

Lessors seem to be Unshockable

THE OPERATING lease industry has come through the pandemic, successfully dealing with the threat of airline bankruptcies and lease defaults. Then all the leased aircraft in Russia were seized. Then interest rates, which represent by far their largest cost element, soared. This has all resulted in a situation where the leading lessors are claiming fundamental strong financial health with a very positive outlook.

In fact, the fall-out from Russia's invasion of Ukraine has had a serious impact on the lessors' profitability but they have responded by publishing two net income figures — the actual result and one adjusted for write-offs they have had to make on aircraft leased to Aeroflot and other Russian airlines.

The implication is that the Russian losses will eventually be recovered from the insurers; after all their assets were in effect stolen in Russia. Numerous legal cases have been launched mostly in the Irish courts and mostly against Lloyd's of London insurers and re-insurers (see table of estimated impairments on the following page). Law firms are the only certain winners as it is not legally clear-cut as to whether the insurance policies do fully cover all the lessors' costs as the leasing companies technically terminated the lease agreements, in line with Western government sanctions.

Three of the main lessors have recently released their financials for calendar 2022 (SMBC and BOC Aviation have yet to report for their full financial years).

✈ AerCap, having completed the "flawless integration" of GECAS, saw its revenues increase by over a third to \$7bn but it reported a net loss of -\$0.73bn, a margin of -10.4%, which

it adjusted to a net profit of \$2.18bn, 31.1%, by stripping out the Russian impairments. AerCap has already made a projection for 2023: \$1.2bn net profit, \$1.7bn after adjustments.

✈ Avolon increased its revenues by 9% in 2022, but achieved a slightly better than break-even result; with relatively little exposure in Russia its adjusted net profit came in at \$0.25bn.

✈ Air Lease Corporation, the most efficient and profitable of the lessors in recent years, also reported a net loss for 2022: -\$0.14bn compared

This issue includes

	Page
Lessors seem to be Unshockable	1
Boeing and Airbus Orders and Deliveries 2022	5
Boeing and Airbus: Finances Stabilised	10
Qantas: Flying Kangaroo Bounces Back	15

to a profit of \$.41bn the previous year; adjusting for Russian impairment (plus some other financial adjustments) ALC produced a pre-tax profit figure of \$0.66bn for 2022.

MAJOR LESSORS 2022 FINANCIALS (\$bn)

		2022	2021	
AerCap	Total Revenue	7.01	5.22	34.3%
	Net Income	-0.73	1.00	na
	Adjusted Net Income	2.18	1.00	118.0%
	Assets	69.73	74.56	
	Debt/equity ratio	2.9	3.0	
Avolon	Total Revenue	2.34	2.14	9.3%
	Net Income	0.01	0.05	-82.0%
	Adjusted Net Income	0.25	0.05	426.3%
	Assets	30.8	30.98	-0.6%
	Debt/equity ratio	2.3	2.4	-4.2%
ALC	Total Revenue	2.31	2.09	10.5%
	Net Income	-0.14	0.41	na
	Adjusted Pre Tax Income	0.66	0.58	13.8%
	Assets	21.75	19.96	
	Debt/equity ratio	2.4	2.4	

Aviation Strategy

Aviation Strategy

ISSN 2041-4021 (Online)

This newsletter is published ten times a year by Aviation Strategy Limited Jan/Feb and Jul/Aug usually appear as combined issues. Our editorial policy is to analyse and cover contemporary aviation issues and airline strategies in a clear, original and objective manner. Aviation Strategy does not shy away from critical analysis, and takes a global perspective — with balanced coverage of the European, American and Asian markets.

Publisher:

Keith McMullan
James Halstead

Editorial Team

Keith McMullan
kgm@aviationstrategy.aero
James Halstead
jch@aviationstrategy.aero

Subscriptions:

info@aviationstrategy.aero

Copyright:

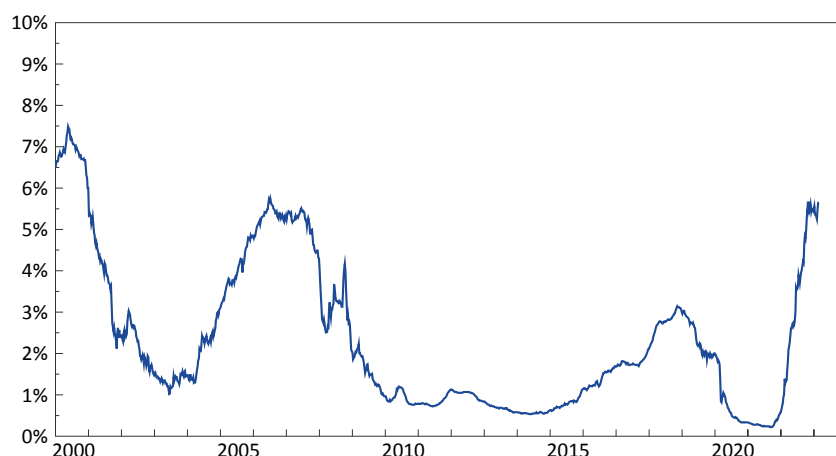
©2023. All rights reserved

Aviation Strategy Ltd
Registered No: 8511732 (England)
Registered Office:
6 Langside Avenue
London SW15 5QT
VAT No: GB 162 7100 38
ISSN 2041-4021 (Online)

The opinions expressed in this publication do not necessarily reflect the opinions of the editors, publisher or contributors. Every effort is made to ensure that the information contained in this publication is accurate, but no legal responsibility is accepted for any errors or omissions. The contents of this publication, either in whole or in part, may not be copied, stored or reproduced in any format, printed or electronic form, without the written consent of the publisher.

Typeset in Calibri and Rockwell using X_qL^AT_EX

1 YEAR LIBOR (US\$)



Source: www.macrotrends.net.

The largely unanticipated invasion of Ukraine effectively terminated the leases of about 500 Western jets, of which about 100 were recovered, so roughly only about 4% of the global operating leased fleet was affected. Understandably, the lessors are not speculating about the next geo-political shock but Taiwan continues to look vulnerable. China is a major player in the aircraft leasing industry, with about 20%, 2,600 aircraft, of the global operating fleet owned by Chinese state banks, other Chinese-backed entities or in joint ventures with Japanese financial institutions. Of this fleet about 28% are leased to North American and European airlines. Could these 700-plus aircraft be weaponised in the event of a PRC/ROC conflict?

The interest rate impact

All the lessors seemed to prosper in the era of ultra-low interest rates that stretched from 2010 until early last year when sudden inflationary pressures, largely caused by the Russian invasion of Ukraine, caused an abrupt change of monetary policy by the Fed, the ECB and the Bank of England.

One-year LIBOR shot up from 0.3% pa at the beginning of the year to 5.85% by the end, the same level as in the 2006-08 peak. (LIBOR — the key benchmark rate — will be replaced after June this year by SOFR (Secured Overnight Financing Rate)).

Interest rates may come down somewhat over the next 12 months but are very unlikely to revert to pre-2022 levels. For the lessors this means that lease rates have to be recalibrated with their new cost of capital.

Their composite cost of capital depends on the proportion of debt in floating or fixed rate debt, the maturity schedule of the debt and the lessor's credit rating. The major

RUSSIAN IMPAIRMENTS

AerCap	\$2,700m
SMBC	1,600
ALC	802
BOC Aviation	682
Carlyle Aviation	700
DAE	576
Avolon	304

Source: KPMG

Aviation Strategy

LESSOR ORDER BACKLOG (December 2022)

Customer	Boeing			Airbus					Total Backlog
	737 MAX	787	Total Boeing	A220	A320neo	A330	A350	Total Airbus	
Air Lease Corporation	98	5	103	71	175	12	13	271	374
AerCap	129	25	154		116			116	270
Avolon	31	2	33		168	4		172	205
CALC	66		66		127			127	193
BOC Aviation	69		69		115			115	184
SMBC Aviation Capital	56		56		116			116	172
NAS Aviation Services					101	11		112	112
Aviation Capital Group	34		34	20	52			72	106
CDB Aviation	19		19		61			61	80
Macquarie AirFinance	20		20	27	20			47	67
ALAFCO					47			47	47
CIT Leasing						23		23	23
Azorra Aviation				22				22	22
Jackson Square Aviation	22		22						22
Accipiter					20			20	20
Goshawk					20			20	20
Nordic Aviation Capital				20				20	20
Timaero					20			20	20
CMB Financial Leasing					14			14	14
Ilyushin Air Finance				14				14	14
Minsheng Leasing	14		14						14
Boeing Capital Corporation		12	12						12
ICBC					6			6	6
Pembroke Capital Limited	4		4						4
GTLK				1				1	1
Total	562	44	606	175	1,178	50	13	1,416	2,022

lessors have predominantly fixed into historic low rates; ALC, for example had 91% of its debt at fixed rates at the end of 2022, giving it a composite cost of funding of 3.07%.

But raising new funds has become expensive. At the beginning of 2022 the top-tier lessors could raise five-year senior unsecured debt at an all-in rate of around 2-3% but that rate has more than doubled. For example, ALC achieved funding of \$1.5bn in January 2022 for five-year unsecured notes at 2.20% and 2.875% but in November and December it was paying 5.85% on two five-year loans of \$700m each.

The credit rating companies have maintained their investment grade ratings for the leading lessors — BBB or BBB- from Fitch, focusing on strong cashflow and liquidity. Avolon, for instance, generated \$1.2bn in oper-

ating cashflow in 2022, more than in pre-pandemic 2019, and had total available liquidity of \$5.6bn. AerCap claims to have \$18bn of liquidity sources.

Lessors have seen one source of funding virtually disappear. Asset Based Securities — packages of aircraft leases offered to investors — are no longer viable as the lease rates still reflect low interest rates.

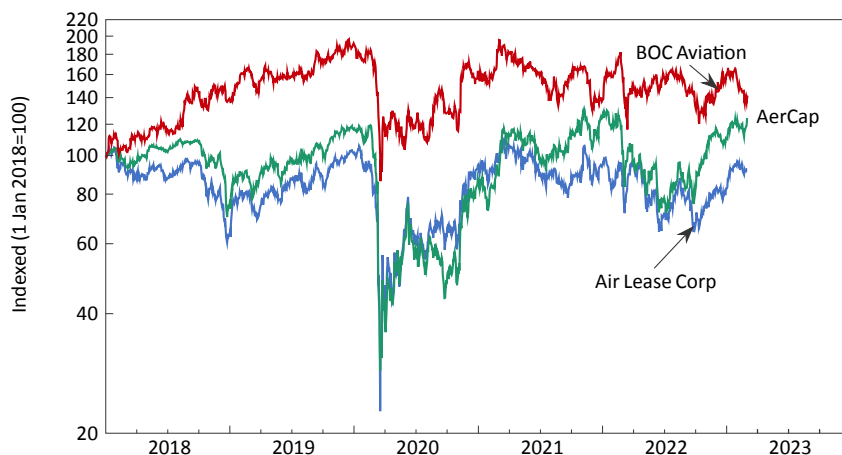
Still, lease rates have to follow interest rates, which they will do with lags depending on the expiry profile of the lease portfolio. None of the lessors has been willing to put a timescale on their lag period. Typically, five-year operating leases have fixed rentals with escalation clauses relating to specific inflation measures. The new higher lease rates apply just for new agreements and are negotiated between lessor

and lessee with regard to rolling over existing leases and signing new leases.

