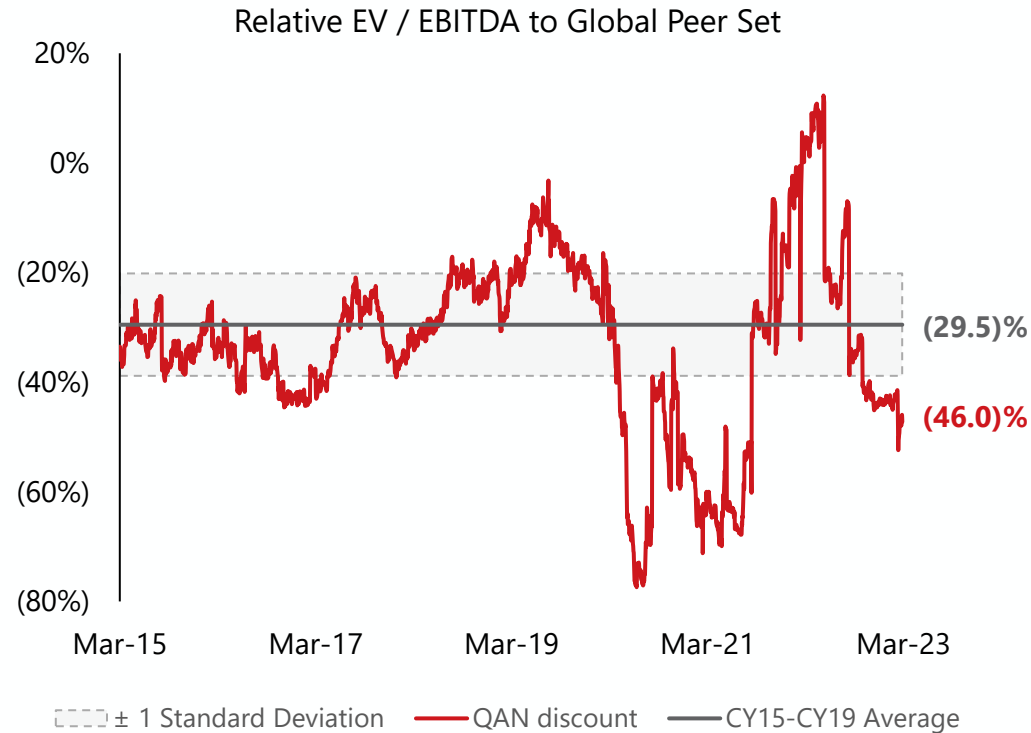


QAN's domestic market

Qantas' structural market advantages will be uncovered by Virgin's IPO roadshow

Despite structural advantages, QAN's discount to peers has widened

Virgin's international roadshow will educate investors...



1.9 standard deviations below historical global peer discount

FINANCIAL REVIEW
Virgin IPO pitch starts with ABCs of Australian aviation – Mar 22, 2023

... providing exposure to Qantas, the industry's market leader

4% 20-year Australian domestic aviation demand CAGR

Duopoly market structure with rationalized competition drives industry leading margins



2. Elevated post-COVID unit profitability

The sky's the limit: a renewed cost base and accretive CAPEX enhance earnings power

Higher post-COVID unit profitability

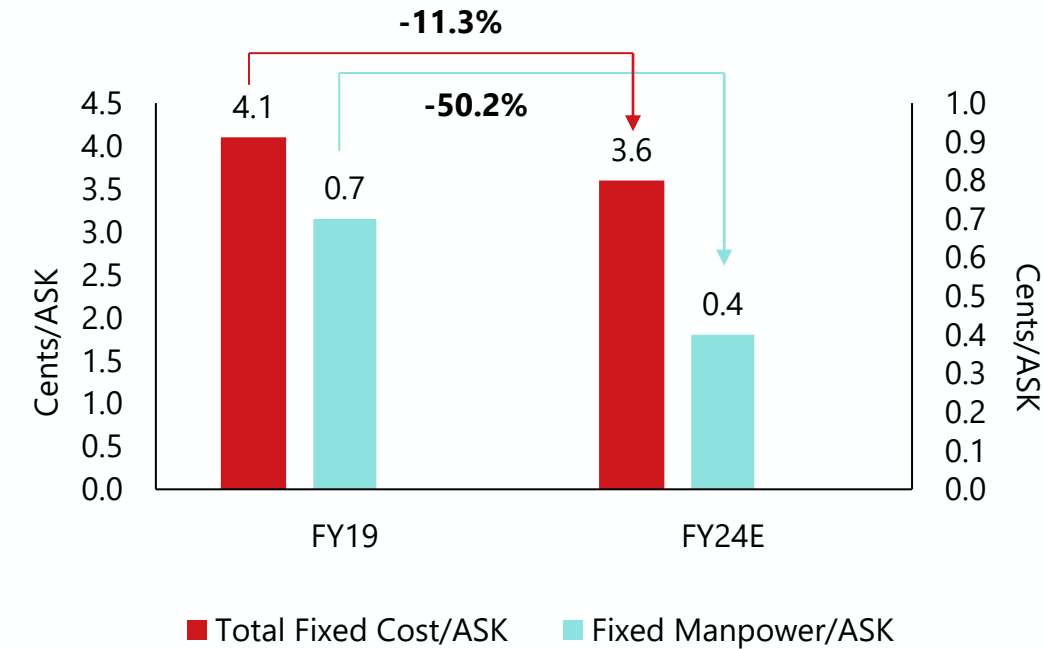
QAN has emerged a more agile, cost-efficient airline

In a disciplined market, QAN has flexibility to adjust capacity...

