

QANTAS GROUP MARKET UPDATE

SYDNEY, 5 December 2013: The Qantas Group today announced a market update, accelerated cost reductions and a capital expenditure and structural review, in response to fundamentally changed market conditions.

Market update

The Group expects to report an underlying loss before tax in the range of \$250 million to \$300 million for the six months ending 31 December 2013. Trading conditions saw a marked deterioration in November in particular, with both passenger loads and yields below the already negative trends for the year to date.

The Group can also provide the following guidance for the first half of FY14:

- Group capacity is expected to increase by 1.1 per cent in 1H FY14 compared to 1H FY13. Group Domestic capacity (comprising Qantas Domestic, QantasLink and Jetstar Domestic) is expected to increase by 1.9 per cent in 1H FY14 compared to 1H FY13;
- Total domestic market capacity is expected to increase by approximately 2.7 per cent, driven by estimated competitor capacity growth of 3.9 per cent;
- Group yield (excluding the impact of foreign exchange movements) is expected to be approximately 3.5 per cent lower in 1H FY14 compared to 1H FY13, largely due to increased capacity in the domestic and international markets;
- Group loads are expected to be 1.6 percentage points lower in 1H FY14 compared to 1H FY13; and
- Underlying fuel costs (excluding the impact of the carbon tax) for 1H FY14 are expected to be approximately \$2.27 billion, an increase of \$88 million from 1H FY13.

The outlook for the second half of FY14 remains volatile and, given the uncertainty in global economic conditions, fuel prices and foreign exchange rates, it is not possible to provide further guidance at this time.

Qantas CEO Alan Joyce said the circumstances demanded urgent action.

“We will do whatever we need to do to secure the Qantas Group’s future,” Mr Joyce said.

“The challenges we now face are immense – but we will overcome them and we will continue to build a stronger and better Qantas for Australia.

“Since the Global Financial Crisis, Qantas has confronted a fiercely difficult operating environment – including the strong Australian dollar and record jet fuel costs, which have exacerbated Qantas’ high cost base.

“The Australian international market is the toughest anywhere in the world.

“Our competitors in the international market, almost all owned or generously supported by their governments, have increased capacity to pursue Australian dollar profits, changing the shape of the market permanently.

“Since early 2012, there has also been an unprecedented distortion of the Australian domestic market, with Virgin Australia’s strategy to seek majority ownership and massive financial backing from foreign government-owned airlines (see Appendix 1).

“This foreign government capital has been used to finance dramatic increases in domestic capacity, with profound implications for the future of Australia’s aviation industry. In November, Virgin signalled its intention to continue its strategy, which is designed to weaken Qantas in the domestic market, with a \$300 million-plus injection from its foreign owners.

“The uneven playing field in Australian aviation is being tilted further.

“We cannot and we will not stand still in these extraordinary circumstances.

“As we take these urgent actions, we will continue to take the fight to the competition and strengthen our leading position in the domestic market, and we will continue the turnaround of Qantas International.”

Accelerated cost reduction program

The Group will make accelerated cost reductions across all areas of the business, to achieve total cost savings of \$2 billion over three years.

The existing Qantas Transformation program will be accelerated, with an expanded mandate to achieve these targets, including the following steps:

- Head count reduction of at least 1,000 positions within 12 months, with an ongoing review
- CEO and Board pay cut
- Pay freeze and no FY14 bonus for executives
- Review of spending with top 100 suppliers
- Network optimisation and improved fleet utilisation
- Further overhead reductions

Mr Joyce said the Group had already made significant progress in becoming leaner and more efficient.

“We have reduced the Group’s unit costs, excluding fuel, by a total of 19 per cent since FY09, including by 5 per cent in FY13 (see Appendix 2).

“But these actions are not enough to deal with the current situation.”

Capital expenditure and structural review

Given the deterioration in earnings, the Group no longer expects to generate positive net free cash flow in the current financial year.

The Group will conduct a review of all planned capital expenditure to achieve further substantial reductions to ensure that the business generates positive net free cash flow from FY15.

This continues the deep cuts to capital expenditure already achieved since 2011.

The Group will also launch an immediate review to identify structural changes that could potentially unlock sources of capital and value for shareholders. No options will be excluded from the review.

Mr Joyce said the Group would take all steps necessary to respond to the toughest market conditions it had ever faced.

“We will focus relentlessly on cutting costs and improving productivity, while maintaining our competitive advantages as a business,” Mr Joyce said.

Australia’s best airline for customers

Mr Joyce said customers would remain at the heart of the Group’s strategy, with a continued focus on service in all areas.

“We have Australia’s best airline and loyalty program, with nearly 10 million loyal frequent flyers,” Mr Joyce said. “Over the past two years, we have developed a global network based on strategic alliances, including the ground-breaking Emirates partnership and expanding relationships in Asia.

“The Qantas customer experience is the best it has ever been. After an intensive fleet renewal program, our average passenger aircraft age is now below eight years, the youngest in two decades, and we have

revitalised service with a focus on training and new technology. Customer satisfaction is soaring, with record scores in both the international and domestic markets.”

Discussions with the Australian Government

“As we work through our cost reductions, capital expenditure and structural review, no options will be off the table,” Mr Joyce said.

“Political leaders recognise Qantas’ strategic importance, its critical role in providing essential air services, and the benefits to Australia of a strong and viable national carrier.

