



## ASX and Media Release

### **QANTAS GROUP FINANCIAL RESULTS<sup>1</sup>**

#### **Summary**

- 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

**SYDNEY, 28 August 2014:** 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.

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<sup>1</sup> Refer to the Review of Operations for definition and explanation of non-statutory measures including Underlying PBT, Underlying EBIT, yield, passenger loads, net free cash flow, capital investment, average fleet age, comparable unit cost and controllable unit cost. Unless otherwise stated, amounts are reported on an underlying basis. Refer to the Investor Presentation for a reconciliation.

“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 million Qantas 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.

**Issued by Qantas Corporate Communication**

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## ATTACHMENT 1

### EXPLANATION OF RESULTS

The Qantas Group reported an Underlying PBT<sup>1</sup> loss of \$646 million for the financial year ended 30 June 2014. The result reflects the very difficult operating environment the Group has faced, with challenges including:

- Weak underlying demand growth in Australia, with consumer spending and business confidence remaining subdued
- \$566 million of yield and load factor decline from market capacity growth running ahead of demand
- \$253 million higher fuel expense, driven by the weaker Australian dollar

The Qantas Group took decisive action to address these challenges, commencing the accelerated Qantas Transformation program on 1 January 2014. This program is targeting the delivery \$2 billion<sup>2</sup> of benefits by the end of financial year 2016/2017. The program delivered \$204 million of benefits in the second half of the year, building on the benefits derived from previous Qantas Transformation and fuel burn initiatives. Combined, all these measures delivered \$440 million of cost reduction in the period.

All accelerated Qantas Transformation milestones were met in the second half, with strong momentum heading into 2014/2015. Transformation is at the centre of the Group's strategy to drive an earnings recovery, strengthen the balance sheet and build long-term shareholder value. Other key pillars of that strategy include:

- Group capacity and network response to shifting demand and competitive environment
- Targeted investment in the customer to maintain brand and yield premium
- Reduced capital investment to maximise free cash flow for debt reduction

A comprehensive Group structural review was announced in December 2013, and has now been completed. The outcomes from the review are both structural and strategic for the future direction of the Qantas Group:

- Non-core assets identified and valued, including terminals, land and property holdings. The Group will continue to assess opportunities to sell, with proceeds to repay debt.
- Detailed assessment of potential for Qantas Loyalty minority sale undertaken. After careful consideration, the decision has been made that Loyalty continues to offer major profitable growth opportunities and there was no justification for a partial sale.
- No new Jetstar ventures to be established while Group focused on Transformation. Substantial value exists across Jetstar Group Airlines, to be realised over time.
- Following partial repeal of *Qantas Sale Act* foreign ownership limits, the decision has been made to establish a new holding structure and corporate entity for Qantas International to increase the potential for future external investment, and creates long-term options for Qantas International to participate in partnership and consolidation opportunities. This change to the Group's organisational structure resulted in the write-down of the Qantas International fleet.

The Qantas Group's Statutory Loss After Tax was \$2,843 million for the financial year ended 30 June 2014. The Statutory result includes the impact of fleet restructuring costs of \$394 million and redundancies, restructuring and other transformation costs associated with the accelerated Transformation program of \$428 million. In addition, triggered by the Board decision relating to Qantas International on conclusion of the Structural Review, a non-cash impairment of the Qantas International fleet of \$2,560 million has been recognised. The Group's underlying financial position is strong and improving with cash of \$3,001 million, liquidity of \$3,631 million, net debt<sup>4</sup> reduction of \$96 million and neutral free cash flow achieved alongside significant investment in fleet and product.

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<sup>1</sup> Underlying Profit Before Tax (PBT) is the primary reporting measure used by the Qantas Group's chief operating decision-making bodies, being the Chief Executive Officer, Group Management Committee and the Board of Directors, for the purpose of assessing the performance of the Group. The primary reporting measure of the Qantas International, Qantas Domestic, Jetstar Group, Qantas Loyalty and Qantas Freight operating segments is Underlying Earnings Before Net Finance Costs and Tax (EBIT) as net finance costs are managed centrally. The primary reporting measure of the Corporate/Unallocated segment is Underlying PBT. Refer to Note 2 of the Preliminary Final Report for a reconciliation of Underlying PBT to Statutory (Loss)/Profit Before Tax.

<sup>2</sup> Excluding the impact of inflation.

## EXPLANATION OF RESULTS (continued)

The Board's decision on 28 August 2014 changes the organisational structure of the Group. As a result, for the purpose of assessing the carrying value of the Group's assets, each of the Segments will now be required to be tested for impairment on a stand-alone basis. There are significant surpluses in the Qantas Domestic, Qantas Freight, Qantas Loyalty and Jetstar Group Cash Generating Units (CGUs), but an impairment of \$2,560 million arose in the newly created Qantas International CGU.

Performance highlights in the year include:

- Record<sup>3</sup> result for Qantas Loyalty, and fifth consecutive year of double-digit EBIT growth
- Both Qantas and Jetstar domestic businesses profitable in intensely competitive market
- Qantas Domestic outperformed major competitor in on-time performance for fifth consecutive year
- Record customer satisfaction and advocacy levels reached at Qantas Domestic, Qantas International, Qantas Loyalty and Jetstar

The challenging operating environment precipitated the loss of the Group's investment grade credit rating. Despite this, the Qantas Group continues to display strong financial discipline. Financial highlights in the year included:

- Delivery of neutral free cash flow in the context of significant earnings pressure and significant investment in the Qantas Transformation program
- \$3 billion cash held at year end
- Reduction in net debt<sup>4</sup> of \$96 million
- Significantly extending unsecured debt maturity profile through \$700 million of landmark bond issuances
- Prudent capital investment<sup>5</sup> of \$874 million

## Underlying PBT

The Qantas Group full-year Underlying PBT decreased to a loss of \$646 million, compared to Underlying PBT of \$186 million in financial year 2012/2013. The deterioration in earnings was driven by a decline in revenue, with both yield and passenger loads lower due to capacity growth running ahead of demand in domestic and international markets. A three per cent improvement in comparable unit cost<sup>6</sup> related to benefits being realised from the \$2 billion<sup>2</sup> accelerated Qantas Transformation program, though was offset by the \$253 million increase in fuel cost to the prior year.

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<sup>3</sup> Qantas Loyalty record Underlying EBIT result compared to prior periods normalised for changes in accounting estimates of the fair value of points and breakage expectations effective 1 January 2009.

<sup>4</sup> Net debt including operating lease liabilities includes net on balance sheet debt and off balance sheet aircraft operating lease liabilities. Operating lease liability is the present value of minimum lease payments for aircraft operating leases which, in accordance with AASB 117: Leases, is not recognised on balance sheet. The operating lease liability has been calculated as the present value of future non-cancellable operating lease rentals of aircraft in service, using a discount rate of seven per cent applied in Standard and Poor's methodology.