IPO

Virgin is unlikely to irrationally expand capacity

...supported by a materially reduced fixed cost base

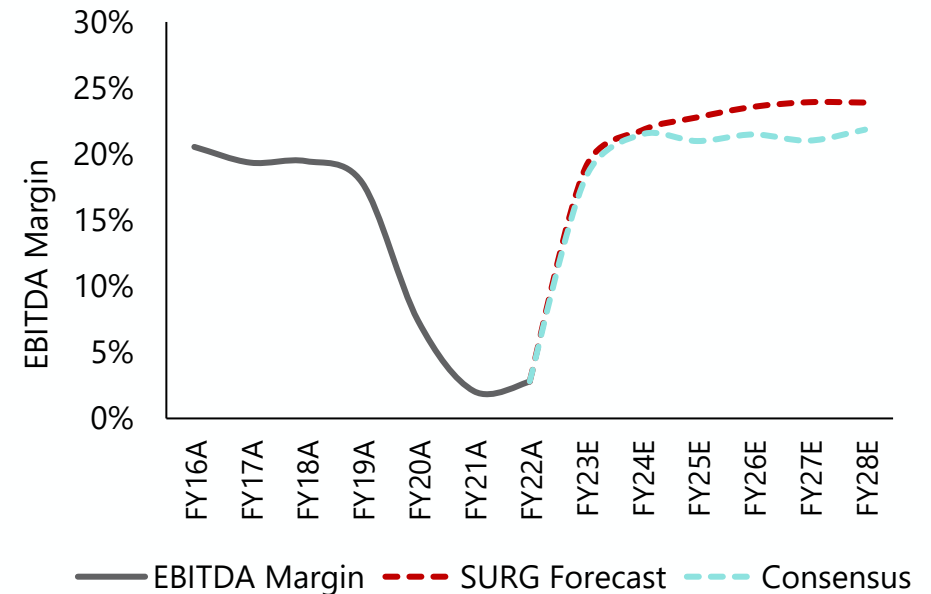


Recovery Plan and Transformation delivering cost savings

\$828m

Structural reduction in OPEX post-inflation

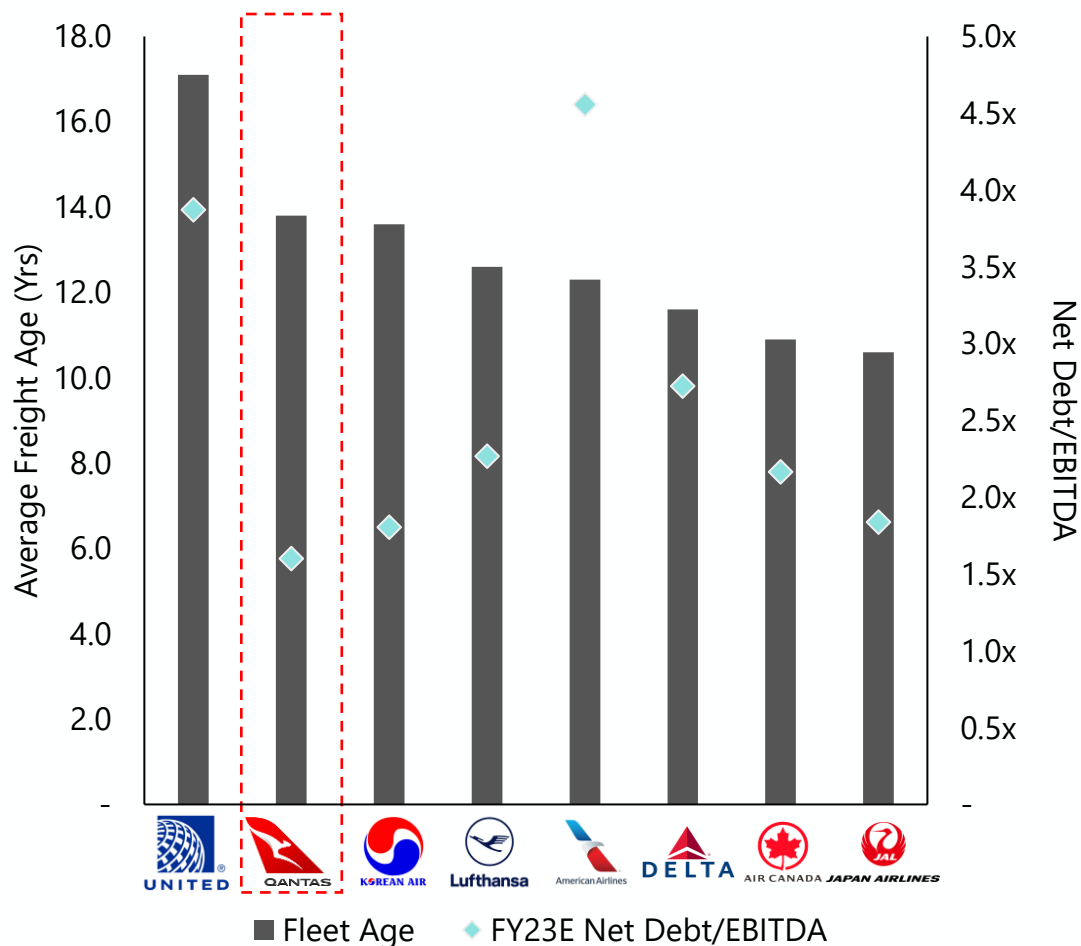
...with consensus underappreciating operating leverage