“None of the measures being discussed with the government would alleviate the need for us to take the comprehensive actions we have announced today. Government action will, however, be key in enabling us to keep competing effectively on a level playing field.”

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Appendix 1 – Developments in the Australian Aviation Market

The regulation of Australia's aviation industry is like no other in the world.

In the international market, in line with most countries, Australia requires that international airlines be Australian majority owned and controlled in order to be eligible for Australian carrier designation. The Australian Government negotiates bilateral access rights and traffic slots around the world on behalf of Australian-designated carriers under the terms of the Air Navigation Act.

In the domestic market, however, unlike every comparable jurisdiction in the world, Australia permits domestic airlines to be 100% foreign owned, with one exception, namely Qantas. Every other comparable jurisdiction requires at least majority local ownership and control, and the USA, for example, caps foreign ownership at 25%.

In February 2012, Virgin Australia split its corporate structure to enable foreign-government owned airline shareholders – Air New Zealand, Etihad and Singapore Airlines, plus the Virgin Group - to buy a majority ownership position in the business, now 73%, and rising potentially to 80% following its capital raising. Apart from its Board, Virgin Australia's international business has no existence independent of the domestic arm: no assets, management, people or funds.

In August 2013, the three foreign government-owned airlines provided a loan of \$90 million to Virgin. This was subsequently replaced by an equity capital injection of \$350 million. The purpose of this sovereign foreign capital is to fund Virgin Australia's strategy in the domestic market and weaken Qantas so that Qantas will be less able to provide support to its international operations. For example, having reported a statutory loss of \$98 million in the last financial year, Virgin Australia has added more than 2.5% new capacity to the market, and Tiger has added more than 26% to the domestic market this financial year to date (July 2013 to October 2013) neither of which is the behaviour of a profit-maximising organisation.

The foreign airline owners are not driven by the same commercial disciplines as Qantas. Over the longer term they are focused on directing passenger traffic to their home ports for sovereign strategic goals.

Virgin Australia is able to fund its activities through its foreign shareholders in a way that Qantas cannot due to the limitations of the Qantas Sale Act. The Act puts restrictions on Qantas' ownership and access to foreign capital, which compounds the advantages that foreign government-owned and supported competitors enjoy over Qantas. Unlike many of its competitors, Qantas gets no government subsidies, no tax benefits or concessions, no preferred access to airports and no preferential access to Australian Government business.

Qantas has been raising these issues privately with the current and the previous Federal Government since February 2012. It is also contributing to the current public debate which has intensified since the Treasurer's comments on 27 November.

Qantas believes that Virgin Australia should not have the benefits conferred by an Australian carrier designation when it has only 20 per cent Australian ownership, and more than two thirds foreign sovereign airline ownership.

In addition, Qantas believes the Foreign Investment Review Board should address the fact that the current Virgin Australia share placement process is facilitating a flood of foreign government funds to prolong anti-competitive action aimed at weakening Qantas.

Qantas is in discussion with the Government about a range of additional policy measures the Government could consider in order to provide a more level playing field for the aviation sector in Australia.

Appendix 2 – Capital Expenditure, Costs and Transformation Milestones

Since announcing a wholesale review of costs, capital expenditure and a new strategic direction for Qantas International in August 2011, the Group has made significant progress towards building a strong, viable business for the future. Transformation initiatives across the group have resulted in redundancies of approximately 3000 full-time employees.

Milestones over the past two years include:

Fleet & Capital Expenditure

- Deferred delivery of six Airbus A380s to between 2018 and 2021, lining up with the retirement of the last B744ER aircraft in the fleet. Deferred capital expenditure of \$US2.3 billion at list prices
- Deferred delivery of two A380 aircraft to financial year 2017 at earliest
- Reconfigured 12 x A380 aircraft to increase efficiency, adding 8% more seats by reducing business class and adding more economy and premium economy
- Reconfigured 9 x B744 aircraft, adding 19% more seats and upgrading interiors to A380 standard
- Restructured Boeing 787 order, reducing firm commitments for 35 x 787-9 aircraft. Reduction in capex commitments of \$US8.5 billion at list prices
- Reduced B744 fleet from 26 in August 2011 to 16 as of June 30 2013
- Youngest average fleet age since privatisation, at 7.9 years as of June 30 2013
- Increase in Qantas jet aircraft utilisation – FY14 forecast at ~9.9 hours per day compared to FY13 at ~9.4 hours

Network

- Withdrawal from unprofitable international routes including Bangkok and Hong Kong-London, Singapore-Frankfurt, Auckland-Los Angeles, Singapore-Mumbai, Perth-Hong Kong and Adelaide-Singapore
- Global partnership with Emirates including hub shift for European flying to Dubai from Singapore, integration of Frequent Flyer schemes, joint sales, marketing and flight scheduling
- Expanded or entered into new alliances with American Airlines, LAN Chile, China Eastern, China Southern, Malaysia Airlines
- Restructure of Asia flying to focus on right timing and connections, including 40% increase in available seats to Singapore and 14% increase in available seats to Hong Kong

Qantas Transformation & Asset Sales

- Heavy maintenance consolidation from three facilities to one (as of early 2014)
- Line Maintenance efficiencies; 'maintenance on demand'
- Catering facility consolidation
- Airport ground operation efficiencies
- Corporate and commercial overhead reductions
- Exit from Freight joint venture with Australia Post with the sale of Star Track Express road freight, and acquisition of 100% of Australian Air Express
- Sale of Qantas Defence Services