



# QANTAS'S NEXT DILEMMA: WHETHER TO BUY WITH BLOOD ON THE STREETS

News / Airlines



**Qantas [Airways](#) Ltd. has just posted its best profit result in seven years. Chief Executive Officer Alan Joyce must now decide whether to throw the cash at expansion in a region where competitors have lost US\$462 million over the last 12 months.**

The best time to buy is when there's blood on the streets, according to a maxim attributed to a member of the Rothschild banking dynasty. That sounds a lot like current conditions in Southeast Asia's airline sector, where a market-share war has dented everyone's revenue, said Tony Webber, an independent aviation consultant and former Qantas chief economist.

"Southeast Asia is just a bloodbath at the moment," he said.

Growing the route network of Qantas's low-cost Jetstar brand in Asia is the best hope for generating growth long-term, according to Contango Asset Management Ltd. The market share war that's maimed Jetstar's competitors provides it with an opportunity, according to Con Korfiatis, founding chief executive of Singapore-based Jetstar Asia.

"Outside their domestic business, their only avenue is to expand into the Asian region via the Jetstar brand," said George Boubouras, who helps manage about AU\$900 million (US\$641

million) including Qantas stock as chief investment officer of Contango in Melbourne. "It still is the fastest-growing market in the world, despite the slowdown."

## **Rising Incomes**

Even amid recent market turmoil, the region is seen as a prize because of the long-term rise in incomes and the opening of airline markets via an open-skies agreement. The Asia-Pacific region will add 1.2 billion middle-class households over the decade to 2023, compared with just 15 million more in Europe and North America combined, according to an April presentation by Airbus Group SE.

The future of aviation will be in Asia and Qantas only has a "brief window" to exploit it, Joyce said in a 2011 speech.

The scale of the opportunity has created its own problems as airlines rush to grab market share.

In the Bloomberg Asia-Pacific Airlines Index, yields -- a measure of ticket prices -- fell in the June quarter to 6.70 U.S. cents per passenger, per kilometer. That's down 21 percent from a year earlier and roughly at mid-2009 levels, when yields reached the lowest point in records dating back to 2002.

The region's major listed low-cost carriers -- Malaysia's AirAsia Bhd. and AirAsia X Bhd., Singapore Airlines Ltd.- controlled Tiger Airways Holdings Ltd., Thailand's Nok Airlines Pcl, and India's Spicejet Ltd. -- had a combined net loss of US\$462 million over the 12 months that ended in June, according to data compiled by Bloomberg.

## **Irrational Behaviors**

That dynamic appears to be bottoming out, according to Joyce. "Irrational behaviors in the past" by airlines adding too many flights are no longer happening in Singapore, he said at a media conference on Aug. 20 while announcing annual results.

Qantas, which spent nearly three years in a losing battle to set up a Jetstar subsidiary in Hong Kong, is looking to focus on its existing brands for now.

"We won't be starting any new ventures until we've gotten all of the Jetstar operations to where we want them," said Joyce. "We're going to do things in a sensible way."

That doesn't preclude growing its network. Singapore-based Jetstar Asia will add routes to two cities on Indonesia's Sumatra island and to Danang in Vietnam over the coming 12 months, and has struck two codeshare agreements with other carriers, the company said in a presentation.

The Jetstar Pacific venture in Vietnam has added four planes and flights to Bangkok, Singapore and Macau, and Qantas is investing an extra AU\$55 million into its Jetstar Japan venture with Japan Airlines Co.

## **Cash Generation**

Qantas's profit recovery leaves it unusually well-protected right now: It will have generated about US\$2.1 billion of cash to invest in new projects over the four fiscal years ending in 2018, according to analyst estimates compiled by Bloomberg.

By contrast, the analysts expect Jetstar's main competitors, AirAsia and Singapore Air -- which

controls SilkAir, Scoot and Tiger Air -- to eat into their cash reserves over the same period, constraining their ability to spend.

That doesn't mean investment is the best use of Qantas's cash. Slowing economic growth in Asia is posing a challenge to airline expansion, according to Bloomberg Intelligence. The carrier would be wise to wait until a recovery in the regional aviation sector is established, said Webber, the former Qantas chief economist.

## **Paying Debt**

Joyce might be better off using excess funds to further pay down debt, according to Cameron McDonald, an analyst at Deutsche Bank AG in Melbourne. Jetstar Asia's return to profit is "an accomplishment, not necessarily a reason to look to do more," said Will Horton, a Hong Kong-based analyst at CAPA Centre for Aviation.

Still, the years ahead may present an opportunity that Joyce will recognize from earlier in his career, said Korfiatis, the Jetstar Asia founder who's now a partner with executive recruiter Heidrick & Struggles International Inc.

An open-skies agreement being implemented across Association of Southeast Asian Nations members offers the prospect of deregulation, like that which contributed to the rise of low-cost carriers Southwest Airlines Co. in the U.S. and Ryanair Holdings Plc in Europe. The agreement "creates great opportunities for our airlines," Joyce said.

The Irish-born executive founded Jetstar as Qantas's discount brand in 2003. His first job was at Aer Lingus Plc when it was dealing with upstart competition from Dublin-based Ryanair.

Qantas now has the same opportunity as Ryanair to use low-cost flights to expand beyond its smaller home market, said Korfiatis.

"When the low-cost model was being rolled out through Europe there were a lot of naysayers, but they were wrong," he said. "Asia's the same. If you're looking for a growth story for Qantas, how much more can you exploit a country of 20-plus million people?"

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