Higher post-COVID unit profitability

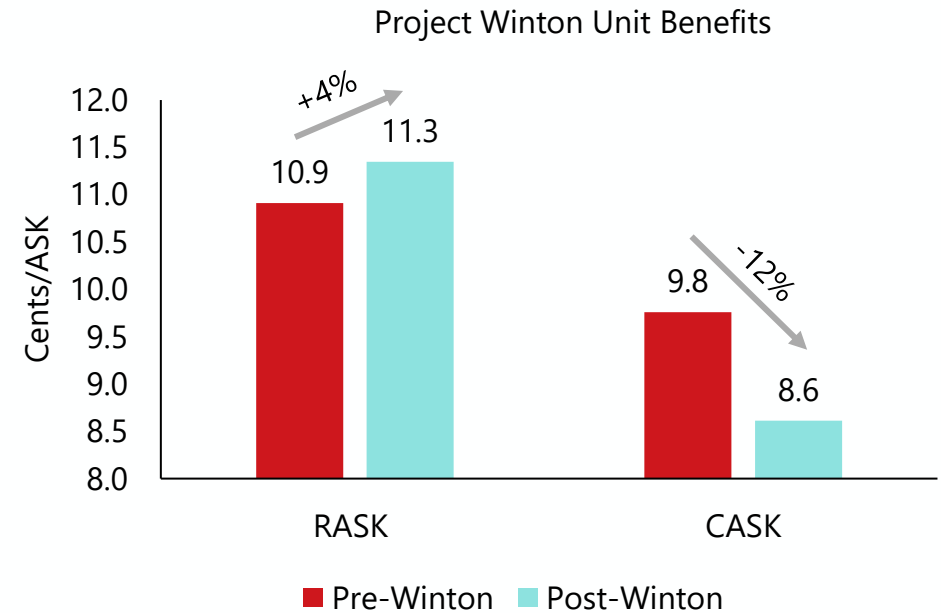
Domestic fleet project renewal Project Winton to bring medium-term margin uplift

QAN is better placed than peers to undertake fleet renewal...



...with the new Airbus narrowbodies to boost unit metrics

- 1 **RASK** benefits from maximising Sydney airport slot usage and route optionality
- 2 **CASK** benefits from higher capacity, aircraft utilisation, fuel efficiency



Source: Company filings, SURG Analysis



3. A diversified, resilient portfolio

QAN's portfolio flies under the radar: quality revenue diversification reduces cash flow risk



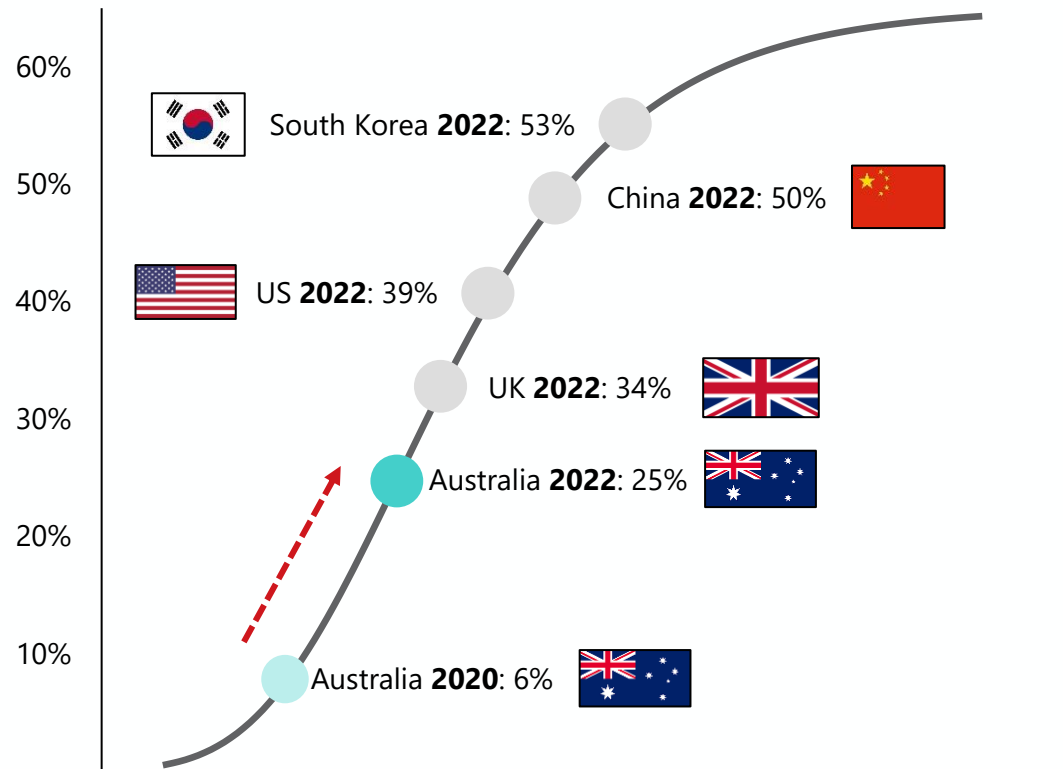
A diversified, resilient portfolio

Freight is an underestimated element of QAN's business

Australia to catch up in eCommerce uptake...

