17 November 2015

Companies Announcement Office
Australian Securities Exchange
20 Bridge Street
SYDNEY NSW 2000

Dear Sir/Madam

Reinstatement to Investment Grade Credit Rating by Standard and Poor's

Attached is an announcement just released by Standard and Poor's that reinstates Qantas' long-term corporate credit and issue rating to investment grade (BBB-), with a stable outlook. Standard and Poor's has also raised Qantas' short-term corporate credit rating to A-3 and withdrawn the recovery rating on Qantas' senior unsecured debt.

Yours faithfully

Andrew Finch
Company Secretary

STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Research Update:

Qantas Airways Ltd. Upgraded To 'BBB-/A-3' On More Prudent Financial Framework; Outlook Stable

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Research Update:

Qantas Airways Ltd. Upgraded To 'BBB-/A-3' On More Prudent Financial Framework; Outlook Stable

Overview

- Qantas Airways Ltd. has committed to a more conservative financial policy framework.
- We assess Qantas' revised financial framework to be more formal, forward-looking, and preemptive, and should help to buffer the group against the earnings volatility inherent in the airline industry.
- As a result, we have raised the long-term corporate credit and issue ratings on the airline to 'BBB-' from 'BB+'. At the same time, the short-term corporate credit rating has been raised to 'A-3' from 'B' and the recovery rating on senior unsecured debt has been withdrawn.
- The outlook is stable, reflecting our view that the group's more conservative financial framework, strengthening balance sheet, and domestic market position, should underpin credit quality at the 'BBB-' rating level.

Rating Action

On Nov. 17, 2015, Standard & Poor's Ratings Services raised the long-term corporate credit and issue ratings on Qantas Airways Ltd. to 'BBB-' from 'BB+'. At the same time, the short-term corporate credit rating has been raised to 'A-3' from 'B'. We have also withdrawn the recovery rating of '3' on the airline's debt following the upgrade to investment-grade rating status. The outlook on the long-term rating is stable.

Rationale

The upgrade follows Qantas' announcement on Nov. 17, 2015, that it has adopted a more conservative financial framework that includes a commitment to maintain funds from operations (FFO)-to-debt (after Standard & Poor's adjustments) of greater than 45% through the cycle. We view this framework to be materially more prudent and creditor-friendly than previously announced policies.

Qantas' revised financial framework is more formal, forward-looking, and preemptive. It places greater emphasis on acting preemptively to protect the balance sheet when the airline anticipates periods of financial stress. Qantas' forward-looking view incorporates a range of factors including its internal forecasts, fuel hedging, transformation benefits, growth opportunities, the competitive landscape, refinancing risk, short-term liquidity, unencumbered assets, and key credit metrics. The financial framework is designed to manage the group's optimal capital structure in a manner which is consistent with FFO-to-debt (after Standard & Poor's adjustments) at more than 45% through the cycle. Qantas' principal financial levers include shareholder distributions, growth capital expenditure; and, potentially, equity raisings.

Our base-case forecast remains unchanged. Relatively benign domestic market competition, structurally lower fuel prices, restructuring initiatives, and a lower Australian dollar are expected to translate into the airline recording an FFO-to-debt of between 45% and 60% over the 2016 and 2017 fiscal years ending June 30. However, we have revised Qantas' financial risk profile to "modest" from "intermediate" to reflect the reduced likelihood of medium-term variance to our base-case forecast under the group's revised financial framework.

The revised framework does not preclude sizable shareholder returns. Indeed, our base case assumes a fiscal 2016 capital distribution of larger magnitude than the 2015 distribution. However, Qantas has not committed to regular dividends and will only distribute surplus capital once it exceeds its optimal capital structure. The revised financial framework implies that Qantas' optimal capital structure will shift much more quickly to protect creditors if fundamentals are viewed to have weakened. We therefore expect Qantas to maintain a measured approach to shareholder returns. This is evidenced by Qantas' most recent capital return of A$505 million, which was the first since the global financial crisis. The distribution also occurred in the context of the airline's strengthened balance sheet, solid operating performance, strong liquidity, prudent fleet expansion plans, and forward-looking expectations. We also note that Qantas retains some flexibility in the form of future distributions.

We are mindful that Qantas has committed to measures that may become less palatable to shareholders during periods of financial stress. A key rating consideration will be Qantas' willingness to preemptively implement creditor-friendly policies that, in our opinion, may not necessarily have broad-based support among shareholders. However, we acknowledge that Qantas has established a sound track-record of responding to earnings pressure in the past through managing costs and deferring capital expenditure. We believe that Qantas is committed to taking preemptive action, including reducing costs and capital expenditure and raising equity if necessary, to maintain its target credit metrics. We do not view Qantas' revised financial framework as a panacea to all downside risk. Rather, we view the revised financial framework as a prudent set of measures that support the investment-grade credit rating on the airline.

Qantas' "fair" business risk profile remains unchanged. However, we believe that a strong and flexible balance sheet is supportive of the airline's business risk profile in so far as it acts to ward off competitive threats, particularly in the domestic market.