As a theoretical example: a year ago an airline might expect to lease a new A320neo at around \$300,000 a month but to fully cover the increase in the lessor's interest costs that rate would have to be increased by 33% to about \$400,000 (based on a three point interest rate increase and 80% debt financing). At the end of last year IBA, the aircraft appraiser and consultancy, noted that it was observing 14% to 20% increases in lease rates for new-technology narrowbodies compared to the previous year.

Some investors in leasing companies are worried that airlines will not be able to absorb this type of cost increase. To allay these concerns, AerCap produced a pie chart during its results presentation showing that air-

LESSORS FIVE YEAR SHARE PRICE PERFORMANCE



craft rentals and ownership costs accounted for only 5% of airlines' total costs in 2022. This argument, which used to be frequently deployed by airports, is questionable. Airlines tend to focus on what percentage of the operating or net result the cost item accounts for. And some major leasing clients have much higher exposure: for example, at Wizzair, an airline with almost all its fleet under operating leases, rentals and depreciation accounted for 24% of total costs in 2022.

Lessors and OEMs

Have the lessors been prescient or lucky or both? In 2021 they seemed to be facing a very problematic situation with grounded airlines demanding deferrals on their lease payments or threatening to go out of business, defaulting on the leases. In the event, the pandemic fall-out turned out to be controllable thanks mainly to the state support afforded to the airlines filtering through to the lessors. Of the 30 top lessees identified in the May 2021 issue of *Aviation Strategy*, many looked financially vulnerable at that time but only three have had ma-

yor defaults — the Russian carriers Aeroflot and S7, and Hainan Airways — and none of those was as a direct result of the pandemic. The latest results presentations scarcely referred to deferrals and defaults.

In the current market, with rising interest and lease rates, one might expect asset values to come under pressure. But this does not appear to be the case; rather, new and second-hand prices held firm throughout 2022 and are predicted by IBA to increase markedly this year, both for narrowbodies and for widebodies.

The fundamental reason is the tight supply/demand balance for new aircraft caused by production shortfalls at the OEMs — see pages 5–10. AerCap focused on the effect of supply constraints in its results presentation. It estimated that during the period 2019–2022 1,800 fewer narrowbodies were delivered than was planned, which equated to 11% of the 2019 fleet. For widebodies, the production delays hit in 2020–22 when 720 fewer aircraft were delivered than planned; this was equivalent to 15% of the 2019 fleet. AerCap expects the supply constraints

“to persist for some time”.

ALC too is sceptical about the OEMs' production targets, and reckons that restricted supply combined with post-pandemic demand recovery, particularly when China fully re-opens, probably means that the airline industry will be able to achieve strong growth in traffic and in yields, a favourable environment for pushing up lease rates.

On the other hand, the balance sheets of many airlines have been weakened by the state-backed debt taken on during the pandemic, which also has a positive implication for the lessors, in that airlines will prioritise paying down debt from their improving cashflow rather using it for capex, which means more demand for operating leases. Demand for new aircraft is coming from some new sources — notably Air India's mega-order and perhaps an upcoming order from Saudi Arabia. The lessors with their formidable orderbooks — see table on the previous page — are in a much better position to fulfil early delivery slots than the OEMs.

The long-anticipated point where leasing companies own over half the global commercial fleet has been bypassed. Lessors have accounted for 60% of new deliveries over the past three years, with the result that the lessors' global fleet, according to Avolon's estimates, increased by 1,850 units to 12,950 between 2019 and 2022 while the airlines' owned fleet fell by 350 aircraft to 12,750. So operating lessors now control about 50.4% of the total. Increasingly, lessors are not only the main supplier of aircraft but also the main driving force determining the demand for technological and ESG innovation at the OEMs.

Orders, Deliveries and Production Rates

IN THE annual aircraft orders race, Airbus pipped Boeing to the finishing line once more in 2022 with 1,078 new orders, some 15% higher than its rival's 935. These figures were up by 40% and 3% respectively from the numbers achieved in 2021.

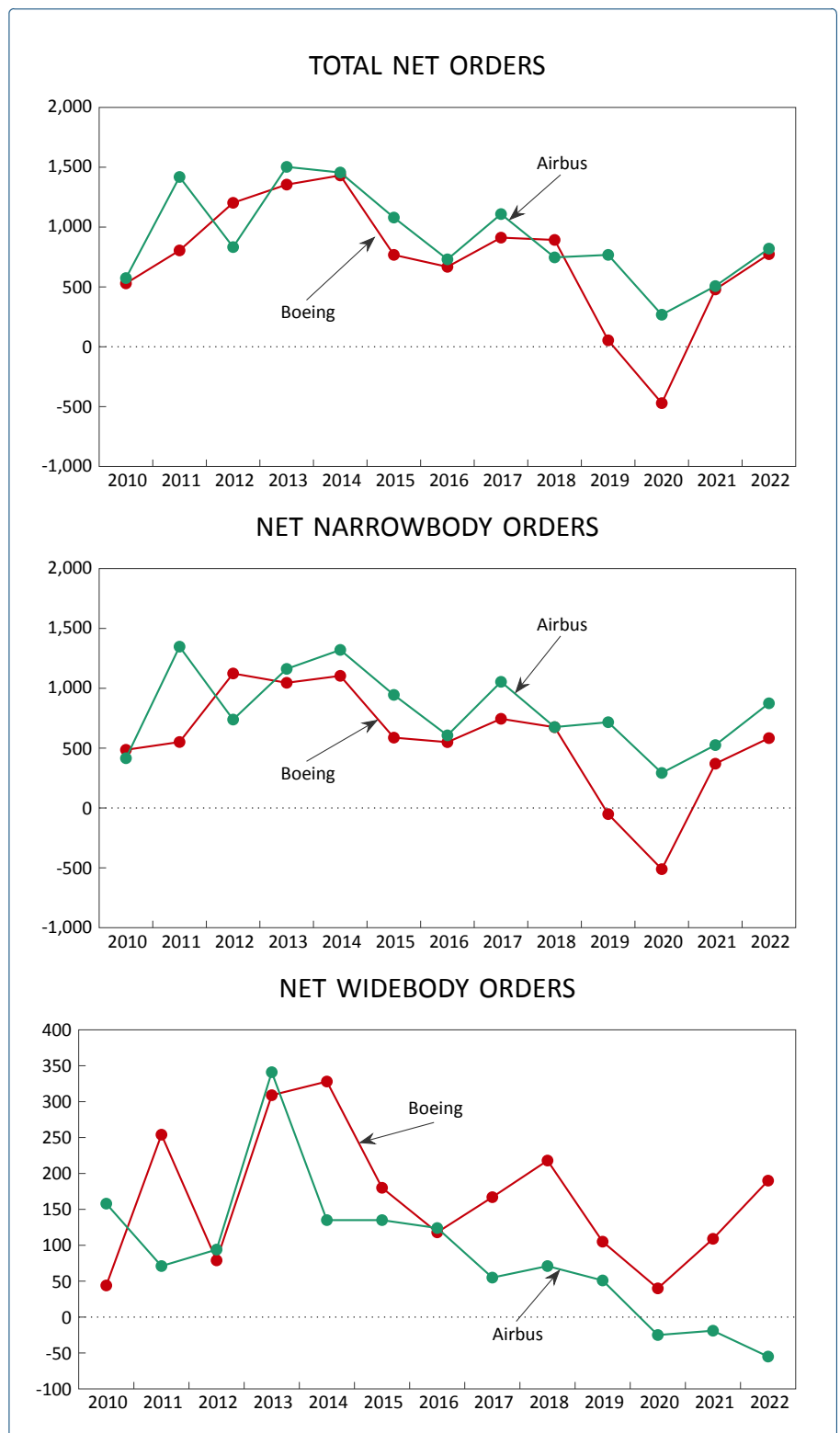
But on a net basis, after taking into account cancellations and changes to the backlog, the two manufacturers finished the year neck-and-neck. Airbus reported net orders for the year of 820, Boeing 815. Both these figures were 62% higher than those of the previous year.

This must have given some satisfaction in Seattle: back to the normal duopolistic market after Boeing's torrid time in 2019 and 2020 in the wake of the 737MAX grounding.

However, there were distinct differences in the performance of the two manufacturers' sales teams in 2022.

Narrowbody/Widebody

Firstly on narrowbody aircraft Airbus outgunned its rival yet again with a net 875 units ordered, 50% higher than Boeing's 584. It's not just the fight between the A320 and 737 families — the workhorses of the short-haul markets — Airbus is helped by having the A220 (formerly Bombardier's C-Series) in its offering and accounting for 124 of last year's orders. Airbus has outperformed Boeing in this segment in each of the past ten years — having announced a net 8,176 narrowbody orders over the decade, 60% above Boeing's 5,100 units — and boasts a backlog



Aviation Strategy

BOEING ORDERS 2022

	Customer	737	767	777	787	747	Total	
Asia/Pacific	ANA	20					20	
	China Airlines			4	16		20	
	EVA Air			1			1	
	Silk Way West†			2			2	
	Asia/Pacific Total	20		7	16		43	5%
Europe	Cargolux			10			10	
	IAG	50					50	
	Lufthansa			9	7		16	
	Europe Total	50		19	7		76	8%
MEAF	EL AL				1		1	
	Emirates			5			5	
	Ethiopian			5			5	
	Qatar	25		16			41	
	MEAF Total	25		26	1		52	6%
North America	Air Canada			2			2	
	Alaska	52					52	
	American	30					30	
	Arajet‡	20					20	
	Delta	100					100	
	DHL Aviation			6			6	
	FedEx		2	2			4	
	Hawaiian				2		2	
	Southwest	74					74	
	United	100			100		200	
	UPS		8				8	
	Western Global			2			2	
	WestJet	42					42	
	N America Total	418	10	12	102		542	58%
Lessors	AerCap	6			5		11	
	ALC	50					50	
	ACG	21					21	
	Avolon	5			2		7	
	Bain Capital	5					5	
	BBAM	5					5	
	BOC Aviation	40					40	
	Pembroke Capital	5					5	
	Lessors Total	137			7		144	15%
	Unidentified Customers	47		4	6		57	
	Government/Military		21				21	
	Gross Orders	697	31	68	139		935	
	Cancelled/Changes	-113	17	2	-25	-1	-120	
	Net Orders	584	48	70	114	-1	815	
	Backlog	4,312	106	440	574	1	5,430	

Note: † Cargo airline in Azerbaijan; ‡LCC in Dominican Republic.