...where QAN will capture 3.9% more freight market share

Weekly Online Shopping Frequency Adoption Curve



Unique Value Drivers



\$1.4bn Australia Post contract



An Amazon fleet contract



A high-value chain across ANZ, SE Asia and USA



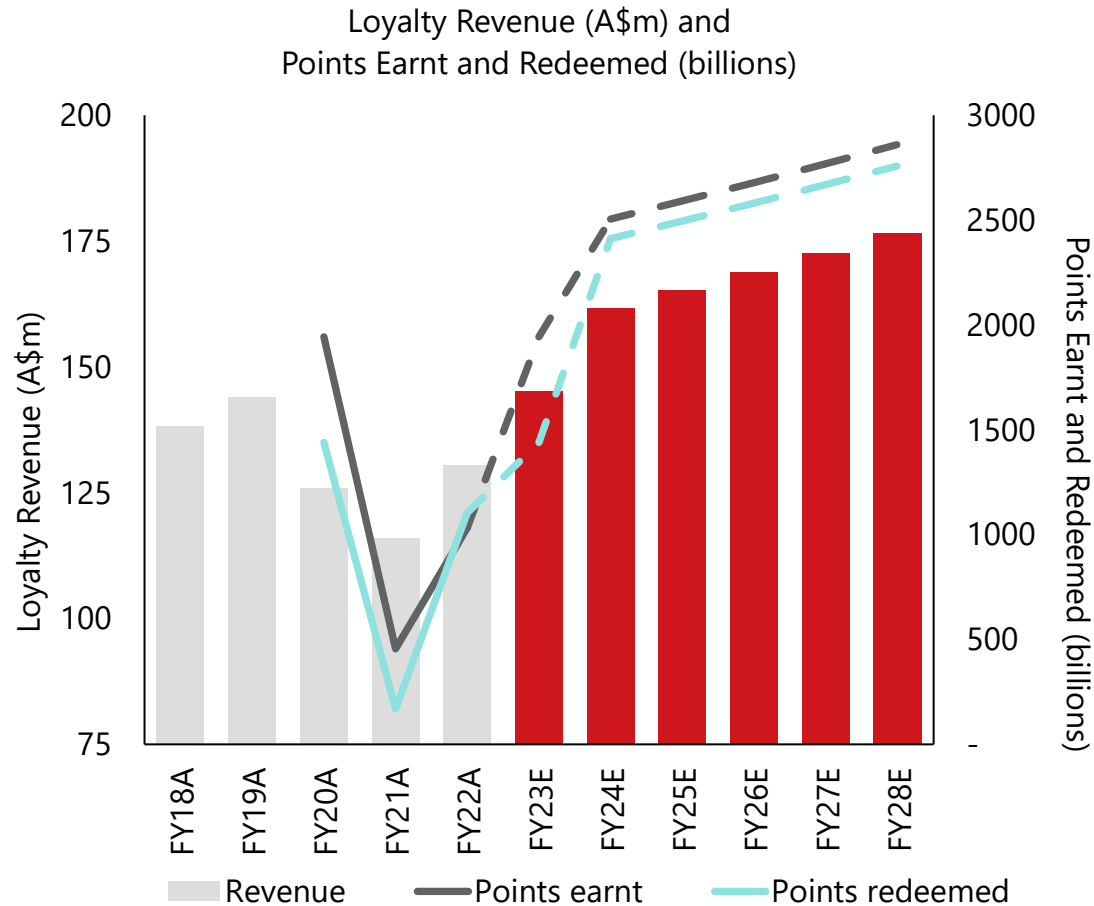
Air freight meeting consumers' next-day delivery mindset

A diversified, resilient portfolio

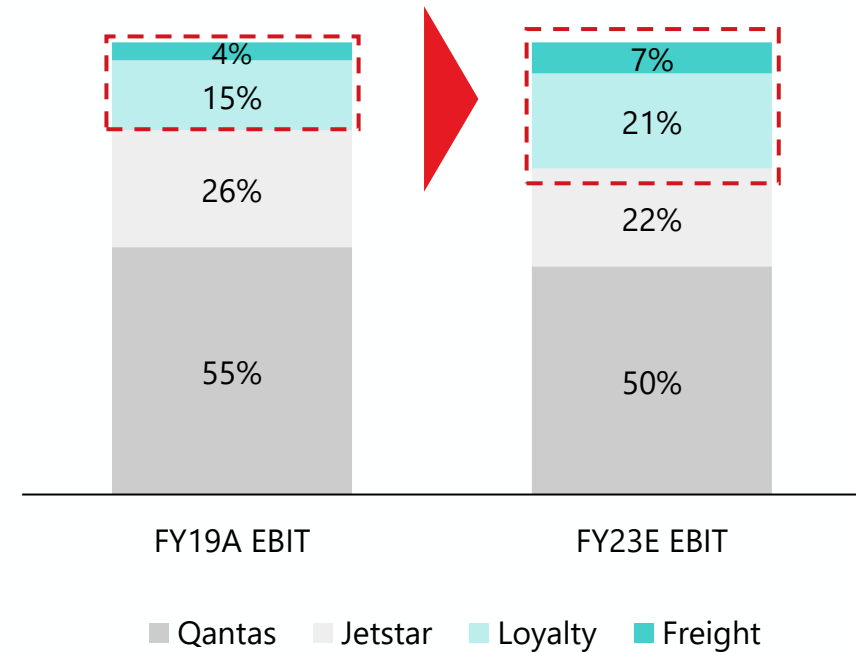
QAN's world-class customer Loyalty program helps to stabilise EBIT

A best-in-class Loyalty program....