<sup>5</sup> Capital investment is net cash from investing activities, net of changes in operating lease liability and including non-cash investing activities. Operating lease liability is the present value of minimum lease payments for aircraft operating leases which, in accordance with AASB 117: Leases, is not recognised on balance sheet.

<sup>6</sup> Unit cost is adjusted to aid comparability between reporting periods. Comparable unit cost is calculated as Underlying PBT less passenger revenue and fuel, adjusted for the impact of Boeing settlement and change in estimate of passenger revenue received in advance (2012/2013), changes in foreign exchange rates. Share of net loss of investments accounted for under the equity method and movements in average sector length per ASK. Comparable unit cost is the primary measure of unit cost used by the Qantas Group to aid comparability between reporting periods.



## EXPLANATION OF RESULTS (continued)

| Group Underlying Income Statement Summary                                       |            | June 2014       | June 2013<br>Restated <sup>7</sup> | Change       | %<br>Change      |
|---|------------|-----------------|------------------------------------|--------------|------------------|
| Net passenger revenue <sup>8</sup>  | \$M        | 13,242          | 13,673                             | (431)        | (3)              |
| Net freight revenue   | \$M        | 955             | 935                                | 20           | 2                |
| Other revenue <sup>8</sup>  | \$M        | 1,155           | 1,294                              | (139)        | (11)             |
| <b>Revenue</b>  | <b>\$M</b> | <b>15,352</b>   | <b>15,902</b>                      | <b>(550)</b> | <b>(3)</b>       |
| Operating expenses (excluding fuel) <sup>9</sup>                                | \$M        | (9,288)         | (9,279)                            | (9)          | –                |
| Share of net (loss)/profit of investments accounted for under the equity method | \$M        | (66)            | (39)                               | (27)         | (69)             |
| Fuel <sup>9</sup>   | \$M        | (4,496)         | (4,243)                            | (253)        | (6)              |
| Depreciation and amortisation   | \$M        | (1,422)         | (1,450)                            | 28           | 2                |
| Non-cancellable aircraft operating lease rentals                                | \$M        | (520)           | (525)                              | 5            | 1                |
| <b>Expenses</b>   | <b>\$M</b> | <b>(15,792)</b> | <b>(15,536)</b>                    | <b>(256)</b> | <b>(2)</b>       |
| <b>Underlying EBIT</b>  | <b>\$M</b> | <b>(440)</b>    | <b>366</b>                         | <b>(806)</b> | <b>&gt;(100)</b> |
| Net finance costs <sup>9</sup>  | \$M        | (206)           | (180)                              | (26)         | (14)             |
| <b>Underlying PBT</b>   | <b>\$M</b> | <b>(646)</b>    | <b>186</b>                         | <b>(832)</b> | <b>&gt;(100)</b> |

  

| Operating Statistics                             |       | June 2014 | June 2013<br>Restated <sup>7</sup> | Change    | Change<br>% |
|--|-------|-----------|------------------------------------|-----------|-------------|
| Available Seat Kilometres (ASK) <sup>10</sup>    | M     | 141,715   | 139,909                            | 1,806     | 1.3         |
| Revenue Passenger Kilometres (RPK) <sup>11</sup> | M     | 109,659   | 110,905                            | (1,246)   | (1.1)       |
| Passengers Carried                               | '000  | 48,776    | 48,276                             | 500       | 1.0         |
| Revenue Seat Factor <sup>12</sup>                | %     | 77.4      | 79.3                               | (1.9) pts |             |
| Yield (excluding FX) <sup>13</sup>               | c/RPK | 10.02     | 10.29                              | (0.27)    | (3)         |
| Comparable unit cost <sup>6</sup>                | c/ASK | 5.00      | 5.15                               | 0.15      | 3           |

Revenue fell three per cent, driven by a three per cent decline in net passenger revenue and an 11 per cent fall in other revenue. The decline in passenger revenue was the result of aggressive international competitor capacity growth into Australia<sup>14</sup>, with an increase of 9.5 per cent in the year and growth above eight per cent for each of the last four years. Foreign airlines have continued to grow capacity into Australia in recent years, attracted by the country's relative economic strength and the high Australian dollar, though that pace of growth has slowed into financial year 2014/2015. In the Australian domestic market, capacity growth slowed in the second half of the year, though has still grown ahead of demand for a second consecutive year. Demand has been impacted by the resource sector slowdown, cautious business environment, and most recently by subdued consumer spending.

Net freight revenue increased with the acquisition and consolidation of Australian air Express. This was offset by lower Qantas Freight capacity as a result of Qantas International network reductions.

<sup>7</sup> The 2012/2013 Group Underlying Income Statement has been restated as a result of the application of new or revised accounting standards. Refer to Note 10 of the Preliminary Final Report.

<sup>8</sup> Net passenger revenue has been adjusted in 2013/2014 to include charter revenue previously reported as Other revenue. 2012/2013 Net passenger revenue and Other revenue has been reclassified accordingly. These items remain excluded from the calculation of yield.

<sup>9</sup> Underlying operating expenses (excluding fuel and Share of net loss of investments accounted for under the equity method), fuel and net finance costs differ from equivalent statutory expenses due to items excluded from Underlying PBT, such as adjustments for impacts of AASB 139 which relate to other reporting periods and other items identified by Management. Refer to Note 2 of the Preliminary Final Report for a reconciliation of Underlying PBT to Statutory (Loss)/Profit Before Tax.

<sup>10</sup> ASK – total number of seats available for passengers, multiplied by the number of kilometres flown.

<sup>11</sup> RPK – total number of passengers carried, multiplied by the number of kilometres flown.

<sup>12</sup> Revenue Seat Factor – RPKs divided by ASKs. Also known as seat factor, load factor or load.

<sup>13</sup> Yield (excluding FX) – Passenger revenue excluding foreign exchange, divided by RPKs.

<sup>14</sup> BITRE data, Qantas modelled for June 2014.

## EXPLANATION OF RESULTS (continued)

Other revenue declined by 11 per cent, reflecting reduced third party contract revenue following the sale of catering centres in the 2012/2013 financial year and the sale of Qantas Defence Services. Other revenue in the prior year included the one-off Boeing settlement<sup>15</sup> of \$125 million in the first half.

Qantas Loyalty reached the milestone of 10 million members<sup>16</sup>, and continued to grow revenue through new and existing commercial partners to achieve another record result.

Group comparable unit cost<sup>6</sup> improved three per cent compared to the prior year, reflecting the early delivery of benefits from the accelerated Qantas Transformation program.

Fuel costs increased by six per cent. The increase was driven by an 11 per cent devaluation of the average Australian dollar over the period, mitigated by the Group's hedging program and a three per cent improvement in fuel efficiency<sup>17</sup> from fleet modernisation, cabin reconfigurations, and other fuel burn initiatives.

