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
QAN is Australia’s travel provider of choice

The only Australian airlines with extensive international flights...

...renowned for its safety and quality

Jet airliner fatalities and hull losses

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

Source: ACCC, BITRE, SURG analysis
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
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...

<table>
<thead>
<tr>
<th>City pair</th>
<th>Distance</th>
<th>High speed rail alternative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Melbourne - Sydney</td>
<td>900km</td>
<td>☒</td>
</tr>
<tr>
<td>Brisbane - Sydney</td>
<td>900km</td>
<td>☒</td>
</tr>
<tr>
<td>Brisbane - Melbourne</td>
<td>1,800km</td>
<td>☒</td>
</tr>
<tr>
<td>Adelaide - Melbourne</td>
<td>730km</td>
<td>☒</td>
</tr>
<tr>
<td>Melbourne – Perth</td>
<td>3,400km</td>
<td>☒</td>
</tr>
<tr>
<td>Perth – Sydney</td>
<td>3,900km</td>
<td>☒</td>
</tr>
</tbody>
</table>

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

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

Income elasticity of airfare demand

Source: SURG Analysis, BTS, Qantas, Australian Financial Review
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...

**Relative EV / EBITDA to Global Peer Set**

- **QAN discount**
- **CY15-CY19 Average**

Source: Eurostat, BTS, BITRE, SURG analysis as at 12-Mar-23

1.9 standard deviations below historical global peer discount
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....

Virgin is unlikely to irrationally expand capacity

Recovery Plan and Transformation delivering cost savings

$828m

Structural reduction in OPEX post-inflation

...supported by a materially reduced fixed cost base

...with consensus underappreciating operating leverage

Virgin is unlikely to irrationally expand capacity

Source: Company filings, ACCC, SURG Analysis
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

- 10%
- 20%
- 30%
- 40%
- 50%
- 60%

South Korea 2022: 53%
China 2022: 50%
US 2022: 39%
UK 2022: 34%
Australia 2022: 25%
Australia 2020: 6%

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

Source: AusPost, IBISWorld, QAN Company Filings
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

QAN beta sits below the pureplay airline average of 1.55

Source: QAN Company Filings, SURG Analysis
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

- Recovery Plan and Growth: 5%
- ESG: 15%
- Financial Performance (UPBT): 20%

FY22 R&D investment to establish Australia’s own SAF industry

A$50 million

Market-first USD co-investment partnership with Airbus

US$200 million

QAN Fuel Efficiency (bbl consumption per million ASKs)

Source: QAN Company Filings, SURG Analysis
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

... and a strong governance pipeline

On-Time Performance will continue QAN’s reputational ascent

40% 60% 80%

Peer Board Gender Diversity

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%

Source: BITRE, Company filings, SURG Analysis
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

Source: SURG Analysis
We recognise two key downside risks to our BUY recommendation:

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

**Source**: SURG Analysis
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

BUY

Target Price: $7.76
18.3% Upside
1-Month VWAP
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