...allows QAN to weather all storms



1.36 QAN beta sits below the pureplay airline average of 1.55





Environmental, Social & Governance

Improving shareholder confidence in QAN's brand beyond the balance sheet



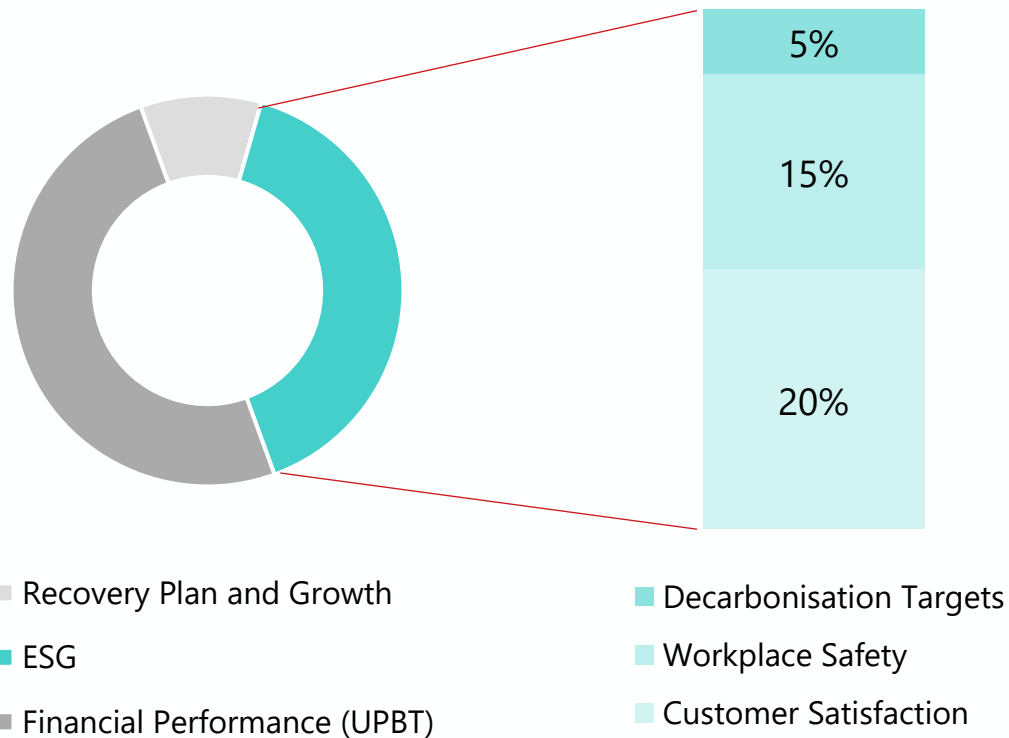
Environment, Social & Governance

QAN is becoming a mover and shaker with its growing green mindset

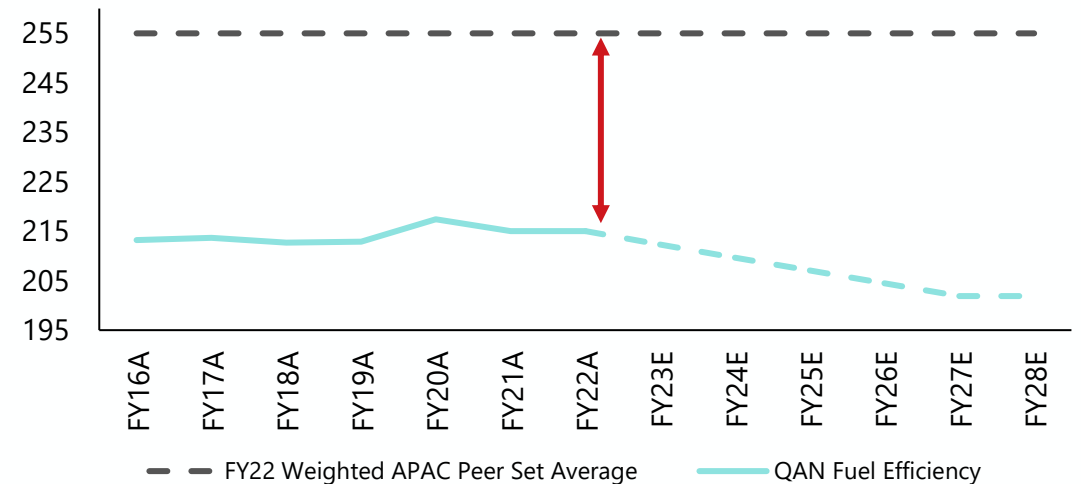
The only domestic airline linking remuneration with ESG targets...

... and leading the industry in Sustainable Aviation Fuel investments

FY22/23 Short Term Incentive Plan Scorecard
Category and Weighting



QAN Fuel Efficiency (bbl consumption per million ASKs)