The increase in net finance costs was the result of a reduction in interest income due to lower average deposit rates and a reduced average cash balance. The average cost of debt did not materially increase over the period following the loss of the Group's investment grade credit rating in December 2013.

| Segment Performance Summary |            | June 2014    | June 2013<br>Restated <sup>7</sup> | Change       | %<br>Change      |
|-----------------------------|------------|--------------|------------------------------------|--------------|------------------|
| Qantas Domestic             | \$M        | 30           | 365                                | (335)        | (92)             |
| Qantas International        | \$M        | (497)        | (246)                              | (251)        | >(100)           |
| Qantas Loyalty              | \$M        | 286          | 260                                | 26           | 10               |
| Qantas Freight              | \$M        | 24           | 36                                 | (12)         | (33)             |
| Qantas Brands Eliminations  | \$M        | 3            | 3                                  | –            | –                |
| <b>Qantas Brands</b>        | <b>\$M</b> | <b>(154)</b> | <b>418</b>                         | <b>(572)</b> | <b>&gt;(100)</b> |
| Jetstar Group               | \$M        | (116)        | 138                                | (254)        | >(100)           |
| Corporate/Unallocated       | \$M        | (168)        | (191)                              | 23           | 12               |
| Eliminations                | \$M        | (2)          | 1                                  | (3)          | >(100)           |
| <b>Underlying EBIT</b>      | <b>\$M</b> | <b>(440)</b> | <b>366</b>                         | <b>(806)</b> | <b>&gt;(100)</b> |
| Net finance costs           | \$M        | (206)        | (180)                              | (26)         | (14)             |
| <b>Underlying PBT</b>       | <b>\$M</b> | <b>(646)</b> | <b>186</b>                         | <b>(832)</b> | <b>&gt;(100)</b> |

Qantas Domestic reported full-year Underlying EBIT of \$30 million, a pronounced deterioration from the prior year with a three per cent improvement in comparable unit cost offset by weaker yield and passenger loads. Intense market competition continued, with the negative impact of market capacity additions exacerbated by weak underlying demand.

Qantas Domestic maintained its leading network and frequency advantage in the market, supporting the retention of over 80 per cent of corporate account revenue<sup>18</sup>.

Qantas International reported an Underlying EBIT loss of \$497 million, a \$251 million decline compared to the prior year. The reduction was primarily due to the continuation of market capacity oversupply, led by competitor airlines in Asia and the Middle East, and unfavourable fuel cost from foreign exchange movements. Strategic highlights in the year included enhancements to the international network offering, with expanded code share partnerships agreed with both China Eastern and China Southern as well as the bedding down of the alliance with Emirates.

<sup>15</sup> Boeing settlement of \$125 million in first half of 2012/2013 following the restructuring of the Group's B787-8 deliveries.

<sup>16</sup> As of 2 June 2014.

<sup>17</sup> Fuel efficiency is measured as litres per ASK adjusted for movements in average sector length.

<sup>18</sup> Qantas modelled share of total corporate account revenue.

## EXPLANATION OF RESULTS (continued)

The focus on business transformation at Qantas International continued, with a four per cent reduction in comparable unit costs as major initiatives including the B747-400 retirement program, cabin reconfigurations, and increased aircraft utilisation delivered benefits. Over the past two financial years, Qantas International has reduced comparable unit costs by nine per cent, with a 10 percentage point improvement in customer advocacy over the same period. These gains have been eroded at an earnings level by unfavourable fuel cost and revenue decline caused by excess market capacity growth.

Qantas Loyalty achieved another record<sup>3</sup> full-year Underlying EBIT of \$286 million, up 10 per cent on the prior year. Membership in the Qantas Frequent Flyer program passed 10 million<sup>16</sup> in the period, with 14 new partners added to the program, delivering more ways to earn and increased member interaction. Growth initiatives including Qantas Cash and the Acquire loyalty program have diversified Loyalty's customer base and added new revenue streams.

Jetstar Group's first full-year Underlying EBIT loss of \$116 million reflects the intense competitive environment in both domestic Australia and South East Asia. Domestic Australia remained profitable, however sustained aggressive competitor capacity growth in South East Asia depressed yields and loads in the period. As a result, Jetstar Asia, based in Singapore, reported losses of \$40 million. Associate losses of \$70 million were consistent with the rapid growth of Jetstar Japan as it expanded to consolidate its leading low-cost carrier position in the Japanese market and the establishment of Jetstar Hong Kong. Continued underlying unit cost<sup>19</sup> improvements helped mitigate increased fuel cost of \$86 million.

Qantas Freight Underlying EBIT of \$24 million is down \$12 million on the prior corresponding period, with \$11 million of the decline reported in the first half of financial year 2013/2014. Qantas International capacity reductions reduced freight capacity, and air freight markets were challenging in the first half of financial year 2013/2014 in particular. The full run-rate of benefits from the integration of Australian air Express began to be received in the second half of financial year 2013/2014.

### Qantas' guiding strategic principles remain consistent

As the Group undergoes the most significant business transformation in its history, repositioning both its cost base and competitive position in every market we operate in, our guiding strategic principles as a business remain consistent:

- Safety is always our first priority
- The first choice for customers in every market we serve
- Maintaining dual-brand strength in the Australian market
- Reshaping Qantas International to remain competitive
- Maintaining the Jetstar opportunity in Asia
- Broadening Qantas Loyalty for strong, diversified earnings growth
- Driving efficiency and productivity across the Group

In order to continue implementing that strategy and to deliver sustainable returns to shareholders in what will remain a very challenging operating environment, the Group must accelerate the pace of Qantas Transformation.

With overarching targets to implement initiatives that will deliver \$2 billion<sup>2</sup> of benefits by the end of financial year 2016/2017 and reduce net debt<sup>20</sup> by more than \$1 billion by the end of financial year 2014/2015, Qantas Transformation is the key to driving earnings recovery and simultaneously deleveraging the Group's balance sheet.

At the same time, the Group is focused on targeted reductions in capital investment to ensure sustainable positive free cash flow from financial year 2014/2015 onwards. To remain the first choice for customers and maintain our brand and yield premium, key customer-facing investments, including gateway lounges, cabin reconfigurations to the A330 and B738 fleets, and the prioritisation of fleet simplification through the arrival of the B787-8 Dreamliner into Jetstar, are all proceeding.

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<sup>19</sup> Unit cost – Unit cost is measured using controllable unit cost in line with industry benchmarks for low-cost carriers. Controllable unit cost is adjusted to aid comparability between reporting periods. Controllable unit cost is measured as total underlying expenses excluding fuel, carbon tax, Jetstar Group costs and Share of net loss of investments accounted for under the equity method, adjusted for changes in foreign exchange rates and movements in average sector length per ASK.