Aviation Strategy

AIRBUS ORDERS 2022

	Customer	A220	A320	A330-900	A350	A350F	Total	
Asia/Pacific	Air China		64				64	
	China Eastern		100				100	
	China Southern		96				96	
	Qantas	20	20		12		52	
	Shenzhen		32				32	
	Sichuan		6				6	
	Silk Way West†					2	2	
	Singapore					7	7	
	Xiamen		40				40	
	Asia/Pacific Total	20	358		12	9	399	37%
Europe	Aer Lingus		4				4	
	Air France					4	4	
	British Airways		6				6	
	Condor		10				10	
	Croatia	6					6	
	Easyjet		56				56	
	Iberia		5				5	
	IAG		73				73	
	Jet2		38				38	
	Pegasus		8				8	
MEAF	Turkish				6		6	
	Europe Total	6	200		6	4	216	20%
	Air Côte D'Ivoire			2			2	
	Etihad					7	7	
	Jazeera		28				28	
	Kuwait		3	3			6	
	MEAF Total		31	5		7	43	4%
	Azul			3			3	
	LATAM		17				17	
	S America Total		17	3			20	2%
N America	Air Canada	15	10				25	
	American		4				4	
	Delta	12		1			13	
	Jetblue	30					30	
	Spirit		5				5	
	N America Total	57	19	1			77	7%
Lessors	Aviation Capital Group	20					20	
	Azorra Aviation	22					22	
	BOC Aviation		80				80	
	CDB Leasing		2				2	
	CIT Leasing			10			10	
	Financial Institutions				2		2	
	Lessor Total	42	82	10	2		136	13%
	Private Customer	2	3				5	
	Undisclosed		178			4	182	
	Gross Orders	127	888	19	20	24	1,078	
	Cancellations/changes	-3	-137	-84	-34		-258	
	Net Orders	124	751	-65	-14	24	820	
	Backlog	527	6,093	215	369	35	7,239	

Note: † Cargo airline in Azerbaijan

at the end of December of 6,093 A320s and 527 A220s compared with Boeing's backlog of 4,312 737s.

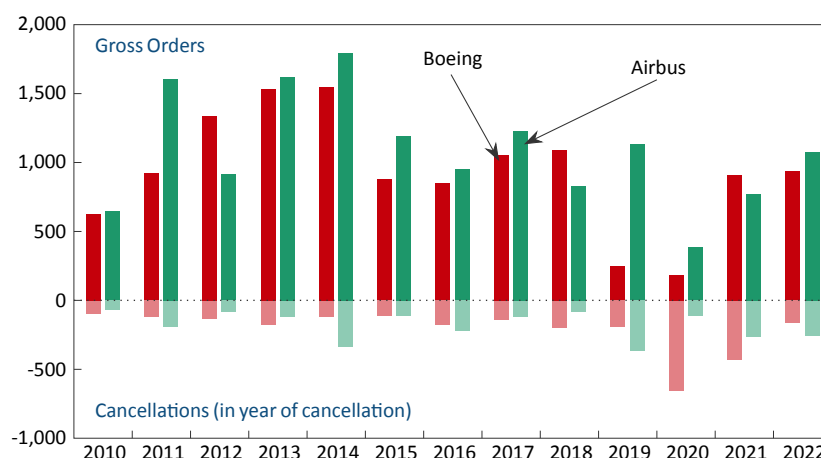
On widebody equipment the fortunes appear reversed. Boeing registered 190 net orders, 75% up on that reported for 2021 — its best year's performance since 2018 and nearly 10% above the annual average of the past decade. It is helped by its freight offering and tanker version of the 767, and was achieved in spite of some 25 787 cancellations.

In contrast, Airbus registered net cancellations of 55 widebody units in 2022. There were new orders for 19 A330s, 20 passenger A350s and 24 orders for its yet-to-be-built A350 freighter. But there were cancellations for 84 A330s (including 63 that disappeared in the restructuring of financially-challenged AirAsia X) and 34 A350s.

This was even worse a performance than the net cancellations of 25 units in 2020 and 19 in 2021 and in part the result of an own goal: in retaliation to an acrimonious legal dispute with Qatar Airways over paint cracking issues on the airline's A350s (Qatar has the largest A350 fleet), Airbus decided to cancel Qatar's remaining orders for 19 A350s in September last year. (It had previously in the year, with court approval, cancelled Qatar's order for 50 A321neos). That dispute was settled "amicably" in February and those orders will probably reappear in the backlog.

Over the past decade Boeing has outsold Airbus in the widebody sector: total net orders for 1,764 aircraft over the ten years, more than twice its competitor's 813, and Boeing had a backlog at the end of 2022 of 1,121 units compared to 619 (excluding those Qatari orders) at Airbus.

ORDERS/CANCELLATIONS



Regional disparity

Both manufacturers reported similar levels of orders from leasing companies who accounted for 15% of Boeing's gross orders and 13% of Airbus's — both ratios slightly below normal.

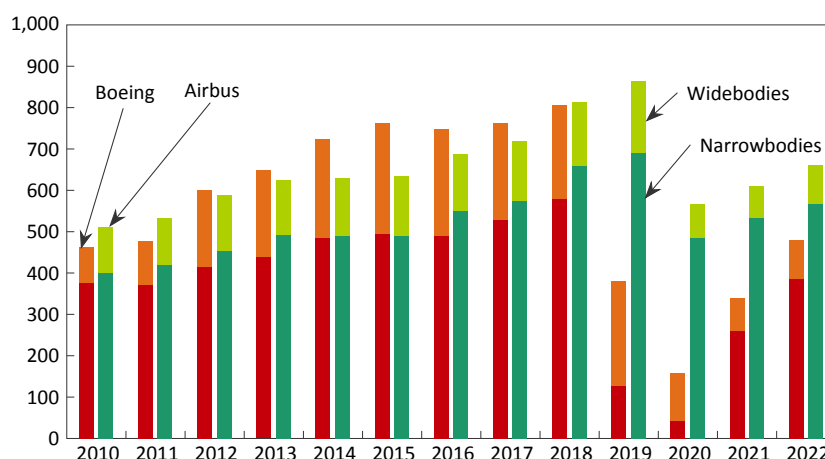
But Boeing's intake of orders was heavily skewed to North America which accounted for 58% of the total. In this it particularly benefited from large orders from United (100 737s and 100 787s), Delta (100 737s) and good-sized orders from Southwest, Alaska, Westjet and American. Fedex

and UPS also added to their 767F orders, and DHL, Fedex and Florida-based cargo carrier Western Global ordered a total 10 777Fs.

Airbus did pick up orders in the region — particularly for A220s from Air Canada, Delta and Jetblue — but the region only accounted for 7% of its total gross orders for the year.

In Europe, the only major network carrier to make orders played both sides. IAG (along with its subsidiaries British Airways, Aer Lingus and Iberia) placed orders for 50 737MAX (+100 options) from Seat-

OEM DELIVERIES



tle and nigh on 100 A320s from Toulouse. Airbus in addition gained reasonable-sized orders from easyJet, Jet2, Condor and Pegasus, to give it 216 gross orders for the region, some three times that achieved by Boeing.

Where Airbus scored highly was in Asia/Pacific — the region accounted for 37% of its orders in 2022 compared with a mere 5% for Boeing. Qantas came up with a useful order for 12 A350s to provide the equipment for its ultra-long haul Project Sunrise, but also 20 each A320s and A220s (plus 95 options) as part of its domestic fleet renewal replacing aging 717s and 737s.

But Airbus was particularly successful in China, where the three national airlines China Eastern, China Southern and Air China (along with its subsidiary Shenzhen) announced orders for nearly 300 A320s.

In this it is an apparent beneficiary of the difficult Sino-US trade relationship since Trump's initiation of tariffs in 2018, to Boeing's detriment.

China's airlines continued to take delivery of aircraft through the pandemic and under China's zero-Covid policy, but the country, while recertifying the 737MAX at the end of 2021 — one of the last countries to do so — did not allow flights of Boeing's flagship narrowbody until the beginning of 2023.

It may also help that Airbus has had a final assembly line in Tianjin for its A320s since 2008 which may be deemed to provide more economic benefit to the PRC than Boeing's 737 customer completion facility based in Zhoushan which it opened in 2018 in partnership with COMAC.

And then COMAC delivered its first C919 (to China Eastern) in December 2022.

BOEING DELIVERIES 2022

Region	737NG	737MAX	767	777	787	747	Total	
Asia/Pacific		19		3	2		24	5%
Europe		59	3	2	9		73	16%
MEAF		26		2	3		31	7%
North America		141	15	7	16	5	184	41%
Latin America		28					28	6%
Lessors		99		10	1		110	24%
Commercial Deliveries		372	18	24	31	5	450	
Government/Private	12	2	15				29	
Unidentified								
Total	12	374	33	24	31	5	479	

Deliveries hampered

The previous cycle's delivery peak was in 2018 (see graph on the facing page) when Boeing and Airbus between them delivered 1,619 aircraft. (It would have been even higher in the following year had it not been for the grounding of the 737MAX in March 2019.)

The 737MAX-8 was recertificated in late 2020 by both EASA and the FAA. But then in May 2021 the FAA decided to stop the certification of new 787s because of "production issues" (key takeaway: don't embarrass the regulator), not

to resume until October last year.

In total Boeing delivered 479 aircraft in 2022, including 374 737MAXs and 31 787s, slightly ahead of plan. Production of the 737 appears to have been running at c23 a month, nearly half the rate of 2019, and, because of supply chain constraints, below its planned rate of 31 a month. It is targetting 400-450 737 deliveries in 2023. The manufacturer ended the year with 250 of the type in inventory (down from 335 at the end of 2021). These included 138 units due for delivery to Chinese carriers, and 30 of the -7 and -10 variants for which it expects to get FAA certification by the

AIRBUS DELIVERIES 2022

Region	A220	A320neo	A330	A330neo	A350	Total	
Asia/Pacific		116		2	26	144	22%
Europe	19	106	1	1	27	154	23%
MEAF	1	24		2	1	28	4%
Latin America		30				30	5%
North America	29	76	4	10	4	123	19%
Lessors	4	163		8	4	179	27%
Commercial deliveries	53	515	5	23	62	658	
Government/military			4			4	
Private		1				1	
Total	53	516	9	23	62	663	

end of 2023. The supply chain problems are also affecting the 787, but Boeing hopes to return to producing five aircraft per month, and expects to deliver 70-80 of the type this year, although production again stopped at the end of February.

There were 100 787s in inventory at the end of 2022. With luck it might be able to achieve its 2025/26 objective of 800 aircraft deliveries (which may even include the long delayed 777X).

In contrast Airbus delivered 663 aircraft in 2022 (net of two A350s, booked as delivered in 2021, that didn't quite make their way to Aeroflot as planned), disappointingly below its target of 700 units. It too has been suffering from supply chain and employment skills issues, and is having trouble ramping up production, particularly of the key A320 family of aircraft. The company delivered 516 of the type in 2022, equivalent to a production rate of 43

per month — somewhat below its planned rate of 50 and well below the prepandemic peak of 60 a month. It had hoped to build production to a rate of 75 aircraft a month, but now accepts that this is unlikely before the middle of the decade. For 2023 Airbus is targeting total deliveries of 720 aircraft.

The OEMs' Finances Stabilised

IN THE past two years Boeing and Airbus have stabilised their finances. But Boeing reported another net loss for 2022 while Airbus has been profitable for the past two years.

Based on a ramp-up in production rates, detailed in the previous article — 400-450 MAX deliveries and 70-80 787 deliveries for Boeing, and 720 total deliveries for Airbus — they have made some cautiously optimistic sounds about 2023, and outlined targets for returning to sustained profitability.