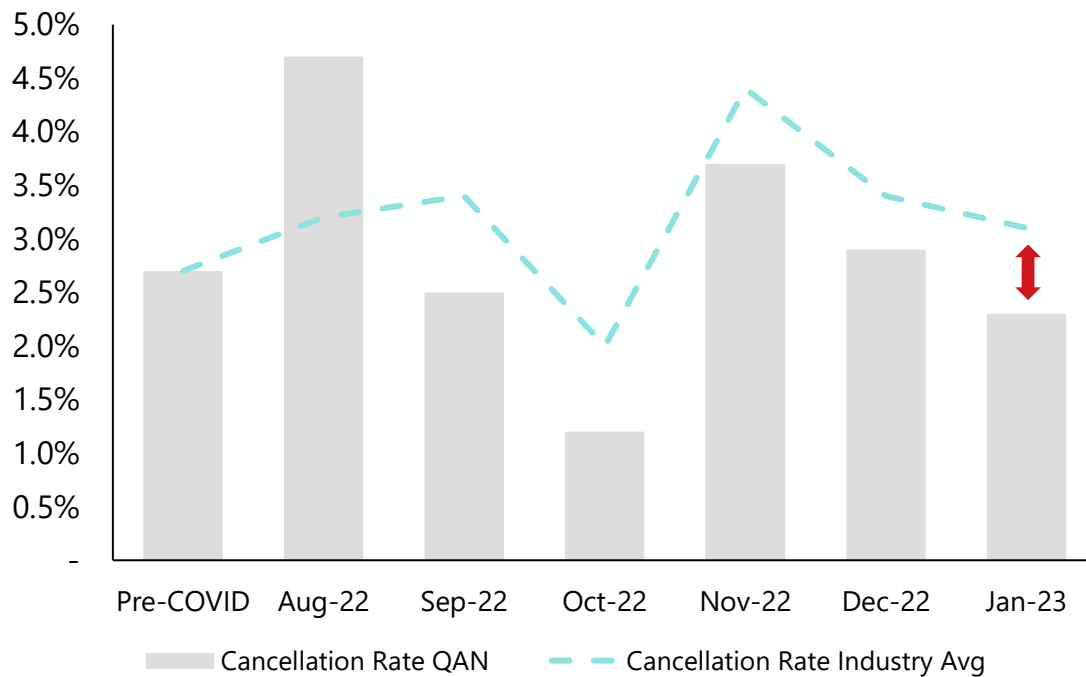
Environment, Social & Governance

QAN is rejuvenating its reputation as Australia's trusted and reliable airline

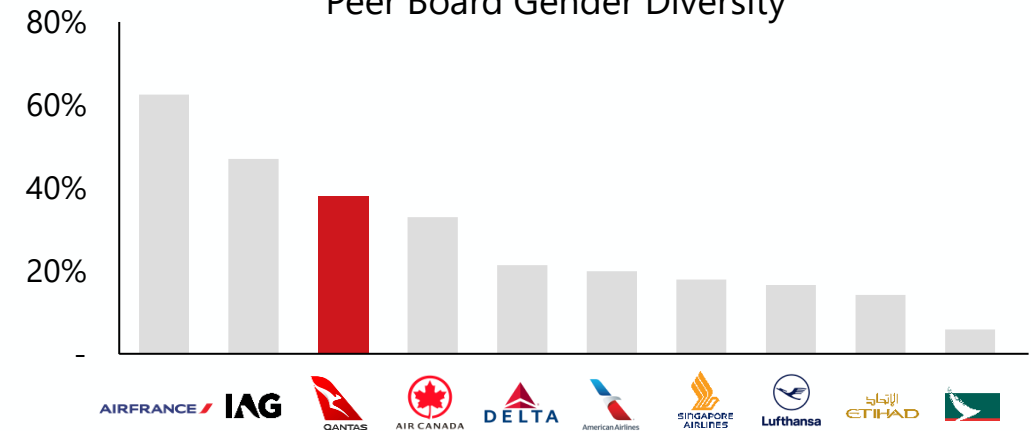
QAN's reputation has resumed having emerged from turbulence...

... supported by a diverse team

Cancellation Rates



Peer Board Gender Diversity



... and a strong governance pipeline

Forward planning for CEO Alan Joyce with ~15 year tenure

QAN's track-record of in-house promotions and guidance on 3 clear candidates for succession

81.7%

On-Time Performance will continue QAN's reputational ascent



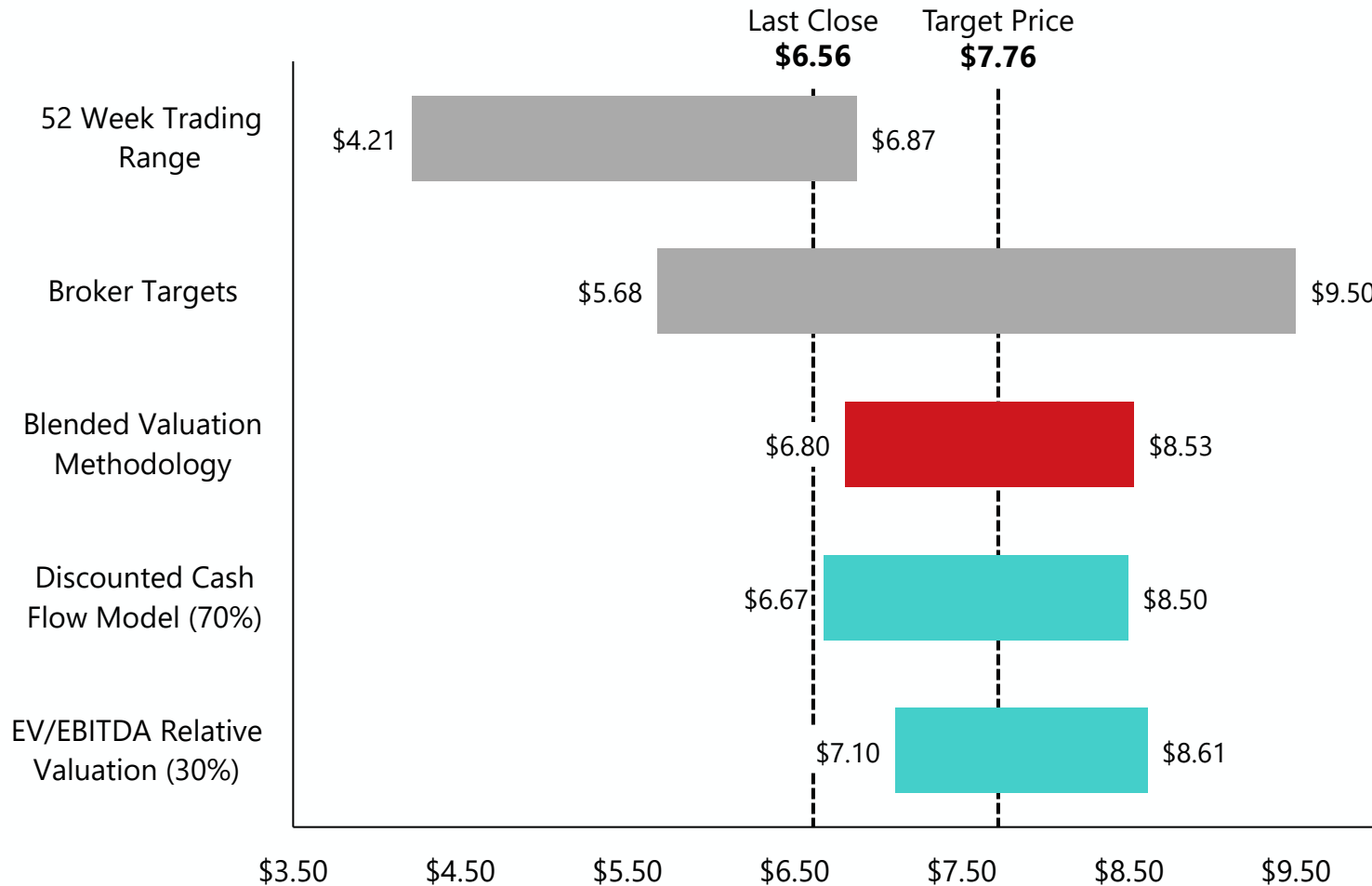
Valuation and investment risks

Soaring with a margin of safety

Valuation

We calculated a share price of \$7.76, a 18.3% premium to 1-month VWAP

We valued Qantas using a blended approach consisting of a discounted cash flow model (70%) and a relative valuation (30%)



Discounted Cash Flow Model Drivers

- **Flying:** Yields, ASKs, RPKs, Load Factor
- **Loyalty:** 2 year weighted points lifecycle
- WACC 9.6% (forecast); 9.1% (terminal); TGR 2.5%