<sup>20</sup> Net debt including operating lease liabilities includes on balance sheet debt and off balance sheet aircraft operating lease liabilities. Operating lease liability is the present value of minimum lease payments for aircraft operating leases which, in accordance with AASB 117: Leases, is not recognised on balance sheet. The operating lease liability has been calculated as the present value of future non-cancellable operating lease rentals of aircraft in service, using a discount rate of seven per cent applied in Standard and Poor's methodology.

## EXPLANATION OF RESULTS (continued)

Strategic priorities delivered on in the 2013/2014 financial year include:

- **Dual brand strength:** number one and two most profitable Australian Domestic airlines<sup>21</sup>; maintained margin premium over competition; market-leading on-time performance; unrivalled network and frequency; retained over 80 per cent of corporate accounts by revenue
- **First choice for customers:** new and expanded lounges opened in Singapore, Hong Kong, Los Angeles and in the domestic market; roll-out of B787-8 Dreamliner on new routes; record customer satisfaction levels; ongoing commitment to staff training
- **Reshaping Qantas International:** strong comparable unit cost improvement of four per cent; enhanced code share relationships with China Eastern and China Southern; successful integration with major alliance partner Emirates after move to new hub in Dubai
- **Maintaining Jetstar opportunity in Asia:** largest Low Cost Carrier (LCC) in domestic Japan market, second base in Osaka launched, market leading OTP; Jetstar Asia 'Best Budget Airline' in 2014<sup>22</sup>; Jetstar Pacific business recapitalisation complete; all A320-200 fleet driving unit cost improvement
- **Broadening Qantas Loyalty:** customer innovation with launch of Qantas Cash and Aquire, new revenue streams; reached milestone of over 10 million members<sup>16</sup> in Qantas Frequent Flyer

### Qantas Transformation strong momentum towards \$2 billion target

The pillars that underpin the Group's transformation are:

- Accelerating cost reduction
- Right-sizing fleet and network
- Working existing assets harder
- Deferring growth
- Aligning capital expenditure to financial performance
- Accelerating simplification
- Focus on customer and revenue

In the second half of financial year 2013/2014, \$204 million of Transformation benefits were realised and an even greater pipeline of initiatives entered the implementation phase for delivery in financial year 2014/2015 and beyond. The accelerated Qantas Transformation program builds upon the significant cost reduction and strategic achievements of recent years.

Transformation milestones achieved in the first six months of the accelerated program include:

- \$204 million of benefits realised, \$900 million worth of initiatives in implementation phase
- Accelerating comparable unit cost<sup>6</sup> reduction: two per cent in first half, four per cent in second half of 2013/2014
- 2,200 of targeted 5,000 FTE reduction exited as at 30 June 2014. Redundancy, restructuring and other transformation costs of \$428 million<sup>23</sup> recognised in financial year 2013/2014
- Avalon heavy maintenance facility closed
- Line Maintenance Operations changes enacted
- Right-sizing fleet and network at a cost of \$394 million<sup>23</sup> in financial year 2013/2014
  - Qantas International network optimisation under way; exit Perth-Singapore, down-gauge aircraft to A330s on Sydney-Singapore and Brisbane-Singapore, re-time of QF 9/10 and maintenance changes to up-gauge Sydney-Dallas/Fort Worth to A380-800
  - Qantas Domestic fleet simplification under way; exit of B737-400 aircraft and completion of B767-300 retirement
  - Over 50 aircraft deferred or sold, accelerated B747-400 and B767-300 retirement in Group fleet restructure
- Jetstar 'Lowest Seat Cost' program lowering unit costs with a two per cent improvement in 2013/2014
- \$1.3 billion reduction<sup>24</sup> in planned capital investment in financial years 2014/2015 and 2015/2016
- Net debt<sup>4</sup> reduced by \$96 million

<sup>21</sup> Based on Qantas Domestic and Jetstar earnings before interest and tax in 2013/2014. Tigerair Australia reported earnings before interest and tax, and consensus estimates for Virgin Australia domestic earnings before interest and tax in 2013/2014.

<sup>22</sup> AsiaOne People's Choice Awards.

<sup>23</sup> Included in items not included in Underlying PBT in the 2013/2014 financial year.

<sup>24</sup> Compared to August 2013 planned capital expenditure.

## EXPLANATION OF RESULTS (continued)

In December 2013, management announced it would freeze wages until the Qantas Group makes a full-year underlying profit. The wage freeze is:

- Ongoing for executives
- Immediate for open Enterprise Bargaining Agreements (EBAs)
- Proposed for other EBA-covered staff

Discussions with respective unions on implementation of the wage freeze continue to take place.

The Qantas Group Chief Executive Officer did not receive an increase in Base Pay during 2013/2014 and elected to forego five per cent of Base Pay from 1 January 2014. All other Qantas Airways Limited Directors also elected to forego five per cent of their fees from 1 January 2014.

In addition to the wages freeze, no bonus payments will be awarded for financial year 2013/2014.

The end of financial year 2013/2014 represents the peak in costs associated with Qantas Transformation being incurred, with the full run-rate of permanent cost reduction to flow in the financial year ahead.

### Unlocking value through a structural review

The outcomes from the review are both structural and strategic for the future direction of Qantas Group:

- **Creating future optionality for Qantas International:** *Qantas Sale Act* foreign ownership restrictions have been a long-standing barrier to Qantas' participation in industry consolidation at a Group level. The partial repeal of the Act's 25% and 35% foreign airline ownership caps removes a substantial barrier to consolidation that was unique to Qantas.

The decision has been made to create a new holding structure and corporate entity for Qantas International. The new structure increases potential for future external investment, and creates long-term options for Qantas International to participate in partnership and consolidation opportunities.

The new structure builds upon existing segmentation of Qantas International and Qantas Domestic at management and financial reporting levels since 2012.

With the change to Group structure, accounting standards require a change to the Group's Cash Generating Units (CGU) for impairment testing.

- **Impact on Qantas International asset carrying values:** Prior to the Board decision to change the structure of the Group, the Qantas Brands CGU comprised the operations of the Qantas fleet and brand to collectively generate cash inflow and derive value. As a result of the decision to create a new holding structure and corporate entity for Qantas International, Accounting Standards require the existing 'Qantas Brands CGU' to be split into four separate CGUs for the purposes of assessing the carrying value of the Group's assets.

While there are significant surpluses in Qantas Loyalty, Qantas Domestic and Qantas Freight CGUs, an impairment of \$2,560 million arose in the stand-alone Qantas International CGU. The size of the impairment loss recognised is largely the result of wide body aircraft being purchased through a period where the Australian dollar was significantly weaker against the US dollar compared to recent years.