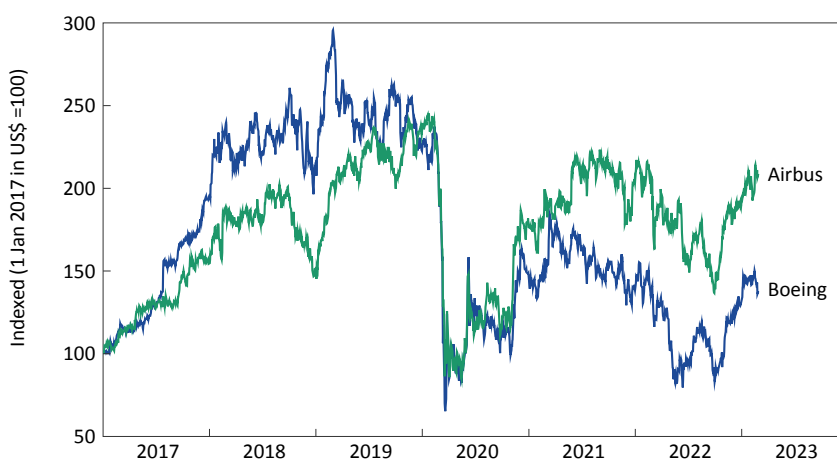
However, Boeing is facing a more difficult task challenge than Airbus — at least that is way that stockmarkets view the two OEMs. Up to the end of 2020, including the period when the MAX crisis emerged and the pandemic started, the share prices of the two OEMs closely tracked each other, then they started to diverge, with Airbus outperforming Boeing. Currently, Airbus is trading at about 7% below its pre-pandemic peak (January 2020) while Boeing is languishing 48% below its peak (July 2019).

The divergence is not simply due to the MAX crisis, which now appears to be well under control, but to the financial policies pursued by Boeing, and to a lesser extent Airbus, in the prepandemic years. To put it bluntly, there was an obsession with quarterly results and share price momentum (one of the drivers of top management's bonuses) resulting in unsustainable amounts of cash being

returned to shareholders. This phenomenon was prevalent in most industrial sectors in the 2010s, but the impact on Boeing was deleterious, with too little capital being allocated for investment in new products or to ensure production quality or simply to bolster reserves in case something unexpected happened.

The financial tables on page 12 and the graphs on the facing page

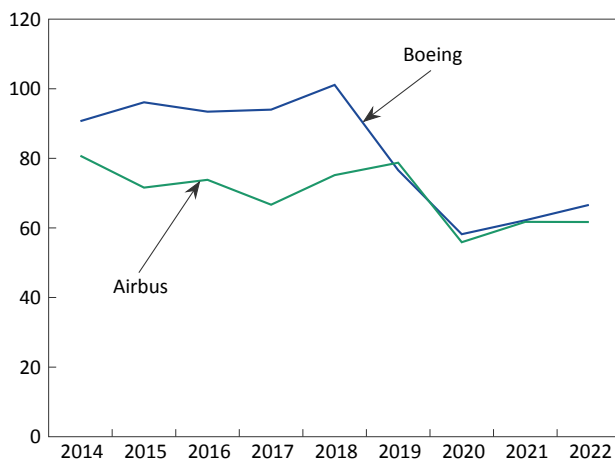
OEM SHARE PRICE PERFORMANCE



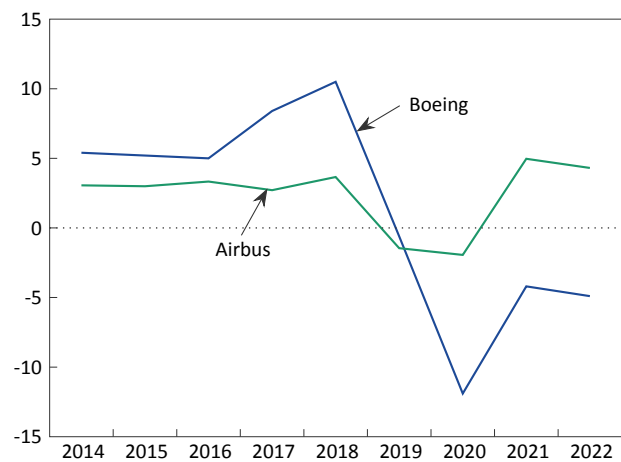
Aviation Strategy

OEM FINANCIAL DATA

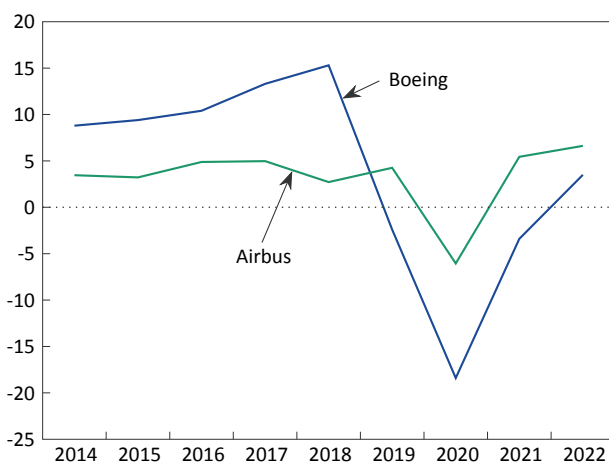
Total Revenues (US\$bn)



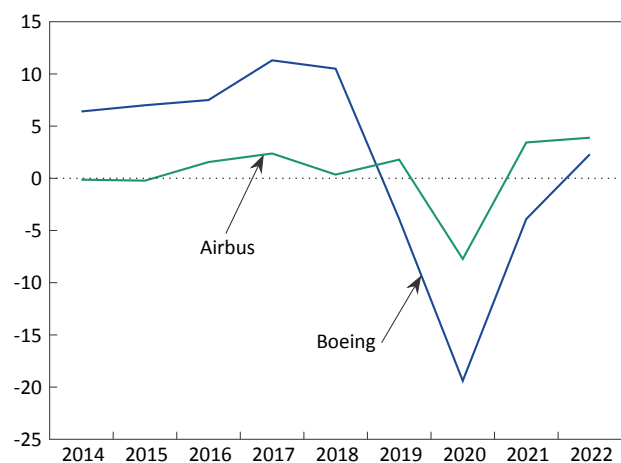
Net Result (US\$bn)



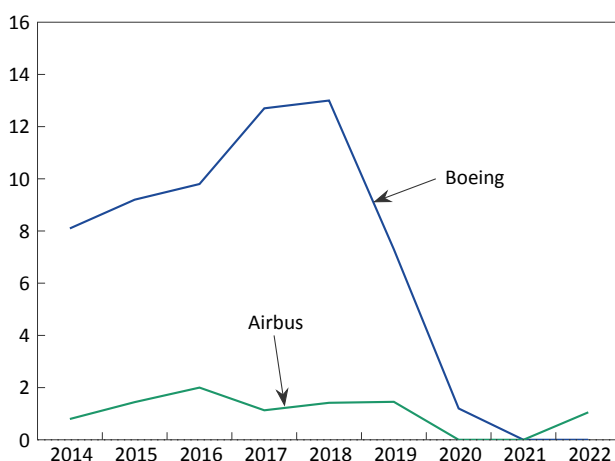
Operating Cashflow (US\$bn)



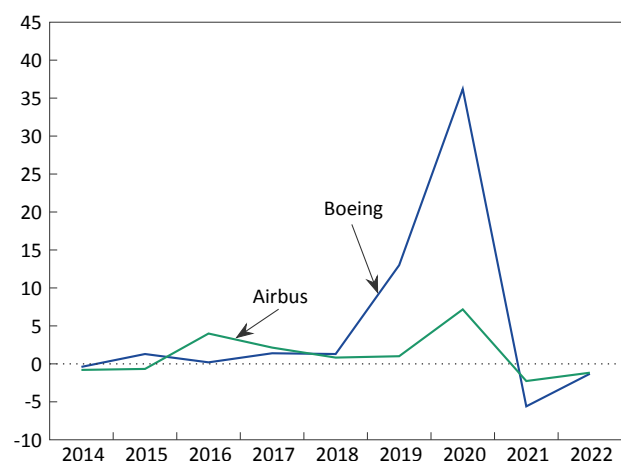
Free Cashflow (US\$bn)



Dividends paid plus share buybacks (US\$bn)



Change in Net Debt (US\$bn)



BOEING CASHFLOWS

	\$bn	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Revenue		90.7	96.1	93.4	94.0	101.1	76.6	58.2	62.2	66.6
Net Result		5.4	5.2	5.0	8.4	10.5	-0.6	-11.9	-4.3	-5.1
Operating Cashflow		8.8	9.4	10.4	13.3	15.3	-2.4	-18.4	-3.4	3.5
Capex/Acquisitions (net)		-2.4	-2.4	-2.9	-2.0	-4.8	-1.5	-1.0	-0.5	-1.2
Free Cashflow		6.4	7.0	7.5	11.3	10.5	-3.9	-19.4	-3.9	2.3
Net Investment Inflow/Outflow*		4.9	0.6	-0.5	-0.1	0.2	0.0	-17.4	9.8	5.5
Net Increase/Decrease in Debt		-0.4	1.3	0.2	1.4	1.3	13.0	36.2	-5.6	-1.3
Share Buy Backs & Dividends		-8.1	-9.2	-9.8	-12.7	-13.0	-7.3	-1.2	0.0	0.0
<i>Total financial Flows</i>		-3.6	-7.3	-10.1	-11.4	-11.5	5.7	17.6	4.2	4.2
Net Change in Cash		2.8	-0.3	-2.6	-0.1	-1.0	1.8	-1.8	0.3	6.5
Cash Balance (end period)		11.9	11.6	9.0	8.9	7.9	9.6	7.7	8.0	14.6
Net Profit Margin		6.0%	5.4%	5.4%	8.9%	10.4%	-0.8%	-20.4%	-6.9%	-7.7%
Op. Cashflow Margin		9.7%	9.8%	11.1%	14.1%	15.1%	-3.1%	-31.6%	-5.5%	5.3%

Note: *related mostly to purchases and sales of financial securities.

trace the financial fortunes of the two OEMs; the statistics may look dry, but they provide some interesting insights into their relative fortunes.

In terms of total revenues, which are mostly driven by deliveries, Boeing had been by some margin the bigger company until 2018. But over the next two years its revenues col-

lapsed by 43%, and the two OEMs are now very close in terms of dollar turnover. Revenue recovery has been insipid for both companies in 2021 and 2022. Boeing's target for 2025/26 is for \$100bn in revenues, which if achieved will return it to the record sum reached back in 2018.

Boeing had historically been a sig-

nificantly more profitable company than Airbus, with a net result peaking at \$10.5bn in 2018, a margin of 10.4%, more than twice that of its European rival. The two manufacturers were equally unsuccessful in 2019, Boeing losing \$0.6bn, because of the MAX grounding, and Airbus, \$1.5bn. because of production difficulties with

AIRBUS CASHFLOWS

	€bn	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Revenue		60.7	64.5	66.5	59.0	63.7	70.5	49.9	52.1	58.8
Net Result		2.3	2.7	1.0	2.4	3.1	-1.3	-1.7	4.2	4.1
Operating Cashflow		2.6	2.9	4.4	4.4	2.3	3.8	-5.4	4.6	6.3
Capex/Acquisitions (net)		-2.7	-3.1	-3.0	-2.3	-2.0	-2.2	-1.5	-1.7	-2.6
Free Cashflow		-0.1	-0.2	1.4	2.1	0.3	1.6	-6.9	2.9	3.7
Net Investment Inflow/Outflow*		-0.6	-0.4	2.2	-0.2	0.4	-0.7	5.6	-1.0	0.2
Net Increase/Decrease in Debt		1.3	1.5	1.7	0.0	-2.0	0.3	6.4	-2.0	-1.1
Share Buy Backs & Dividends		-0.6	-1.3	-1.8	-1.0	-1.2	-1.3	0.0	0.0	-1.0
<i>Total financial Flows</i>		0.1	-0.2	2.1	-1.2	-2.8	-1.7	12.0	-3.0	-1.9
Net Change in Cash		0.0	-0.4	3.5	0.9	-2.5	-0.1	5.1	-0.1	1.8
Cash Balance (end period)		7.8	7.4	10.9	11.8	9.3	9.2	14.3	14.2	16.0
Net Profit Margin		3.8%	4.2%	1.5%	4.1%	4.9%	-1.8%	-3.4%	8.1%	7.0%
Op. Cashflow Margin		4.3%	4.5%	6.6%	7.5%	3.6%	5.4%	-10.8%	8.8%	10.7%

Note: *related mostly to purchases and sales of financial securities.