Relative Valuation Drivers

- **Peers:** 3 geographic peer sets; APAC, EU, NA
- **Approach:** application of historical premiums/discount versus median approach

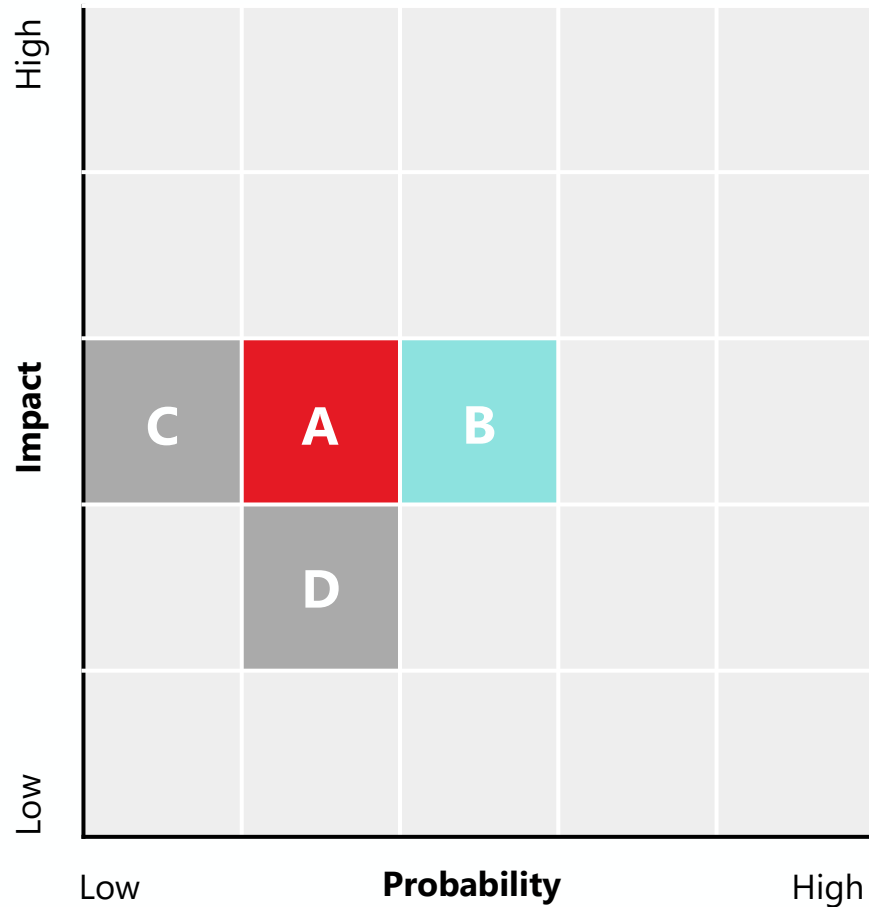
Bear Case Scenario

Yields	▼	-150bps
Load Factors	▼	-350bps
Points Earned	▼	-200bps
CASKs	▲	+150bps

Derives 7.2% downside to last close

Investment risks

We recognise two key downside risks to our BUY recommendation



- A
Jet Fuel Margin Risk: Persistently elevated jet fuel margins could reduce profitability
- B
Macro Risk: Turbulence of macroeconomic downturn subdues demand for air travel
- C
Competition Risk: Increased competitive intensity from domestic and international competitors affects yield performance
- D
Succession risk: CEO Alan Joyce 14+ year tenure vacating position, exposing risks within the successor pipeline

Summary

QAN has weathered the storm and is set to soar



QAN's domestic market advantage is underappreciated



Cost discipline and accretive CAPEX enhance profitability



Revenue diversification reduces QAN's cash flow risk



Target Price: **\$7.76**

18.3% Upside

1-Month VWAP

1. Main Deck

- [2. Business overview](#)
- [3. Industry and market overview](#)
- [4. Share price](#)
- [5. Executive summary](#)
- [6. Thesis 1 – An underappreciated domestic market](#)
- [7. QAN's domestic market](#)
- [8. QAN's domestic market II](#)
- [9. Thesis 2 – Elevated post-COVID unit profitability](#)
- [10. Higher post-COVID profitability](#)
- [11. Higher post-COVID profitability](#)
- [12. Thesis 3 – A diversified, resilient portfolio](#)
- [13. A diversified, resilient portfolio I](#)
- [14. A diversified, resilient portfolio II](#)
- [15. Environmental, Social & Governance](#)
- [16. Environmental, Social & Governance I](#)
- [17. Environmental, Social & Governance II](#)
- [18. Valuation and investment risks](#)
- [19. Valuation](#)
- [20. Investment risks](#)
- [21. Summary](#)

22. Appendix Network

23. Appendix A - Overview

- [24. A1 | What has the market missed?](#)
- [25. A2 | Catalysts](#)
- [26. A3 | Operating divisions overview](#)
- [27. A4 | Share price history](#)
- [28. A5 | Current trading data](#)
- [29. A6 | Asset ownership - Fleet](#)
- [30. A7 | Network map](#)
- [31. A8 | Market dynamics](#)
- [32. A9 | Australian spending habits](#)
- [33. A10 | Fuel price and FX](#)
- [34. A11 | QAN's hedging strategy](#)
- [35. A12 | Virgin](#)
- [36. A13 | Rex and Bonza](#)
- [37. A14 | Domestic and international competitors](#)
- [38. A15 | Alliance acquisition](#)
- [39. A16 | Western Sydney Airport](#)
- [40. A17 | Intercity rail network](#)

41. Appendix B – Thesis 1

- [42. B1 | Margin profile vs peers](#)
- [43. B2 | Effects of dominant market share \(1\)](#)
- [44. B3 | Effects of dominant market share \(2\)](#)
- [45. B4 | Historic Australian aviation entrants](#)
- [46. B5 | Other leading indicators of travel demand](#)
- [47. B6 | Load factor sensitivities](#)
- [48. B7 | QAN's demand environment](#)