This impairment is a non-cash charge, with no impact on the economics of the business or change to cash flow forecasts. The impairment has arisen because Qantas International CGU has been tested as a standalone CGU for the first time. Accordingly the Qantas International fleet assets are not assessed in combination with the collective cash flows of the whole of Qantas' operations. Following the impairment, the carrying value of Qantas International aircraft is more reflective of current market value.

### Material business risks

The aviation industry is subject to a number of inherent risks. These include, but are not limited to, exposure to changes in economic conditions, changes in government regulations, fuel and foreign exchange volatility and other exogenous events such as aviation incidents, natural disasters, war or epidemic.

## EXPLANATION OF RESULTS (continued)

Qantas is subject to a number of specific business risks which may impact the achievement of the Group's strategy and financial prospects:

- **Competitive intensity:** Market capacity growth ahead of demand impacts industry profitability
  - Australia's liberal aviation policy settings coupled with the strength of the Australian economy relative to global economic weakness has attracted more offshore competitors to the Australian international aviation market, predominantly state-sponsored airlines. Qantas is responding by building key strategic airline partnerships with strong global partners. Qantas brings domestic strength and the unrivalled customer offering of Qantas Loyalty. Qantas has also embarked on reducing its cost base through the Qantas Transformation program. Qantas continues to leverage its considerable fleet flexibility and established relationships with manufacturers to adjust capital expenditure in line with financial performance and right-size its fleet and network.
  - The Australian domestic aviation market has attracted increased competition in recent years. The resulting intensity of competition as a result of capacity growth ahead of demand over a sustained period is being mitigated by maintaining the Qantas Group's market leading domestic position and executing Qantas Group's dual brand strategy. This strategy leverages Qantas Domestic (including QantasLink) to serve business and premium leisure customers and Jetstar to serve price sensitive customers. Qantas Domestic is focused on removing the cost base disadvantage to its competitors through its transformation initiatives and fleet renewal, while Jetstar is working to maintain its low-cost scale advantage and continually lower unit costs.
- **Fuel and foreign exchange volatility:** The Qantas Group is subject to fuel and foreign exchange risks: These risks are an inherent part of the operations of an airline. The Qantas Group manages these risks through a comprehensive hedging program.
- **Industrial relations:** The associated risks of a transformation including industrial action relating to Qantas' collective agreements with its employees. This risk is being mitigated through continuous employee engagement initiatives and ongoing, constructive dialogue with all union groups and other relevant stakeholders.
- **Continuity of critical systems:** The Group's operations depend on the continuous functioning of a number of information technology and communication services. The Group has an extensive control and management framework<sup>25</sup> to reduce the likelihood of outages, ensure early detection and to mitigate the impact.
- **Credit rating:** Qantas' credit rating is Ba2 negative outlook and BB+ negative outlook by Moody's and Standard and Poor's respectively. Compared to an investment grade credit rating, the price of new debt funding may increase and/or the Group's access to some sources of unsecured credit could reduce over time. To mitigate the risk, Qantas maintains strong liquidity and has a flexible fleet plan to enable it to reduce Capital Expenditure to ensure debt remains within an acceptable range.
- **Key business partners:** The Qantas Group has relationships with a number of key business partners. Any potential exposures as a result of these partnerships are mitigated through the Group Risk Management Framework<sup>25</sup>.

### Securing the future with financial discipline

| Cash Flow Summary                      |            | June 2014    | June 2013    | Change       | % Change     |
|--|------------|--------------|--------------|--------------|--------------|
| Operating cash flows                   | \$M        | 1,069        | 1,417        | (348)        | (25)         |
| Investing cash flows                   | \$M        | (1,069)      | (1,045)      | (24)         | (2)          |
| <b>Net free cash flow<sup>26</sup></b> | <b>\$M</b> | <b>–</b>     | <b>372</b>   | <b>(372)</b> | <b>(100)</b> |
| Financing cash flows                   | \$M        | 173          | (953)        | 1,126        | >100         |
| Cash at beginning of period            | \$M        | 2,829        | 3,398        | (569)        | (17)         |
| Effect of foreign exchange on cash     | \$M        | (1)          | 12           | (13)         | >(100)       |
| <b>Cash at period end</b>              | <b>\$M</b> | <b>3,001</b> | <b>2,829</b> | <b>172</b>   | <b>6</b>     |

<sup>25</sup> An overview of the Group Risk Management Framework is available through the Qantas Group Business Practices Document on [qantas.com.au](http://qantas.com.au).

<sup>26</sup> Net free cash flow – Operating cash flows less investing cash flows. Net free cash flow is a measure of the amount of operating cash flows that are available (i.e. after investing activities) to fund reductions in net debt or payments to shareholders.

## EXPLANATION OF RESULTS (continued)

The Group ended the financial year with a robust liquidity position, with \$3 billion in cash and \$630 million in undrawn facilities available. Net free cash flow was neutral in the period, despite the significant early cash costs associated with Qantas Transformation. Capital investment<sup>5</sup> for the year was \$874 million.

Total financial year 2014/2015 capital investment is expected to be \$700 million, a \$600 million reduction from previous expectations as highlighted in May 2014<sup>27</sup>.

Cash generated from operations was unfavourable to the prior year largely as a result of revenue deterioration caused by market capacity oversupply and the financial year 2012/2013 one-off receipt of funds related to the Boeing settlement<sup>15</sup> and sale of StarTrack.

Seven new unencumbered aircraft were added to the fleet, and another 15 mid-life aircraft became debt free in the period.

The Group continues to retain significant flexibility in its financial position, funding strategies and fleet plan to ensure that it can respond to any change in market conditions.

| Debt and Gearing Analysis                                   |     | June 2014 | June 2013 | Change   | % Change |
|---|-----|-----------|-----------|----------|----------|
| Net on balance sheet debt <sup>28</sup>                     | \$M | 3,455     | 3,226     | 229      | 7        |
| Net Debt including operating lease liabilities <sup>4</sup> | \$M | 4,751     | 4,847     | (96)     | (2)      |
| Adjusted Equity <sup>29</sup>                               | \$M | 2,938     | 5,717     | (2,779)  | (49)     |
| Gearing Ratio <sup>30</sup>                                 |     | 62:38     | 46 : 54   | (16) pts |          |

## Fleet

The Qantas Group remains committed to a fleet strategy that provides for long-term flexibility, renewal, and that prioritises Group fleet simplification. The fleet strategy is designed to support the strategic objectives of the Group's two flying brands and the overarching targets of the Qantas Transformation program. At all times, the Group retains significant flexibility to respond to any changes in market conditions and the competitive environment.

At 30 June 2014, the Qantas Group fleet<sup>31</sup> totalled 308 aircraft. During financial year 2013/2014, the Group purchased 17 aircraft and leased six aircraft:

- Qantas – four B737-800s, two Bombardier Q400s and five B717-200s.
- Jetstar (including Jetstar Asia) – four B787-8s and eight A320-200s.