BOEING OPERATING RESULTS BY SEGMENT 2022

	\$bn	Revenues	Operating Result	Margin
Commercial Airplanes	25.8		-2.4	-9.3%
Defense	23.2		-3.5	-15.1%
Global Services	17.6		2.7	15.3%
Others and Eliminations	0		-0.2	na
TOTAL	66.6		-3.4	-5.1%

the A321 and cost increases from suppliers. 2020 was calamitous for Boeing — a net loss of \$11.9bn or 20% of revenue while Airbus was just moderately bad — a loss of \$1.9bn equating to a margin of -3.4%. Boeing continued to lose money throughout 2021-22, reporting a net loss of \$(5.1bn) for last year, a margin of -7.7% on revenue. Airbus has managed to push back into profitability in this period and reported a net profit of \$4.3bn in 2022, a fairly impressive 7.0% margin.

In 2020 and 2021 Boeing's Commercial division was in effect supported by the Defense and Global Services divisions which together produced twice the revenue of the commercial aircraft operation and contributed all the profit at operating level. Disturbingly this changed last year when both Commercial and Defense reported losses, in the case of Defense blamed on losses in fixed-price government development programmes. Airbus is predominantly a civil aircraft manufacturer, but its De-

fence and Helicopter divisions also returned to profitability last year.

A major difference between the two OEMs used to be Boeing's superior ability to generate cash. Operating Cashflow — ie, profits plus depreciation and amortisation, changes in inventories, pre-payments, creditor/debtor balance, etc — was huge at Boeing — \$15.3bn in 2018, in contrast to just \$2.7bn at Airbus. Then everything went wrong — for the period 2019-2021 Boeing's operating outflow totalled \$(20.7bn), though it did turn positive last year, while Airbus managed to generate positive cash of \$10.1bn during this period.

Subtracting Capex — which includes new and replacement manufacturing equipment, R&D, investments in or divestment from other companies, such as Airbus' successful integration of Bombardier and Boeing's aborted joint venture with Embraer — from Operating Cashflow gets us to Free Cashflow, which again was historically much

stronger at Boeing than Airbus. In 2018 for instance Boeing generated \$10.7bn, dwarfing Airbus' \$2.7bn. (These calculations of Free Cashflow are taken directly from the published accounts; the OEMs may have different definitions.)

In startling contrast, for 2019-2022 Boeing's Free Cashflow went negative to the tune of \$(24.9bn). Airbus was marginally positive, \$1.3bn, on this measure. Net Capex at Boeing was only \$1.2bn in 2022, about half the historical average; Airbus's expenditure at \$2.8bn was roughly at the historical norm.

At least the 2022 financials indicate that the Free Cash drain has ended and indeed turned positive, caused by revenue recognition on increased deliveries and the reduction in provisions for client liability — Boeing's provisions for MAX-related costs have been reduced to \$1.9bn from an original \$7bn.

However, the reality for Boeing is a large part of future cashflow will, in effect, have to go to paying down debt (as opposed to capex, adding to reserves or paying out dividends). Coming into the crises, first the MAX grounding then Covid-19 plus other supply issues, the OEMs found themselves with inadequate liquidity which led to a surge in borrowing to cover liabilities and contingencies: during 2019-20 Boeing increased its net debt by about \$49.2bn, Airbus by a much more modest \$8.1bn. The OEMs did not take industry-specific state loans, but they have benefited from implicit state support. For instance, Boeing's \$25bn bond issue in April 2020, was issued against the background of the Federal Reserve's \$2tr commitment to buy up distressed corporate bonds.

In 2021-22 they have been paying their debt down — Boeing by \$6.9bn,

AIRBUS OPERATING RESULTS BY SEGMENT 2022

	€bn	Revenues	Operating Result	Margin
Airbus (Commercial)	35.7		4.2	11.8%
Defence	10.1		0.6	5.9%
Helicopters	6.3		0.5	7.9%
Others and Eliminations	0		0	na
TOTAL	52.1		5.3	10.2%

Aviation Strategy

Airbus by \$3.5bn — but Boeing's balance sheet remains weak. Its debt (long and short term) stood at \$57.0bn as at the end of 2022, meaning that its balance sheet showed negative net equity of \$(14.8)bn. Debt totalled \$45.9bn at Airbus, though it has positive net equity of \$18.4bn.

Debt was easily manageable in the era of ultra-low interest rates — for example, Boeing's 2022 interest charges of \$2.5bn equated to just 4% of total costs. But the company may well find it harder now to refinance its more expensive debt — just over half of the \$57bn total debt is at rates ranging from 3.95% to 8.75%.

Liquidity problems appear to have been solved — as at the end of 2022 Boeing held \$15.2bn in cash and near-cash while Airbus had \$13.7bn. (Both OEMs also have broader definitions of liquidity). As long as the production issues are solved, there is adequate liquidity to cover most eventualities. Both

OEMs have managed to retain their investment grade ratings: Fitch rates Boeing's long-term debt at BBB- and Airbus's at BBB+ with stable outlooks.

Boeing has rejected any prospect of an equity raise and has not committed to any future dividends. Airbus, on the other hand, has restored a dividend payment, totalling €1bn for 2022, which will put some pressure on Boeing.

It is worth recalling what happened to all that cash generated during the good times, 2014-18. During this period Boeing generated \$42.7bn in Free Cashflow but then returned \$52.8bn to shareholders in dividends and, especially, through share re-purchases — in other words it paid out more to shareholders than it was producing, funding the gap through borrowing. Airbus followed the same policy, albeit on a much smaller scale — generating a total of \$3.9bn and paying out \$6.8bn.

This policy worked well for shareholders (and top management)

who saw share prices quadrupling between 2014 and 2018. But such a strategy depends on nothing going wrong, which it certainly did with the MAX grounding and Covid-19.

Boeing's problems have been simplistically attributed to a prioritisation of profits over technological innovation. However, there should be no conflict between these two aims; the real problem was the focus on short-term financial manipulation at the expense over longer-term investment, a mistaken policy which the current management is now rectifying.



BOEING'S BALANCE SHEET

End Dec 2022	\$bn
Property and Plant	11.1
Intangibles (inc Goodwill)	10.3
Inventories	78.1
Cash etc	15.2
Other Assets	22.4
TOTAL ASSETS	137.1
Advances and PDPs	53.1
Accrued Liabilities	21.6
Pension/Health Plans	8.6
Accounts payable	10.2
Short-term debt	5.2
Long-term debt	51.8
Other	2.4
TOTAL LIABILITIES	152.9
EQUITY (DEFICIT)	(15.8)

AIRBUS'S BALANCE SHEET

End Dec 2022	€bn
Property and Plant	16.5
Intangibles (inc Goodwill)	16.8
Inventories	32.2
Cash etc	17.5
Other Assets	32.9
TOTAL ASSETS	115.9
Advances and PDPs	37
Other Short-Term Liabilities	9.8
Pension Plans	3.5
Other Liabilities/Provisions	19
Long term debt	33.6
TOTAL LIABILITIES	102.9
EQUITY (DEFICIT)	13.0

Qantas: Flying Kangaroo Bounces Back

IN THE three years to the end of June 2022, covering the depths of the Covid pandemic, Australian flag-carrier Qantas reported total net statutory losses of A\$4.5bn (US\$3bn), somewhat more than the sum of profits reported in the previous five (profitable) years.

And then, this month, it was able to report underlying pretax profits for the six months ended December 2022 of A\$1.4bn — its highest ever level of first half profits.

Indeed the group achieved statutory net profits for the period of A\$1bn, almost as much as it reported for the whole of the year ended June 2016 — hitherto its peak year of profitability.

This record performance was seen in all its main brand operating segments (Domestic, International and Loyalty) and was achieved on a still heavily reduced level of activity in comparison with pre-pandemic levels.

Overall capacity (in ASK) in the half year was still 28% below the comparable period in 2019. Domestic operations were nearly “back to normal” at 94% of pre-pandemic levels, but international operations remained heavily curtailed by the continuing border controls flying only 58% of pre-crisis capacity. Demand (in RPK) was 27% down, unit costs up by a hefty 32% (much to do with fuel costs), but unit revenues were up by an extraordinary 46%.

Qantas’s recovery trend shows a lot of similarities with the recovery in financial fortunes of airlines in Europe and North America.

This was the first downturn in the airline industry which was entirely supply-led: passengers did not fly, not because they could not afford or want to, but because they were not allowed to. Rebuilding operations as travel restrictions eased could not keep pace with the underlying level of pent-up demand, squeezing the supply-demand equation. But for Qantas this squeeze appears abnormally huge.

Part of the reason may be the unique structure of the Australian market.

Australia and aviation

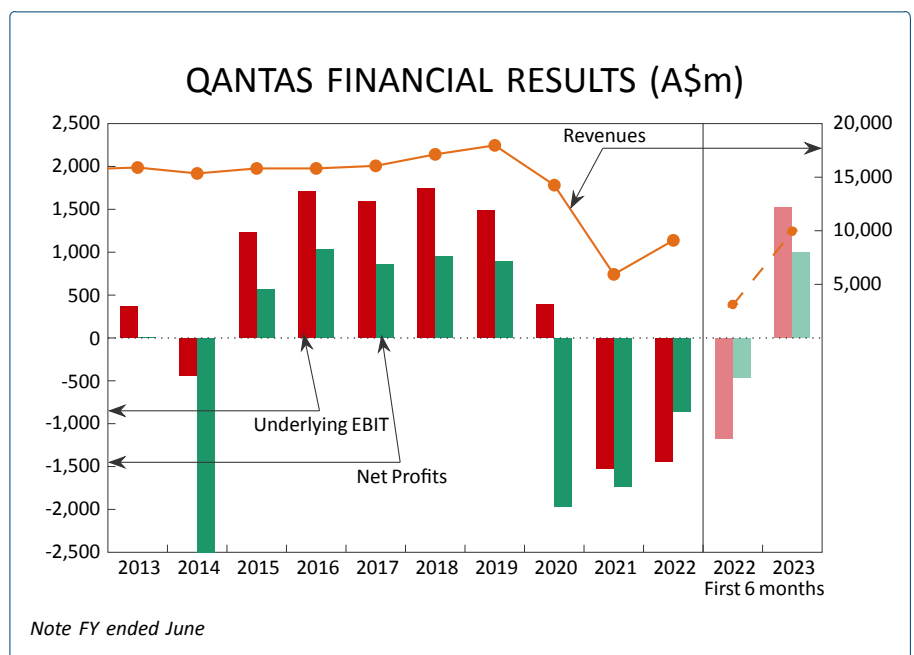
Australia has just 26m inhabitants but a huge land mass of 7.7m km², with one of the lowest population densities in the world at three people per square kilometre. There is a lot of empty space.