Underpinning the corporate credit rating on Qantas is its dominant position in

Australia's duopoly-like domestic aviation market where the airline's dual brands comprise about 63% of domestic capacity. Importantly, Qantas has retained the lion's share of the high-yielding corporate market: the group's strong brand and superior market position allow it to generate a yield premium. This is important since Qantas has a cost disadvantage. A key rating consideration is the extent to which Qantas is able to narrow its cost differential with Virgin while preserving a meaningful revenue premium. Qantas is pursuing a transformation program aimed at addressing the airline's legacy and underlying structural issues. In our opinion, this is imperative given unpredictable industry conditions and our expectation that the recovery in the airline's credit metrics will not be demand-led.

We continue to view Qantas as having a successful dual-brand strategy covering full-service and low-cost segments. In addition, we believe that stable cash flows generated by Qantas' frequent flyer business will continue to partially offset the more-volatile cash flows generated from its traditional airline operations. In our opinion, Qantas' international business weighs on the rating. Qantas is disadvantaged by its position as an 'end-of-the-line' carrier that principally serves a relatively small market of 23 million people.

The long-term issue rating on Qantas's senior unsecured debt is 'BBB-', in line with the corporate credit rating. Although the group has significant secured obligations, Qantas maintains a large unencumbered fleet and other unencumbered assets including their frequent-flyer program which provide adequate asset coverage for unsecured creditors. We no longer perform a recovery analysis following the upgrade on Qantas' to investment-grade. Consequently, we have withdrawn the recovery rating on Qantas' senior unsecured debt.

Liquidity

We consider Qantas' liquidity to be "strong". We expect that sources of liquidity in the next 12 months will exceed uses by at least 1.5x. We expect that liquidity sources will continue to exceed uses if EBITDA were to decline by 50%, which is required for companies that we classify in the transportation cyclical industry. The company has a manageable debt-maturity profile in the next two years.

Principal Liquidity Sources:

- Unrestricted cash and short-term investments, which were A$2.9 billion at June 30, 2015;
- FFO remaining at the high A$2.4 billion level achieved in 2015; and
- A$1.04 billion of undrawn revolving credit facilities.

Principal Liquidity Uses:

- Scheduled debt maturities of around A$281 million in fiscal 2016 and no maturities in fiscal 2017;
- Secured aircraft and other amortizing debt of A$449 million in fiscal 2016 and A$446 million in fiscal 2017;
- Capital return to shareholders of A$505 million for year ended June 30,

2015 (paid 2016);
- Capital spending estimated at between A$1.2 billion and A$1.5 billion per annum (net of disposals); and
- We expect current year uses to include the buy-out of maturing operating leases.

Outlook

The stable outlook reflects our view that the group's strong balance sheet, conservative approach to capital management, dominant domestic market position, and a more benign domestic competitive environment, will underpin credit quality at the 'BBB-' rating level. The rating incorporates our expectation that Qantas will realize an enduring benefit from previously announced restructuring initiatives while limiting pressure on its balance sheet. We do not forecast a demand-led recovery. However, structurally lower fuel prices, a more-benign domestic market environment, restructuring initiatives, and a lower Australian dollar should help the further strengthen the airline's credit metrics. In this regard, we expect Qantas to comfortably exceed FFO-to-debt of 45% over the next 2 years. Further, the stable outlook anticipates that Qantas will maintain its meaningful financial flexibility and strong liquidity position throughout the cycle. The practical application of Qantas' revised financial policies and management's willingness to act preemptively to protect the airline's balance sheet will be key rating considerations over the medium- to long-term.

Downside scenario

We could lower the ratings if FFO-to-debt is sustained below 45%. The airline's metrics could be pressured if proactive capital management actions are insufficient to offset: an intensification of competition across its route network; an appreciation of the Australian dollar; higher fuel costs over the medium-term; the airline being unable to achieve and maintain incremental cost savings; and occurrence of exogenous shocks such as a terrorist or mass-pandemic event. A weakening of Qantas' liquidity position below strong will also put downward pressure on the rating.

Upside scenario

Over the medium term, we could raise the rating if we expect Qantas' financial policies to sustain FFO-to-debt at more than 60% under a range of variable demand conditions, competitive tensions, volatile fuel costs, and exogenous shocks. We view upward rating pressure as a result of a strengthening in the airline's business risk profile as less likely over the medium term.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/A-3

Business risk: Fair
- Country risk: Very low
- Industry risk: High
- Competitive position: Strong

Financial risk: Modest
- Cash flow/Leverage: Modest

Anchor: bbb-

Modifiers
- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb-

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Transportation Cyclical Industry, Feb. 12, 2014
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Corporate Methodology, Nov, 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Upgraded; Withdrawn

	To	From
Qantas Airways Ltd.		
Corporate Credit Rating	BBB-/Stable/A-3	BB+/Stable/B

	To	From
Qantas Airways Ltd.		
Senior Unsecured		
AUD1.18 bil Loan Note Facility tranches due 2010, 2011, 2014	BBB-	BB+
Recovery Rating	NR	3
US$259.6 mil 6.05% nts due 04/15/2016	BBB-	BB+
Recovery Rating	NR	3
AUD250 mil 6.50% nts ser QANT04 due 04/27/2020	BBB-	BB+

Recovery Rating	NR	3
AUD300 mil 7.75% med-term nts ser QANS02 due 05/19/2022	BBB-	BB+
Recovery Rating	NR	3
AUD400 mil 7.50% med-term nts ser QANS03 due 06/11/2021	BBB-	BB+
Recovery Rating	NR	3

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