The Group removed 27 aircraft from service in financial year 2013/2014 including eight lease returns. These included three B747-400s, seven B767-300s, six B737-400s, five A320-200s, two Q200s and four EMB120s.

The Qantas Group's scheduled passenger fleet average age is now 7.7 years. The benefits of fleet investment include improved customer satisfaction, environmental outcomes, operational efficiencies and cost reductions.

With the fleet modernisation program nearing completion, the low fleet age has enabled planned capital investment<sup>5</sup> to be reduced by \$1.3 billion over two years from previous expectations as highlighted in May 2014<sup>27</sup> to \$700 million in financial year 2014/2015 and \$800 million in financial year 2015/2016.

<sup>27</sup> May 2014 Macquarie Australia Conference.

<sup>28</sup> Net on balance sheet debt includes interest-bearing liabilities and the fair value of hedges related to debt less cash, cash equivalents and aircraft security deposits.

<sup>29</sup> Adjusted equity includes equity adjusted to exclude hedge reserves.

<sup>30</sup> Gearing Ratio is net debt including operating lease liability to net debt including operating lease liability and adjusted equity (excluding hedge reserve). The gearing ratio is used by management to represent the Qantas Group's debt obligation including obligations under operating leases.

<sup>31</sup> Includes Jetstar Asia, Qantas Freight and Network Aviation and excludes aircraft owned by Jetstar Japan, Jetstar Hong Kong and Jetstar Pacific.

## EXPLANATION OF RESULTS (continued)

### Qantas Domestic

- Domestic market yields and revenue seat factor were adversely impacted by market capacity growth running ahead of demand for the second consecutive year
- Comparable unit cost improvement of three per cent, up from one per cent improvement in first half of financial year 2013/2014
- Superior on-time performance: market leader in 12 out of 12 months
- Record levels of customer satisfaction and advocacy

|                                |     | June<br>2014 | June<br>2013 | Change    | %<br>Change |
|--------------------------------|-----|--------------|--------------|-----------|-------------|
| Total Revenue and Other Income | \$M | 5,848        | 6,218        | (370)     | (6)         |
| Revenue Seat Factor            | %   | 73.3         | 75.9         | (2.6) pts |             |
| Underlying EBIT                | \$M | 30           | 365          | (335)     | (92)        |

Qantas Domestic Underlying EBIT of \$30 million for the full year ended 30 June 2014 was down from \$365 million in the prior corresponding period.

The reduction in Underlying EBIT was driven largely by continued domestic market capacity growth ahead of demand growth and increased fuel cost of \$68 million. Business and leisure demand remained weak throughout the year, with corporate account revenue impacted by softening resources sector demand, particularly in the Western Australian and Queensland markets and reduced Government spending. This challenging competitive environment resulted in reduced revenue seat factor and weaker yields. However, Qantas continues to be the clear choice for business travellers and has maintained over 80 per cent share of corporate account revenue.

Qantas Domestic's comparable unit cost<sup>6</sup> improved three per cent on the prior corresponding period, as cost savings were realised from the accelerated Qantas Transformation program. Benefits realised stemmed from initiatives including the consolidation of Qantas heavy maintenance bases, continued fleet renewal, and the ongoing management and non-operational restructure.

Qantas Domestic achieved record customer satisfaction levels over the year, with a number of industry awards recognising our product offering and service standards:

- 'Best Domestic Airline'<sup>32</sup> five years running
- 'Best Economy'<sup>33</sup> noting that Qantas Domestic was the world's best by a wide margin
- 'Best Lounges'<sup>33</sup>
- 'Australia's Favourite Airline'<sup>34</sup>

Qantas Domestic has achieved superior on-time performance for the fifth year running, including beating its main competitor for an unprecedented 18 consecutive months to June 2014.

Qantas Domestic continued to strengthen its customer proposition through improved lounge experiences, investing in new and expanded lounges in Melbourne, Tamworth and Broome airports, and continued investment in front-line team training. Network growth continues with commencement of new East Coast premium leisure routes: Brisbane to Port Macquarie, Sydney to Hervey Bay, Melbourne to Coffs Harbour, and Sydney to Hamilton Island.

Qantas Domestic continues to support the regional market position through QantasLink and Network Aviation services. QantasLink launched two-class B717-200 services on Canberra and Tasmania routes and took delivery of two Bombardier Q400 aircraft and two B717-200 aircraft during the period. Network Aviation commenced regular passenger transport operations during June. QantasLink relocated into the Qantas Sydney terminal, creating a more seamless travel experience for Qantas customers through smoother connections and reduced check-in times.

<sup>32</sup> Australian Federation of Travel Agents National Industry Awards 2010 – 2014.

<sup>33</sup> AirlineRatings.com's Airline Excellence Awards, January 2014.

<sup>34</sup> TripAdvisor Traveller's Choice Awards.



## EXPLANATION OF RESULTS (continued)

### Qantas International

- Market capacity oversupply adversely impacted International market yields and revenue seat factors
- Adverse currency movement increased AUD fuel price
- Comparable unit cost<sup>6</sup> improvement of four per cent
- Strengthening alliances through Emirates partnership and new codeshare agreements
- Ongoing product investment to build on recent customer advocacy gains

|                                |     | June<br>2014 | June<br>2013 | Change    | %<br>Change |
|--------------------------------|-----|--------------|--------------|-----------|-------------|
| Total Revenue and Other Income | \$M | 5,297        | 5,496        | (199)     | (4)         |
| Revenue Seat Factor            | %   | 79.6         | 81.6         | (2.0) pts |             |
| Underlying EBIT                | \$M | (497)        | (246)        | (251)     | >(100)      |

Qantas International Underlying EBIT loss of \$497 million represents a \$251 million deterioration on the prior financial year. Significant benefits from the Qantas Transformation program have been materially offset by lower revenue and the unfavourable foreign exchange impact on fuel of \$42 million.

Yields were reduced due to market capacity oversupply, with International capacity in and out of Australia increasing by 9.5 per cent (or 3.7 million additional seats), resulting in an intensely competitive pricing environment. Capacity growth was largely led by Middle Eastern, Asian network and low-cost carriers. The strength of our alliance with Emirates has provided a partial offset, with a strong 'one stop' European proposition and additional frequencies into Asia.

Comparable unit cost improved four per cent. Improved asset utilisation of six per cent, combined with the ongoing restructure of the legacy cost base through the Qantas Transformation program, has delivered this strong unit cost result. The B747-400 retirement program (an additional three units in financial year 2013/2014), reduction in heavy maintenance footprint, and improved fleet economics following the A380-800 and B747-400 reconfiguration program have all made a significant contribution to cost reduction. Ongoing optimisation of the network remains a key focus area. Recent examples include the exit of Perth-Singapore and down-gauge of Brisbane-Singapore and Sydney-Singapore to A330 aircraft.