It is one of the most urbanised

countries in the world with nearly 90% of the population living in cities — and nearly two thirds of the population inhabit the five largest: Sydney, Melbourne, Brisbane, Perth and Adelaide. Distances between the main urban centres are large, with limited realistic transport alternatives to air travel.

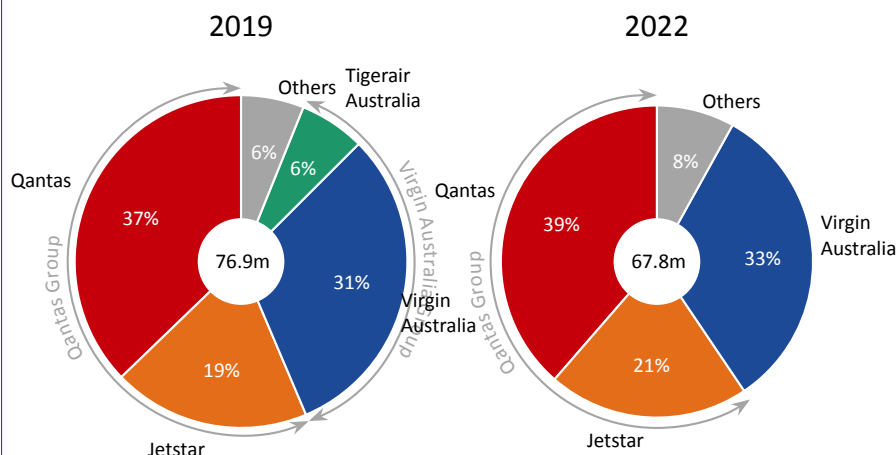
The domestic air system is characterised by a “golden triangle” of routes between Melbourne, Sydney and Brisbane — between them they account for a quarter of all domestic seats. Indeed the 700km route connecting Sydney and Melbourne in 2019 was the second largest route in the world (behind that linking Seoul and Jeju) in terms of the number of flights, and the fourth largest in terms of the number of seats. It regained that accolade in 2022.

Domestically Australia is effectively a two airline market, and has



Aviation Strategy

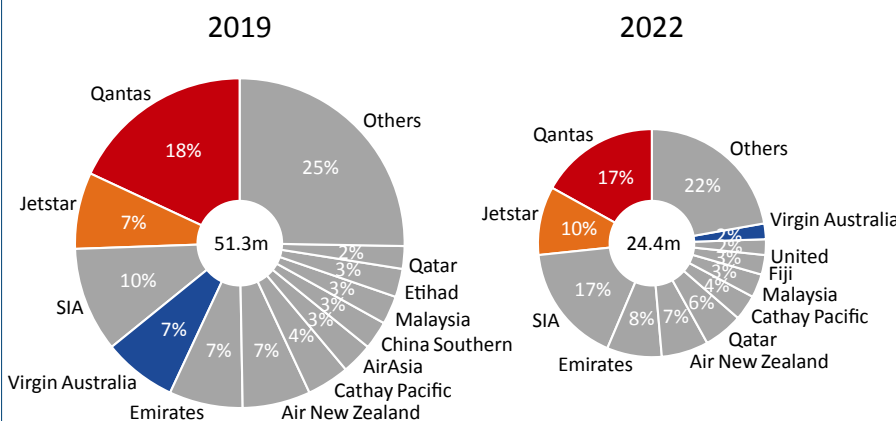
AUSTRALIA: DOMESTIC MARKET SEAT CAPACITY



been for decades even after the dismantling of the official Two Airline Policy when the market was deregulated in 1990. Qantas and its low cost subsidiary Jetstar in 2019 held 56% of the domestic seat capacity; Virgin Australia and its (now defunct) LCC subsidiary Tigerair Australia had 37%. Since then the Qantas group has taken some advantage from Virgin's restructuring out of bankruptcy in 2020 as a "mid-service" airline and pushed up its share of the market to 60% (see charts left).

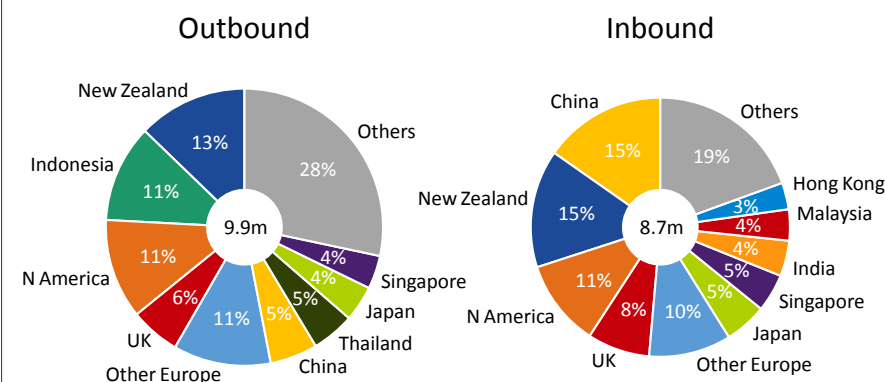
Australia is also a very long way from anywhere.

AUSTRALIA: INTERNATIONAL SEAT CAPACITY



A quarter of tourists (see pie charts below) come from or travel to North America and Europe, and flights to Europe, generally too long to be operated economically as non-stop flights, have a multitude of way points to offer transit or transfer flights. Qantas has maintained a 25% share of the market, but both Singapore Airlines and Emirates, providing one-stop connections through Changi or Dubai, are major players (and Qatar, Emirates' rival super-connector has strongly increased its relative presence in 2022, providing flights via Doha). As part of the Virgin Australia restructuring in 2020, its rival got rid of its widebody aircraft leaving Qantas International as the only Australian long haul carrier.

AUSTRALIA: TOURIST VISITS 2019



But the majority of international trips are closer to home. New Zealand, only 2,000km from Sydney, naturally accounts for 13%-15% of tourist trips — it is after all the closest English-speaking country with similar colonial ties. Indonesia, the closest ASEAN country accounted for 11% of outbound tourism. But China, effectively closed for the past three years, in 2019 accounted for 15% of inbound travel.

QANTAS: FINANCIAL DATA (A\$m)

FY end June A\$m	2018	2019	2020	2021	2022	2023 H1		at end	Jun 19	Jun 22	Dec 22
Revenue	17,128	17,966	14,257	5,934	9,108	9,909		Fixed Assets	12,977	11,181	11,363
Net income	953	891	(1,964)	(1,728)	(860)	1,001		Other non-current assets	2,207	2,839	2,396
								Current Assets	4,193	5,633	6,121
								of which cash	2,157	3,343	4,145
Operating cash flow	3,413	2,807	1,083	(386)	2,670	2,811		Current Liabilities	(8,576)	(10,558)	(11,486)
Net capex	(2,201)	(1,651)	(1,571)	(722)	(240)	(717)		Debt	(4,589)	(6,179)	(5,331)
Net inc in debt	(134)	393	1,163	(239)	(1,307)	(893)		Other non-current liabilities	(2,776)	(3,106)	(3,047)
Equity			1,337	58							
Dividends/buy back	(1,162)	(1,098)	(647)		(3)	(403)					
Net increase in cash	(84)	451	1,365	(1,289)	1,120	798		Equity	3,436	(190)	16

Survival of the fittest

Qantas had entered 2020 in reasonable financial health. It had just completed an acceptable half year performance with an underlying operating margin of 9.5%, and was able to boast a return on invested capital (ROIC) of 19.6%. It had ended December 2019 with A\$1.7bn in cash and another A\$1bn in undrawn facilities. In February at the publication of the half year results it was encouraged enough to declare an interim dividend of 13.5¢ per share and announce an additional off-market share buy-back of up to A\$150m (having paid out A\$643m in dividends and buy-backs during the previous six months).

Only a matter of weeks later the novel coronavirus outbreak in Wuhan had been characterised as a pandemic. Qantas acted quickly. It cancelled the dividend and share buy-back (half way through the process). It raised A\$1.4bn in new equity from shareholders and another A\$1bn in debt to shore up liquidity. It put in place a three year “restructuring” plan to remove A\$1bn from its annual cost base — including getting rid of 6,000 employees, 20% of its 29,000 workforce (subsequently raised to 9,800 through outsourcing) — restore the balance sheet and generate sustainable positive net free cash flow.

Elsewhere in the world some

airlines were banging on government doors for help: help which when it came had stringent restrictions. The Australian Government did provide the domestic industry with “Job Keeper” furlough schemes, subsidies on fees and fares to ensure provision of essential air services, freight and repatriation flights, but resisted calls from Virgin Australia for a A\$1.4bn bailout. Had it done so Qantas may have felt the need to demand equal treatment.

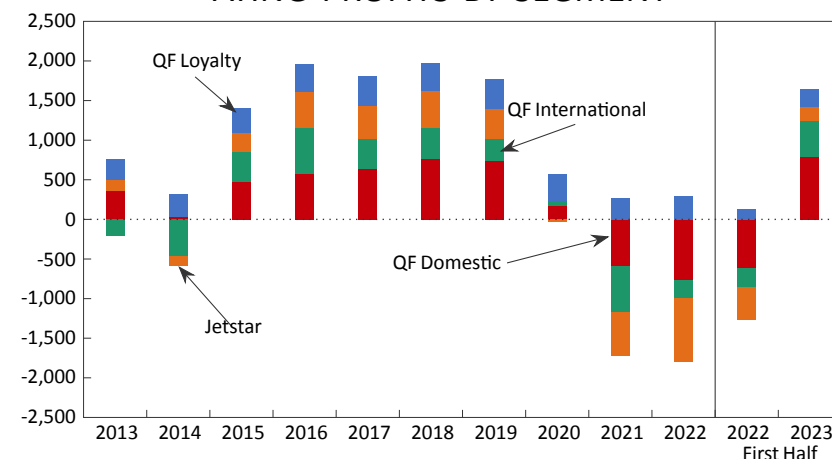
But Virgin Australia was already financially challenged — with heavy net losses in each of the previous eight years, and negative free cash flow in all but one of the previous ten years (see *Aviation Strategy*, Dec 2019).

Qantas CEO, Alan Joyce, was brutal: “Governments are not there to pick winners and losers and governments are definitely not there to support companies that have been badly managed for 10 years. A government is definitely not there to support a company that is owned by Singaporeans, Chinese, Abu Dhabi and a British billionaire”.

And for Qantas, strategically, it was better to let its rival fail.

Virgin Australia ran out of cash, filed for voluntary administration and was sold to Bain Capital, a US private equity firm. The “British billionaire” put in funds for a 5% stake.

QANTAS UNDERLYING OPERATING PROFITS BY SEGMENT



Note: FY end June

Aviation Strategy

Segment Results

Qantas Domestic produced astounding results in the six months to end December, despite operational difficulties connected with the ramp up of capacity. Overall capacity was close to prepandemic levels, only 7% below that offered in the same period in 2019, and load factors were back to a normal 80% (30 percentage points higher than in the prior year period). The company ascribes its performance not just to its leading position in corporate and SME mar-

kets, but more specifically to a strong growth in premium leisure revenues.

