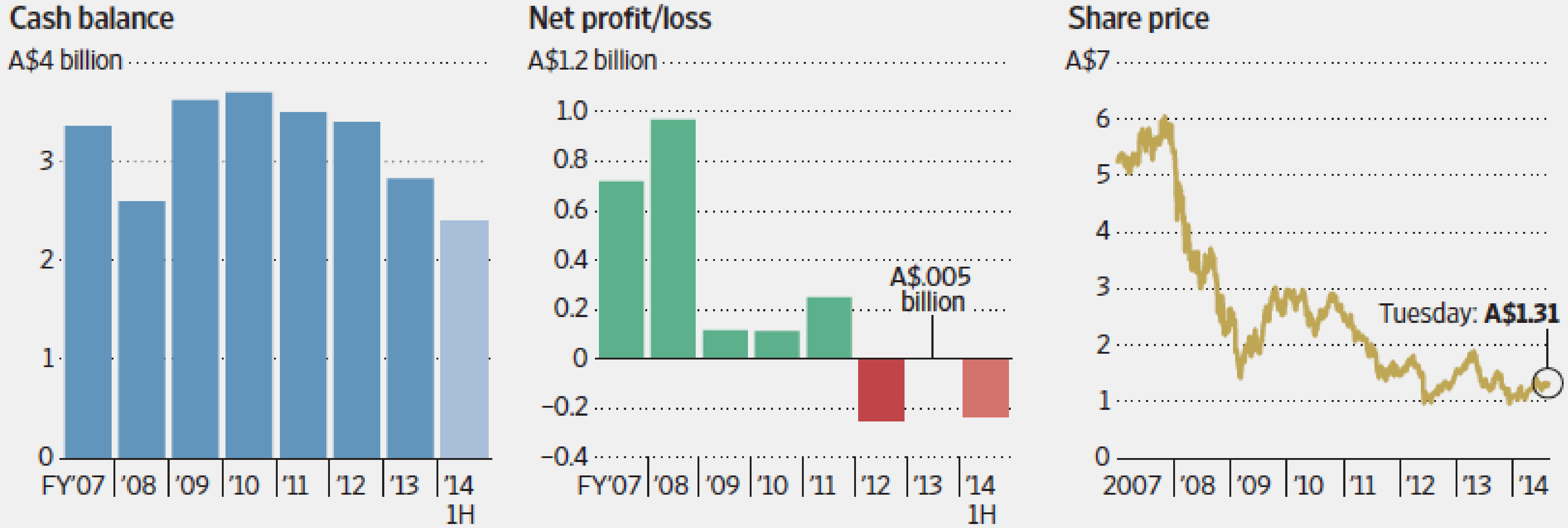
Dilemma Challenges Qantas CEO

By Ross Kelly

Cash Conundrum

Weak financial results are eroding Qantas's cash pile and putting pressure on its balance sheet.



Sources: the company (cash, profit/loss); FactSet (share price)

The Wall Street Journal

SYDNEY—As **Qantas Airways** Ltd. prepares to report the deepest loss in the airline's history, Chief Executive Alan Joyce faces a painful choice.

Mr. Joyce is under growing pressure to sell assets—including Qantas's successful frequent-flier business—to ease strain on the Australian carrier's balance sheet.

Regardless of whether he opts to hold on to the airline's more prized possessions in the hope that better conditions may prevail, it won't be an easy ride for Mr. Joyce—now in his sixth year as boss—when Qantas reports full-year earnings this week. For one thing, industry analysts and credit-rating firms will be standing by to pounce on anything that merits further downgrades.

Like many national airlines, Qantas has long been hampered by high jet-fuel costs, sluggish global demand and competition from Middle Eastern carriers, all of which have been gnawing away at its long-distance business.

More recently, the so-called Flying Kangaroo has also faced challenges at home, where it has been forced to cope with an economic slowdown and intensifying rivalry with **Virgin Australia Holdings** Ltd., which is backed by **Etihad Airways** PJSC, **Singapore Airlines** Ltd. and **Air New Zealand** Ltd.

"Qantas has struggled to grow profits for a decade," said Roger Montgomery, chairman of Montgomery Investment Management. "There's a belief that all the value lies in the loyalty business, but without it the true economics of the company could be laid bare."

Qantas has fortified its traditionally strong balance sheet by canceling and deferring some aircraft orders. But a string of poor earnings has recently driven the airline to even more desperate cost cutting—including thousands of layoffs and the scrapping of some routes.

Qantas booked a net loss of 235 million Australian dollars (US$218 million) for its first half, and analysts are expecting the airline on Thursday to report a loss as deep as A$1 billion for the fiscal year through June. At the end of December, the carrier had A$2.4 billion in cash and A$630 million in undrawn facilities. Net debt including operating-lease liabilities amounted to A$5.33 billion.

Until recently, Qantas's long-distance losses had been offset by earnings at its domestic unit, which benefited from the growing need for people to travel to remote parts of the country for mining. But as Australia's resources boom has slowed over the past two years, that part of Qantas's business has come under pressure as well.

Adding to its woes are the increasingly deep pockets of the airline's main local rival, Virgin Australia, whose international backers have been able to support aggressive price cutting to erode Qantas's market share.

Aside from the highly valued loyalty business, Qantas may be considering spinning off its Jetstar budget offshoot or selling stakes in its subsidiaries in Singapore, Japan, Vietnam and Hong Kong.

Qantas said last week that it hadn't made a decision on the fate of the frequent-flier business—the only division to show an improvement in first-half earnings from a year earlier.

Mark Williams, an analyst at CIMB, is urging Qantas to ride out the storm amid signs that price competition is easing. "We continue to advocate the retention of the loyalty business, given its importance to the overall Qantas customer proposition," he said.

Qantas's biggest shareholder, U.S.-based **Franklin Resources** Inc., also doesn't appear to have lost faith in the airline's strategy, this year increasing its holding to 18.7% from 17.5%.

But for others, there is no case for buying airline shares—Qantas or otherwise. "It's a highly capital-intensive industry and flying's a commodity," Mr. Montgomery said. "People don't care who they fly with, they just go with the cheaper price."