49. Appendix C – Thesis 2

- [50. C1 | Capacity and Virgin IPO](#)
- [51. C2 | Cost savings breakdown](#)
- [52. C3 | Cost inflation and mitigation](#)
- [53. C4 | Past examples of successful transformation](#)
- [54. C5 | Project Winton and Project Sunrise summary](#)
- [55. C6 | Project Winton – Fuel CASK savings](#)
- [56. C7 | Project Winton – Capacity CASK savings](#)
- [57. C8 | Project Winton – Utilisation CASK savings](#)
- [58. C9 | Project Winton – Upgauging RASK benefits](#)
- [59. C10 | Project Winton – Optionality RASK benefits](#)
- [60. C11 | Project Winton – Aggregated benefits](#)
- [61. C12 | Qantas Fleet forecasts](#)

62. Appendix D – Thesis 3

- [63. D1 | Freight – changing consumer behaviour](#)
- [64. D2 | Sensitivities](#)
- [65. D3 | Fleet cargo capacity](#)
- [66. D4 | Loyalty earnings](#)
- [67. D5 | Loyalty partnership network](#)
- [68. D6 | Loyalty Flywheel](#)
- [69. D7 | Loyalty acquisitions summary](#)
- [70. D8 | Peer Loyalty programs](#)
- [71. D9 | Loan collateral case studies](#)
- [72. D10 | Loyalty divestment case studies](#)

73. Appendix E - ESG

- [74. E1 | ESG Scorecard](#)
- [75. E2 | Operational KPIs](#)
- [76. E3 | OTP vs peers](#)
- [77. E4 | Succession plan](#)
- [78. E5 | Executive incentive plans](#)
- [79. E6 | Emissions](#)
- [80. E7 | Diversity plan](#)

- [81. E8 | QAN ownership](#)
- [82. E9 | High Court Appeal](#)
- 83. Appendix F - Valuation**
- [84. F1 | Methodology weighting](#)
- [85. F2 | Revenue derivation](#)
- [86. F3 | Capacity analysis](#)
- [87. F4 | Capacity mix](#)
- [88. F5 | Domestic market share](#)
- [89. F6 | Yield analysis](#)
- [90. F7 | Load factor analysis](#)
- [91. F8 | Passenger revenue analysis](#)
- [92. F9 | Freight revenue analysis](#)
- [93. F10 | Loyalty economics](#)
- [94. F11 | Loyalty pro-forma revenue](#)
- [95. F12 | Eliminations and corporate adjustments](#)
- [96. F13 | Group revenue vs consensus](#)
- [97. F14 | Historical revenue and capacity summary](#)
- [98. F15 | Discounted Cash Flow model](#)
- [99. F16 | FCF to Firm forecasts](#)
- [100. F17 | Cost of debt](#)
- [101. F18 | Cost of equity](#)
- [102. F19 | WACC](#)
- [103. F20 | Monte Carlo Simulation DCF](#)
- [104. F21 | Terminal Growth Rate derivation](#)
- [105. F22 | Scenario analysis](#)
- [106. F23 | Terminal value sensitivity analysis](#)
- 107. Appendix G – Financial analysis**
- [108. G1 | Key ratios \(1\)](#)
- [109. G2 | Key ratios \(2\)](#)
- [110. G3 | Key ratios \(3\)](#)
- [111. G4 | Book equity abnormalities](#)
- [112. G5 | Profitability - RASK](#)
- [113. G6 | Profitability – OPEX CASKs](#)
- [114. G7 | Profitability – OPEX ratios](#)
- [115. G8 | Profitability – One off costs](#)
- [116. G9 | Profitability – Hedging policy \(I\)](#)
- [117. G10 | Profitability – Hedging policy \(II\)](#)
- [118. G11 | Profitability – Hedging Policy Limitations](#)
- [119. G12 | Profitability – Fuel expenses \(post hedging\)](#)
- [120. G13 | Profitability – Margin analysis](#)

- [121. G14 | Capital management - Financing](#)
- [122. G15 | Credit policy framework](#)
- [123. G16 | Pro forma credit ratios and leverage](#)
- [124. G17 | Dividends, payout and buyback](#)
- [125. G18 | Capital expenditure](#)
- [126. G19 | Treatment of lease liabilities post-AASB16](#)
- [127. G20 | Revenue received in advance \(RRIA\)](#)
- 128. Appendix H – Relative valuation**
- [129. H1 | Methodology](#)
- [130. H2 | Justification](#)
- [131. H3 | Comparable sets](#)
- [132. H4 | EV/EBITDA vs comparables](#)
- [133. H5 | P/E vs compables](#)
- 134. Appendix I - Risks**
- [135. I1 | Macroeconomic risk](#)
- [136. I2 | Fuel risk](#)
- [137. I3 | Employee disputes](#)
- [138. I4 | COVID-19 Risk](#)
- [139. I5 | Reputation decline](#)
- 140. Appendix J – Financial statements**
- [141. J1 – Income statement](#)
- [142. J2 – Statement of financial position](#)
- [143. J3 – Cash flow statements](#)
- [144. University of Sydney Team](#)
- 145. Appendix K – Recent developments**
- [146. K1 | COVID travel credits](#)
- [147. K2 | Intent to travel](#)
- [148. K3 | USYD survey details](#)
- [149. K4 | Macro resilience I](#)
- [150. K5 | Macro resilience II](#)
- [151. K6 | New entrant threats](#)
- [152. K7 | Free cash flow multiples](#)
- [153. K8 | Virgin IPO](#)
- [154. K9 | CEO succession planning](#)
- [155. K10 | QAN employment relations](#)
- [156. K11 | QAN safety concerns](#)
- [157. K12 | Institutional hesitance towards airline exp.](#)
- [158. K13 | Qantas EV/EBITDA](#)
- [159. K14 | Group Emissions Pathway](#)
- [160. K15 | ESG Regulatory risks](#)