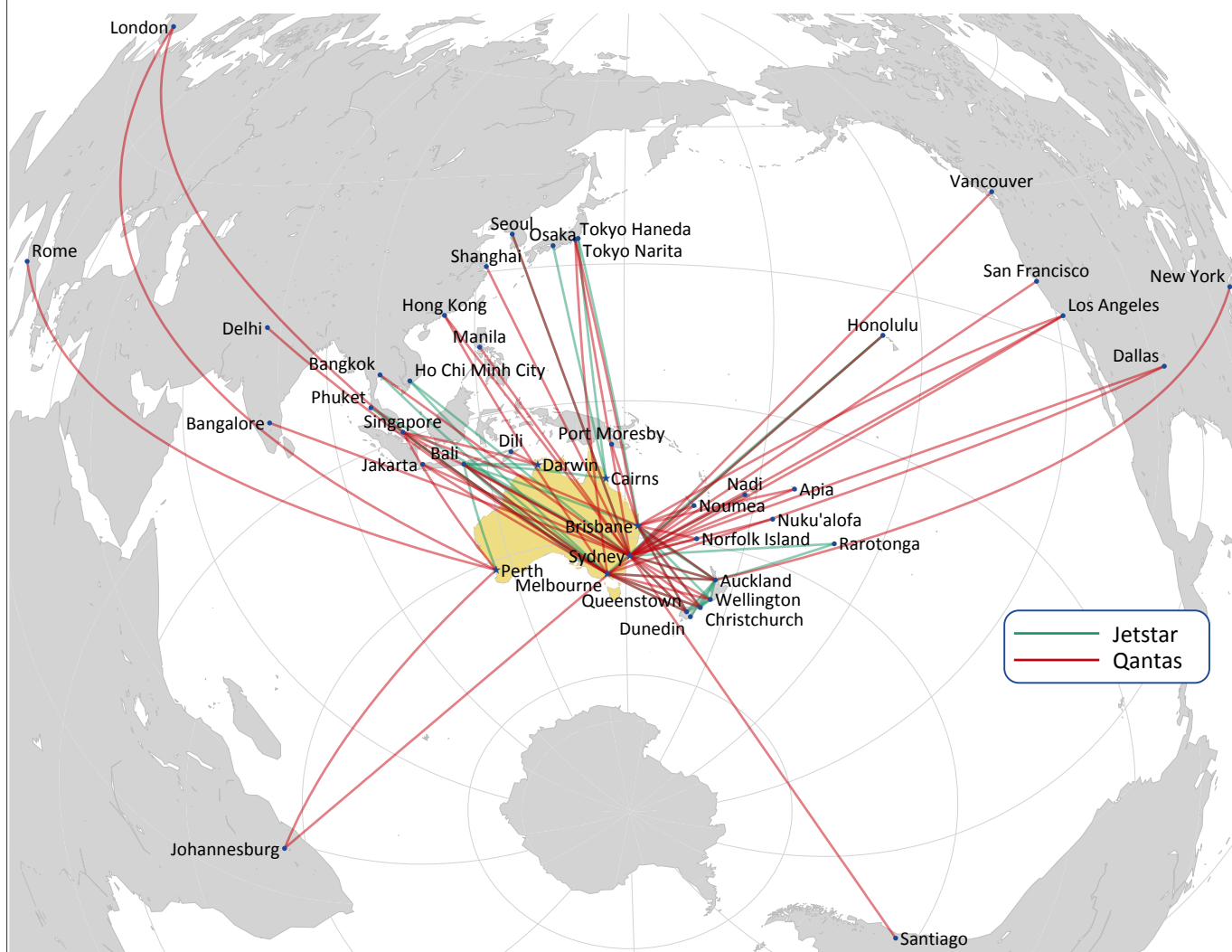
Unit revenues in the period were 25% higher than they had been in the same (pre-pandemic) period in 2019 and the business reported a record level of underlying operating profits at A\$785m — higher even than the peak level of (pre IFRS 16) operating profits recorded for the whole of FY 2018 — and a record 22% operating margin, seven points higher than normal times.

According to the figures from the Australian Bureau of Infrastructure

and Transport Research Economics (BITRE) Qantas achieved an on-time performance of only 65% in the six months to end December — not exactly something of which to be proud, and it shows the difficulty of restoring operations. The company however takes pride in saying that on this measure it outperformed its main rival (Virgin) in five out of the six months.

Qantas International, mothballed through most of the previous two years, only operated 58% of the capacity it had flown in 2019. It achieved a healthy 88% load factor

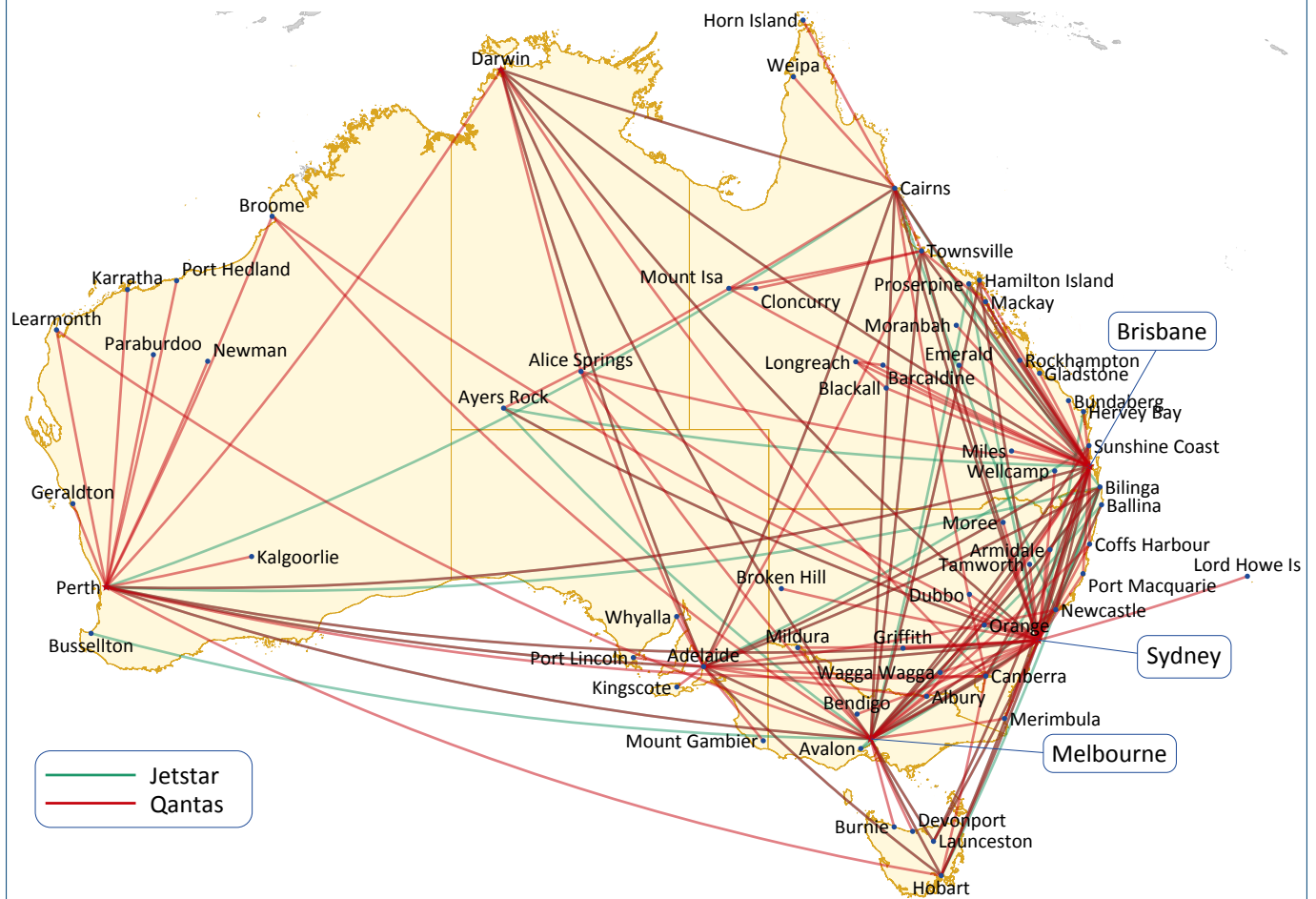
QANTAS: INTERNATIONAL NETWORK



Note: equidistant map projection based on Sydney. Great circle routes from that base appear as straight lines.

Aviation Strategy

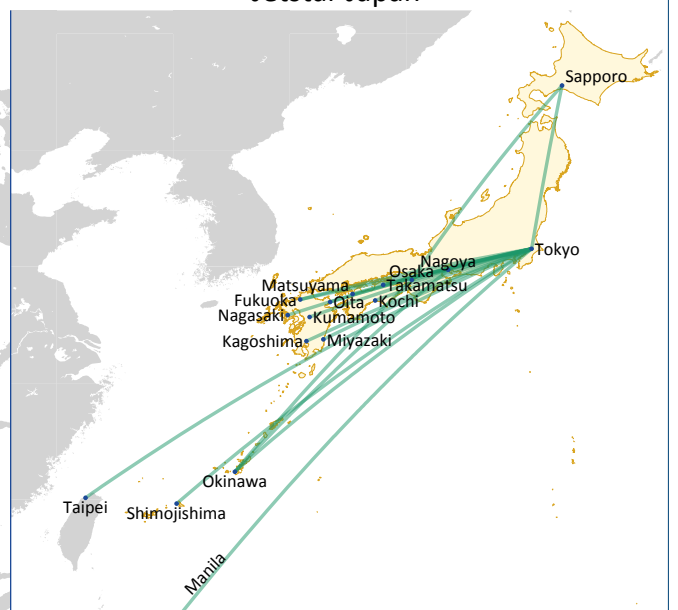
QANTAS: DOMESTIC NETWORK



Jetstar Asia



Jetstar Japan



and strong revenue performance (comparisons here with “normal” times are complicated by turbulence in the freight markets, but total revenues per ASK in the period were 60% higher than they had been in 2019). The division also generated record operating margins of over 12%, and underlying operating profits of A\$464m.

The company notes that one of the prime reasons for the strong performance was ongoing capacity constraints across key routes as international carriers gradually restarted operations.

Qantas had progressively restored six of its A380 fleet back into passenger service during 2022 (two of its pre-pandemic fleet of 12 had been sent to the knackers’ yard), and with them comes a reconfiguration to boost premium cabin offerings — a project started at the tail end of calendar 2019. The company stated that these results reflect the success of that configuration with a five percentage point improvement in cabin mix compared with 2019.

Qantas had originally planned to have the remaining A380s back in service by the end of 2023. However, because of slot constraints at maintenance facilities (and a lot of work is needed to get these behemoths back in service) it now suggests that this may not happen until early 2025. The group is suggesting that its international capacity will only have recovered to 76% of prepandemic capacity in the second half of the current financial year, and will still be 11% below 2019 levels in the following six months.

Jetstar, the Group’s LCC subsidiary, had a good but not record-breaking six months. It achieved operating profits of A\$177m on revenues of A\$2.1bn giving an 8.4%

QANTAS GROUP FLEET						
	Qantas	Jetstar	Total	Avg Age	Δ v 2019	On order
747-400					-6	
A380	10		10	13.5	-2	
787	11	11	22	6.5		3
A350						12
A330	26		26	16.2	-2	
717	20		20	21.0		
737-800	75		75	15.9		
A220						29
A320	11	82	93	12.3	-22	45
A321	3	13	16	9.0	+8	80
ERJ-190	14		14	15.1		
F70/100	19		19	29.5	+2	
Dash 8	50		50	16.6	+1	
Total	192	95	287	18.1	-11	154

Notes: excludes 4x737F, 1x767F, 3 BAe145F operated by Express freighters

operating margin. Total capacity offered was three-quarters of the level in 2019 (almost fully restored on domestic operations but internationally only two-thirds) and load factors a respectable 87%.