Qantas International continues to invest in what our customers value most, including lounges, with significant improvements to the Los Angeles and Hong Kong lounges, and onboard product enhancement including menu design and a sleeper service. These, combined with the broader network proposition through the Emirates alliance, have seen Net Promoter Scores improve a significant 10 points over two years. The launch of the A330 flat bed in late 2014 continues this commitment.

Qantas International continued to strengthen its intra-Asia proposition, including announcing a new codeshare partnership with China Southern and expanded code share with China Eastern. Qantas International now has agreements with three major China-based carriers, providing access to one of the world's largest and fastest growing economies.

### Jetstar

- Domestic business profitable every year since 2004
- Competitive environment impacting yields, in particular in South East Asia
- Unfavourable fuel cost with lower Australian dollar
- Low Cost Carrier (LCC) business fundamentals remain strong
  - Continued unit cost<sup>19</sup> improvement
  - Successful introduction of the B787-8 Dreamliner
- Record customer advocacy levels reached

|                                |     | June<br>2014 | June<br>2013 | Change    | %<br>Change |
|--------------------------------|-----|--------------|--------------|-----------|-------------|
| Total Revenue and Other Income | \$M | 3,222        | 3,288        | (66)      | (2)         |
| Revenue Seat Factor            | %   | 78.5         | 79.1         | (0.6) pts |             |
| Underlying EBIT                | \$M | (116)        | 138          | (254)     | >(100)      |

## EXPLANATION OF RESULTS (continued)

Jetstar Underlying EBIT for the full year ended 30 June 2014 was a loss of \$116 million, down from \$138 million profit in the prior corresponding period.

The decline in earnings was primarily driven by yield pressure from market capacity oversupply in South East Asia and market growth ahead of demand in the Australian domestic market. Unfavourable fuel cost of \$86 million was not recovered in intensely competitive markets. The rapid expansion of Jetstar Japan as the airline consolidates its leading LCC position in the Japanese market and establishment of Jetstar Hong Kong resulted in associate losses of \$70 million.

Jetstar's LCC fundamentals remain strong, improving unit cost by two per cent compared to the prior corresponding period as benefits from the 'Lowest Seat Cost' program – part of the \$2 billion in targeted cost reductions from Qantas Transformation – were realised.

Jetstar has been profitable in the Australian domestic market every year since launch. Domestic seat factor remains high – above 80 per cent in the year.

Jetstar International successfully introduced the B787-8 Dreamliner into long haul operations out of Australia during the period which has enhanced customer experience and delivered significant operational efficiencies.

In Singapore, Jetstar Asia reported a \$40 million loss due to the intense competitive environment. Jetstar Asia continues to provide a strategically important price sensitive gateway to Asia, operating in a highly competitive market with LCC capacity up 27 per cent<sup>35</sup>, putting significant downward pressure on yields for all airlines in the market. This was partially offset by four per cent increase in Ancillary revenue per passenger compared to the prior corresponding period.

Japan continues to be a substantial opportunity within the Jetstar Group, with Jetstar Japan in a strong competitive position. Jetstar Japan is the largest domestic LCC in Japan<sup>36</sup>, with over five million passengers carried since launch, now operating from two domestic bases with the launch of flights from Osaka in June, and with market leading on-time performance<sup>37</sup> and record customer advocacy.

Jetstar Pacific continues to realise the benefits from its fleet renewal program, achieving a two per cent unit cost<sup>19</sup> improvement compared to the prior corresponding period. The successful recapitalisation during the period will support fleet growth and the planned launch of international services in the first half of 2014/2015.

Jetstar Hong Kong's preparation for operational launch continues while seeking necessary regulatory approvals.

### Qantas Loyalty

- Record<sup>3</sup> Underlying EBIT of \$286 million, up 10 per cent on the prior year
- Member growth of eight per cent to 10.1 million members
- Billings<sup>38</sup> up eight per cent to \$1,306 million
- Growth initiatives exceeding expectations – Qantas Cash and Aquire
- Continuing member engagement through Qantas Points Website, Online Mall and upcoming launch of Qantas Golf Club
- Record annual Net Promoter Score<sup>39</sup>

|                 |     | June<br>2014 | June<br>2013 | Change | %<br>Change |
|-----------------|-----|--------------|--------------|--------|-------------|
| Members         | M   | 10.1         | 9.4          | 0.7    | 8           |
| Billings        | \$M | 1,306        | 1,209        | 97     | 8           |
| Underlying EBIT | \$M | 286          | 260          | 26     | 10          |

Qantas Loyalty achieved another record result with a 10 per cent improvement in Underlying EBIT to \$286 million. This has been driven by strong billings growth, continuing member engagement and continued member growth, with more than 720,000 members added over the financial year.

<sup>35</sup> Diio Report published 25 June 2014.

<sup>36</sup> Based on fleet, network and domestic ASKs as at 10 July 2014 compared to Peach Aviation and Air Asia Japan/Vanilla.

<sup>37</sup> MLIT Report January – March 2014 reporting period.

<sup>38</sup> Billings represent point sales to partners.

<sup>39</sup> Net Promoter Score is at its highest level since reporting started in 2008.

## EXPLANATION OF RESULTS (continued)

Billings increased by eight per cent to \$1,306 million. External billings are up by 10 per cent, mainly due to growth in credit card billings driven by promotional campaigns and new products.

New growth initiatives of Qantas Cash and Aquire are already exceeding expectations.

Only 10 months from the initial launch, Qantas Cash is already providing incremental EBIT to the business. Over 300,000 members have activated the facility and almost \$500 million has been loaded onto cards, making it one of the largest prepaid products in Australia. Qantas Cash has won multiple awards including the Australian Business Award for Product Excellence and a 5-Star Canstar rating for Outstanding Value.

Qantas Loyalty launched Aquire on 31 March 2014. The business rewards program continues to grow with close to 35,000 members already registered in the program. Sixteen partners are currently signed up as Aquire partners across airline, financial services, consulting services, car rentals, office supplies and other business expenses.

As the program continues to expand its product offerings, Qantas Loyalty launched a dedicated digital channel in August 2014 – [www.qantaspoints.com](http://www.qantaspoints.com). The channel showcases the depth and breadth of the program and is a responsive design across all devices, making it even easier to access all there is to know about earning and redeeming Qantas Points. Along with Qantas Points, Qantas Loyalty also launched the Online Mall, providing new opportunities for Qantas Frequent Flyer members to earn Qantas Points when shopping online with 17 premium Australian and International retailers such as David Jones, eBay, Net-A-Porter and The Iconic.

