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Senate Standing Committees on Rural and Regional Affairs and Transport
PO Box 6100
Parliament House
Canberra ACT 2600
Australia.

Dear Senators

With my colleagues at UTS I have followed the fortunes of Qantas for many years, and this has formed the core of a teaching case that underpins a capstone subject I have taught for many years. This is more than just an academic analysis and it has the objective of highlighting the application of knowledge gained in degree programs in real world scenarios. The analysis is also guided by our experiences in the professional services and financial services industry, and our in depth knowledge to the travel and tourism industry through business interests.

I will keep my comments succinct, identifying the fundamental problem faced by Qantas and the timeframe for resolution.

Fundamental problem

1. The fundamental problem for Qantas is labour cost and productivity. Labour expense as a percentage of revenues was 24.1% in 2013, and there has been little sustained change since Qantas was privatised twenty years ago. Benchmarked against Singapore Airlines, it is notable that average staff expense per employee is 20% lower and that labour productivity measured as staff per available seat kilometres is 30% higher at Singapore Airlines. If Qantas shed 10,000 staff (30%) this would likely result in results broadly consistent with Singapore Airlines. That is, staff expenses being about 16% of revenues as is the case at Singapore Airlines and this will require action by Qantas management, unions and staff who are all culpable.
2. Whenever the issue of labour cost and productivity is mentioned, safety is always raised as an issue. This is really just a distraction and if this was really a problem of the magnitude suggested aircraft would be falling out of the sky all the time. It simply doesn't happen.
3. Qantas has in part been able to mask its higher costs by having a high domestic market share and relying on economies of scale to offset these higher costs. This is likely why Qantas has become a slave to maintaining 65% domestic market share, but this is likely unsustainable due to the rate of losses.
4. It should also be noted that the significant recent (2009) decline in Qantas profitability coincided not just with the GFC but more critically with the significant increase in competition across the Pacific to the USA (i.e., Virgin Australia and Delta). This saw a dramatic decline in airfares to the USA, which had also been masking Qantas' high cost structure.

5. The predicament Qantas faces was common across so called legacy carriers, most of which have failed or been significantly restructured. The origins of this problem trace back to a period when airlines were highly regulated and markets were much less competitive with this leading to the development of poor administrative and labour practices. Again this is the responsibility of management, unions and staff.
6. It is probably better to express the national interest as being to have a competitive viable aviation industry. This would ensure the retention of jobs and skills in Australia on a sustainable long term basis. This may or may not be Qantas and it should be noted that there other Australian airlines, and others may be established.
7. Providing a debt guarantee or purchasing an equity stake in Qantas would not address this fundamental problem. Unless this is addressed then Qantas will require ongoing material government support.
8. Unless this fundamental problem is addressed, or there is reliable evidence that it is able to be addressed, Qantas will not be attractive to an overseas equity investor.
9. Regulating higher airfares is not considered a viable option as this would be problematic to implement internationally, and domestically would severely disadvantage regional areas and domestic tourism. It should be noted that when domestic airfares were still regulated in the late 1980's the price of a same day return trip from Sydney to Melbourne was over $600 (in actual $ not in adjusted 2014$). Fares of this magnitude in 2014$ would be catastrophic for regional areas and domestic tourism.
10. Singapore Airlines and Air New Zealand are public listed companies. While there are significant government shareholdings in both there is no obvious subsidy and they are both profitable. It is not obvious how they are advantaged relative to Qantas. Emirates is owned by the Dubai Investment Corp and detailed financial information is not available. However, when considered relative to other carriers there is no evidence of heavily discounted or dumped airfares.
11. In summary, the solution is in the hands of Qantas management and staff.

Timeframe

12. Qantas experienced a net free cash outflow of $358m in the half year ended 31 December 2013. Annualised this corresponds to $716m per annum and at this rate cash reserves would be exhausted in under 3 years. Qantas has announced strategies to reduce expenses which would extend this, but offsetting this is the forecast requirement for new aircraft which is greater than acquisitions in the current period and which if not financed through operating cash flows would need to be financed through debt or equity issues. Given the current state of profitability, which is reflected in the Qantas credit rating, this is problematic.
13. A potential issue for Qantas at the end of each reporting period is the recognition of asset impairments which are required by a financial reporting regulation AASB 136 Impairment of Assets. As long as Qantas has a book value of $5.6b but market capitalisation of only $2.3b it will be required to undertake impairment testing and a material impairment would significantly accelerate the time frame required for resolution due to its likely impact on debt contracts.
14. Action is necessary sooner rather than later.

Recommendations

15. Remove regulatory impediments such as the Qantas Sale Act to the restructuring of Qantas to ensure that an economically viable business is able to emerge.
16. Review regulation which potentially slows or inhibits the establishment of new airlines, particularly in regional areas.

Yours Faithfully

Peter Wells