A GREAT DEAL OF LUCK HELPED QANTAS REVERSAL

News / Airlines

A year ago the Herald's view of Qantas tallied with a commonly held belief among business analysts, economists and, indeed, the flying public. Australia's flag carrier was on the nose, its leadership struggling and its finances shaky to the point where it wanted taxpayers to help out. Some observers even wanted to change the Qantas Sale Act to allow greater foreign investment in the national carrier so it could compete better with foreign state-owned rivals.

While we still believe much of Qantas' malaise was self-inflicted, we must admit that the airline's chief executive, Alan Joyce, has exceeded expectations of his ability to implement a tough recovery plan.

The carrier's underlying profit for the year to June was AU$975 million - a AU$1.6 billion turnaround from a AU$646 million loss. Qantas will even reward shareholders with a AU$505 million capital return.

What a difference 12 months makes. Last August we raised the question whether Mr Joyce should even retain his job. He'd had six years to fix the mess, and in some instances had made it worse.

But we bestow a fair helping of praise for Mr Joyce today. No-one can deny his doggedness and willingness to take risks in pursuit of his goal.

His strategy has helped improve the time Qantas takes to get aircraft ready to fly again. Less profitable routes have been dumped. He has scaled back Jetstar's ill-conceived Asian expansion. Old, less-efficient aircraft have been retired. Leases on terminals have been sold. Debt has been paid down.

We still believe Qantas should be majority Australian owned because that is its value proposition. We also maintain Mr Joyce was wrong to ground the airline in 2011 when negotiations with unions were still possible. And we think Mr Joyce overplayed the problems the airline faced then and last year when he sought government help.

Yet his tactics put enormous pressure on Qantas staff to accept a wage freeze and job cuts. Staff will receive an average AU$3200 each in bonuses for tolerating the freeze.

We also maintain Qantas was wrong to go to war with Virgin on domestic routes by trying at any costs to retain 65 percent of the market. To his and Virgin's financial credit, although not to the benefit of fliers, both have called a truce in the price war. Qantas is reaping those benefits and Virgin has decided to compete on Qantas' terms by going upmarket.

His tasks are not done, though. Some of the bad blood with staff and the public remains, too.

As such few will regard the tripling of Mr Joyce's remuneration for 2014-15 to AU$11.9 million as justified. His take-home pay for the year rose from the frozen AU$2 million to AU$6.7 million. About AU$4.6 million of his pay packet came from long-term incentives from share price growth.

True, Qantas shares have risen from AU$1 in 2012 to AU$3.50. But to reward Mr Joyce so generously now irks somewhat, given that at least part of the company's reversal was due to good fortune.

The latest profit looked better than it was. Mr Joyce chose to write down the value of its fleet last year, which inflated the size of the loss. But that has also ensured a succession of years when the earnings will benefit from reduced allowance for depreciation.

Qantas enjoyed a AU$116 million boost from the removal of the carbon tax, too.

But above all the profit surged thanks in large part to a halving of the oil price, which cut AU$461 million straight from the airline's fuel costs. The price has dropped another 30 percent since, meaning the next half-yearly result should look stronger still. Mr Joyce insisted that every airline benefited from the lower oil price "but Qantas is outperforming the market and the rest of the airline groups because of its transformation, and it's only because of the transformation that we have these strong results".

That is mostly correct, although Qantas remains exposed to a reversal of this oil price plunge back to levels about AU$100 a barrel.

When depreciation benefits eventually dissipate, too, the airline will be left with an inflated book value for its fleet. That will require another hefty writedown and pressure the share price once more. New aircraft are expensive as well.

Recall too that many analysts still believe the airline is worth about twice as much broken up than its current sharemarket value suggests.

Mr Joyce will have to either cut more, rely on price falls or expand the revenue growth to ensure the airline's shares reflect its potential. Revenue rose just 3 percent in the latest financial year. All global airlines are struggling and a China slowdown may worsen that.

Qantas is now better placed to handle a world economic hit, and for that Mr Joyce deserves praise. But a falling Australian dollar will reduce domestic demand for international flights and push up the $A price of aviation fuel. The journey remains a bumpy one.

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