Qantas Loyalty announced Qantas Golf Club which will launch in the summer of 2014. This is an online program dedicated to engaging golfers and supporting golf clubs in Australia. The Qantas Golf Club will offer easy access to play at participating golf courses, earn Qantas Points when playing golf, receive invitations to attend Qantas Golf Club events and participate in tournaments, and access to a range of golf travel packages, both within Australia and overseas.

Qantas Loyalty added 14 new partners to the Qantas Frequent Flyer Program during the period, providing members with expanded opportunities to earn and redeem points. New ways to earn include Macquarie Bank Home Loans, secure Parking, iSelect, Jumeirah Hotels & Resorts, Qantas Restaurants, Qantas Cruises and Qantas Hotels. Airline partners that joined the program this year were US Airways, Qatar Airways, LATAM and Sri Lankan Airlines.

### Qantas Freight

- Increased revenue in a competitive environment
- Full run-rate synergies from embedding the Australian air Express acquisition
- Removal of B747F hull from January 2014
- Closure of Qantas Courier Australian operations

|                                   |     | June<br>2014 | June<br>2013 | Change    | %<br>Change |
|-----------------------------------|-----|--------------|--------------|-----------|-------------|
| Total Revenue and Other Income    | \$M | 1,084        | 1,056        | 28        | 3           |
| Revenue Load Factor <sup>40</sup> | %   | 55.1         | 56.2         | (1.1) pts |             |
| Underlying EBIT                   | \$M | 24           | 36           | (12)      | (33)        |

Qantas Freight's Underlying EBIT was \$24 million for the year ended 30 June 2014, down \$12 million on the prior corresponding period, of which \$11 million relates to the first half of 2013/2014. The result reflects an overall reduction in international capacity of nine per cent, including the impact of freighter hull reduction, and delivery of full run-rate synergy benefits from the Australian air Express acquisition from the second half 2013/2014.

Due to ongoing challenging domestic conditions, the Australian operations of Qantas Couriers ceased operations on 27 March 2014. The New Zealand operations continue to contribute positively to the Freight segment.

<sup>40</sup> Revenue Load Factor – Revenue Freight Tonne Kilometre (RFTK) over Available Freight Tonne Kilometre (AFTK).

## EXPLANATION OF RESULTS (continued)

### Reconciliation of Underlying PBT to Statutory PBT

The Statutory Loss Before Tax of \$3,976 million for the year ended 30 June 2014 is \$3,987 million down on the prior year.

#### *Underlying PBT*

Underlying PBT is the primary reporting measure used by the Qantas Group's chief operating decision-making bodies, being the Chief Executive Officer, Group Management Committee and the Board of Directors, for the purpose of assessing the performance of the Group. The primary reporting measure of the Qantas International, Qantas Domestic, Qantas Loyalty, Qantas Freight and the Jetstar Group operating segments is Underlying EBIT. The primary reporting measure of the Corporate/Unallocated segment is Underlying PBT as net finance costs are managed centrally.

Underlying PBT is derived by adjusting Statutory (Loss)/Profit Before Tax for the impacts of AASB 139 Financial Instruments: Recognition and Measurement (AASB 139) that relate to other reporting periods and certain other items which are not included in Underlying PBT.

| Reconciliation of Underlying PBT to Statutory (Loss)/Profit Before Tax                    |            | June<br>2014   | June<br>2013 |
|---|------------|----------------|--------------|
| <b>Underlying PBT</b>   | \$M        | <b>(646)</b>   | <b>186</b>   |
| <b>Ineffectiveness and non-designated derivatives relating to other reporting periods</b> |            |                |              |
| - AASB 139 mark-to-market movements relating to other reporting periods                   | \$M        | 72             | 32           |
| <b>Other items not included in Underlying PBT</b>   |            |                |              |
| - Redundancies, restructuring and other transformation costs                              | \$M        | (428)          | (118)        |
| - Fleet restructuring   | \$M        | (394)          | (90)         |
| - Impairment of Qantas International CGU  | \$M        | (2,560)        | –            |
| - Other impairment <sup>41</sup>  | \$M        | (59)           | (22)         |
| - Net profit on disposal of investments   | \$M        | 62             | 30           |
| - Other   | \$M        | (23)           | (7)          |
| <b>Total items not included in Underlying PBT</b>   | <b>\$M</b> | <b>(3,330)</b> | <b>(175)</b> |
| <b>Statutory (Loss)/Profit Before Tax</b>   | <b>\$M</b> | <b>(3,976)</b> | <b>11</b>    |

#### *AASB 139 mark-to-market movements relating to other reporting periods*

All derivative transactions undertaken by the Qantas Group represent economic hedges of underlying risk and exposures. The Qantas Group does not enter into speculative derivative transactions. Notwithstanding this, AASB 139 requires certain mark-to-market movements in derivatives which are classified as 'ineffective' to be recognised immediately in the Consolidated Income Statement. The recognition of derivative valuation movements in reporting periods which differ from the designated transaction causes volatility in statutory profit that does not reflect the hedging nature of these derivatives.

Underlying PBT reports all hedge derivative gains and losses in the same reporting period as the underlying transaction by adjusting the reporting period's statutory profit for derivative mark-to-market movements that relate to underlying exposures in other reporting periods.

All derivative mark-to-market movements which have been excluded from Underlying PBT will be recognised through Underlying PBT in future periods when the underlying transaction occurs.

<sup>41</sup> Includes impairment of investments and other intangible assets.

## **EXPLANATION OF RESULTS** (continued)

### ***Other items not included in Underlying PBT***

Items which are identified by Management and reported to the chief operating decision-making bodies as not representing the underlying performance of the business are not included in Underlying PBT. The determination of these items is made after consideration of their nature and materiality and is applied consistently from period to period.

Items not included in Underlying PBT primarily result from major transformational/restructuring initiatives, transactions involving investments and impairments of assets outside the ordinary course of business.

Items not included in Underlying PBT in the 2013/2014 year were driven by the accelerated Qantas Transformation program, fleet restructuring, the disposal of Qantas Defence Services, impairment of an investment in an associate (Helloworld Limited) and the impairment of the Qantas International CGU.

Redundancy, restructuring and other transformation costs of \$428 million include the reduction of management and non-operational roles, further consolidation of engineering and catering facilities and the integration of Australian air Express.

Fleet restructuring costs of \$394 million include impairment of aircraft, together with associated support property, plant and equipment, inventory and other related costs following strategic network changes and accelerated fleet retirements resulting from the Qantas Transformation program.

Impairment of cash generating unit of \$2,560 million relates to an impairment being recognised in the Qantas International CGU arising because as a result of the outcome of the Structural Review the Qantas International CGU has been tested as a standalone CGU for the first time. The size of the impairment loss recognised is largely the result of wide body aircraft being purchased through a period where the Australian dollar was significantly weaker against the US dollar compared to recent years.