On domestic services, unit revenues also were strong, being 16% higher than prepandemic levels, while ancillary sales per passenger were 39% higher. The company cites particularly strong demand on core leisure routes (eg Melbourne to Sunshine Coast and Gold Coast respectively 23% and 10% higher than 2019).

Its international network was profitable with an underlying operating profit of A\$72m having relaunched services to Japan and Korea. Singapore-based Jetstar Asia (49% owned) was described as “delivering strong profitability”, even though it is much smaller than it had been, operating only seven aircraft on 11 routes. Pre-pandemic it had a fleet of 18 A320s and a network of 29 routes — including eight destinations in Greater China.

These numbers exclude its A\$25m share of losses at Jetstar Japan, where it was challenged by “demand weakness and excess capacity”. Japan did not fully open its borders until October 2022. The 33%-owned associate with a fleet of 19 A320s and 2 A321LR aircraft restarted international services (to Taipei and Manila) in December.

Jetstar sold its stake in Jetstar Pacific to Vietnam Airlines in 2020.

Qantas is one of the few airline groups that (legitimately) treats its frequent flier programme as a stand-alone profit center. **Qantas Loyalty** indeed was the only part of the business to register profits during the covid crisis.

Profits are generated from three sources: spread, the difference between the reward and redemption values of points; float, the interest earned between earn and burn; and breakage, the proportion of awarded points that expire. Qantas Loyalty does not recognise profits on transaction between itself and Qantas Group airlines. (For a detailed analysis of

the finances of airline frequent flier programmes see *Aviation Strategy* Jul/Aug 2020). Its strength is that it has, through its Qantas branded credit cards, 35% of total Australian credit card spend.

Loyalty also produced a record half year profit of A\$220m, up by 73% year on year, on revenues more than double the prior year period. It gained 1m new members in the past twelve months. Credit card spending was 10% above pre-covid levels. There was a doubling in airline redemption activity and a doubling in revenues from OTA TripAdeal (in which Qantas acquired a 51% stake in May 2022).

The management is expecting a full year profit from this segment of up to A\$450m — 20% higher than its previous peak in the year ended June 2019.

Fleet renewal

As part of the measures to mitigate the crisis caused by the pandemic, Qantas accelerated the disposal of its six remaining 747s, disposed of two of its A380s (putting the remaining 10 into hibernation) and deferred delivery of three 787s. The latter are supposedly due for delivery during 2023.

On a net basis the group fleet is now 11 units smaller than it had been in 2019 with 287 aircraft (see table on the preceding page).

Encouraged by the apparent success of its restructuring plan, in May 2022 Qantas announced a major aircraft order — the largest order in Australian aviation history. To replace its aging 717 and 737 fleet it ordered 20 A220s and 20 A321XLRs for delivery starting in calendar 2023. The new generation aircraft will be configured to produce an increase in gauge and fuel efficiency to help Qantas fulfill its zero-carbon aims: 25% more seats and 28% better fuel efficiency per seat for the A220 compared with the 717s; and a 15% increase in seats and a 17% lower fuel burn for the A321XLR against the 737NGs they will replace. They also come with ranges (nominally respectively 6,000km and 8,700km) that open up more than just domestic Australian routes.

The order included options for an additional 94 aircraft for delivery to at least 2034. It has been combined with Jetstar's existing then order for 109 A320s (plus options) into a single Qantas Group narrowbody order for 299 aircraft (half of which are options)

with the flexibility to draw down on that order by choosing any variant from the A320 and A220 families. (The Group subsequently converted nine of the options to firm A220 orders).

In addition Qantas finally took the decision to go ahead with "Project Sunrise" (see *Aviation Strategy*, Jan/Feb 2020) ordering 12 A350 ultra long range aircraft for delivery 2025-28. These will be configured "premium heavy" with a mere 238 seats (compared with the more normal 335) and, with luck, will enable Qantas to fulfill its dream of non-stop services on the 17,000km (20 hour) route between Sydney and London. That is always assuming that Russian airspace will have reopened by then.

Qantas avers, with some unfathomable confidence, that Project Sunrise "will be carbon neutral from day one".

Unfortunately neither party to the aircraft order took account of the current severe supply chain issues suffered by the OEMs, and the delivery schedule has slipped: the A320XLRs will not now be available until 2024-25 and the first A350 is now expected at the end of calendar 2025. It's a heavy schedule: Qantas on average will be taking delivery of one new aircraft every three weeks for the next three years.

A bonza year

Qantas seems set for a record year of profitability.

The same may be said for the whole of the Australian airline industry: even the reborn Virgin Australia is suggesting it will be profitable in the current year to end June and is considering a return to the Australian stock exchange "at the earliest opportunity".

AIRCRAFT DELIVERY SCHEDULE

	FY end June	2023	2024	2025	2026	...	2029
Qantas	787-9	3					3
	A350-1000ULR				3		12
	A220-300		5	9	10		29
	A321F		3	2	3		9
	A321XLR			3	9		20
Jetstar	A320neo			5			7
	A321LR	8	6	8	1		23
	A321XLR				3		15
		11	14	27	29		118

Note: committed orders for delivery by June 2029. Excludes Network Aviation aircraft and additional firm A320, for delivery after June 2029

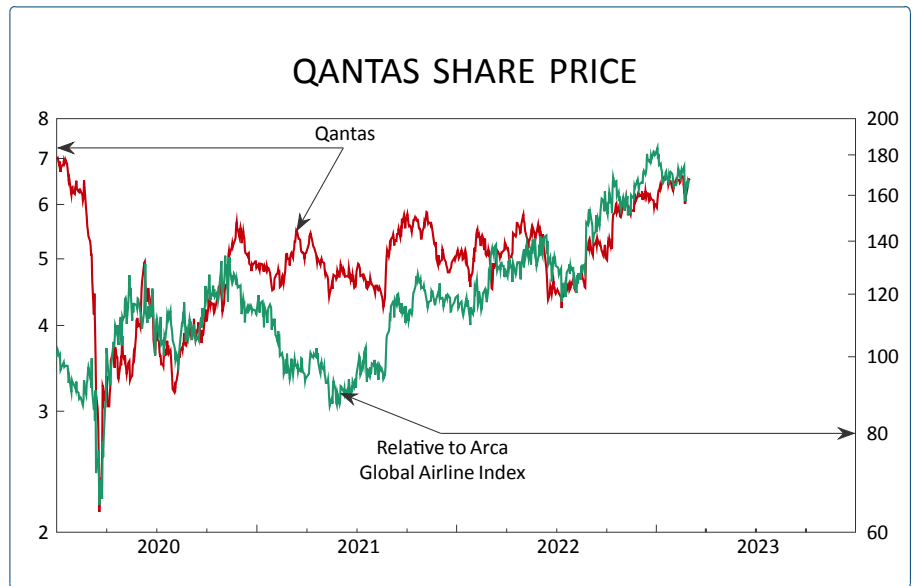
Aviation Strategy

Qantas also appears optimistic that it will achieve its 2024 targets set out at its 2019 investor day: a 15-18% operating margin on domestic operations; an 8-10% margin for international; and an underlying operating profit of A\$500-600m for Qantas Loyalty.

All its planning is deeply focused on a solid financial framework: minimise the cost of capital by targeting a net debt range of 2-2.5x EBITDA where ROIC is 10%; deliver returns on capital greater than the weighted average cost of capital (ie in excess of 10%); grow invested capital with disciplined investment, and return surplus capital to shareholders.

In the five years pre-covid Qantas provided shareholders with regular distributions in a mixture of dividends and share buy-backs totalling A\$4.3bn (and a third of originally outstanding shares).

The A\$900m buy-back announced for FY2023 (equivalent to 65% of the emergency money raised in 2020) has locally been criticised



as “reckless” for being done in the face of government support during the pandemic, staff redundancies and customer dissatisfaction at operational shortcomings.

But the strategy may help explain how Qantas’ share price is back to where it was at the beginning of 2020 and has outperformed the Arca global airline index by 80% since the start of the pandemic (see chart above).

Arguments for share buy-backs are dubious at the best of times and at the moment one might think that the group would need the equity: the balance sheet is shot to pieces (see table on page 17). Net assets at the end of December while back in positive territory stood at a paltry A\$16m. Presumably, it is relying on future retained earnings to restore net shareholder funds.

Aviation Strategy

Aviation Strategy in recent years has produced special analyses for our clients on a wide range of subjects. Examples include:

- ✈ Implications of Virtual Mergers on the North Atlantic
- ✈ The Future of Airline Ownership
- ✈ Air Cargo in the Internet Era
- ✈ LCC and ULCC Models
- ✈ Intra-European Supply and Demand Scenarios
- ✈ Super-Connectors: Financial and Strategic Analysis
- ✈ Key Trends in Operating Leasing
- ✈ Business Jet Operating Leasing Prospects
- ✈ Widebody Jet Demand Trends

For further information please contact: info@aviationstrategy.aero

Aviation Strategy

The Principals and Associates of Aviation Strategy apply a problem-solving, creative and pragmatic approach to commercial aviation projects.

Our expertise is in strategic and financial consulting in Europe, the Americas, Asia, Africa and the Middle East, covering:

- ✈ Start-up business plans
- ✈ Due diligence
- ✈ Antitrust investigations
- ✈ Credit analysis
- ✈ IPO prospectuses
- ✈ Turnaround strategies
- ✈ Privatisation projects
- ✈ Merger/takeover proposals
- ✈ Corporate strategy reviews
- ✈ Antitrust investigations
- ✈ State aid applications
- ✈ Asset valuations
- ✈ Competitor analyses
- ✈ Market analyses
- ✈ Traffic/revenue forecasts

For further information please contact:

James Halstead or Keith McMullan

Aviation Strategy Ltd

e-mail: info@aviationstrategy.aero

Subscription Form

Enter my Aviation Strategy subscription for: 1 year (10 issues – Jan/Feb and Jul/Aug are combined)

- ✈ UK: £475
- ✈ EU: €610 (+VAT where applicable)
- ✈ USA and Rest of world: US\$780

starting with the _____ issue.

- ☐ I enclose a Sterling or Euro cheque made payable to Aviation Strategy Ltd
- ☐ Please invoice me
- ☐ I wish to pay by credit card or PayPal.
- ☐ I am sending a direct bank transfer of the the relevant sum net of all charges to Aviation Strategy's bank account:
Metro Bank Ltd, 1 Southampton Row, London WC1B 5HA
IBAN: GB04 MYMB 2305 8013 1203 74
Sort code: 23-05-80 Account no: 13120374
Swift: MYMBGB2L

Delivery Address

Name _____
Position _____
Company _____
e-mail _____
Telephone _____
VAT No _____

Invoice Address

Name _____
Position _____
Company _____
Address _____

Country _____
Postcode _____

DATA PROTECTION ACT

The information you provide will be held on our database and may be used to keep you informed of our products and services or for selected third party mailings

PLEASE RETURN THIS FORM TO:

Aviation Strategy Ltd, 6 Langside Avenue
London SW15 5QT, UK
e-mail: info@aviationstrategy.aero
VAT Registration No: GB 162 7100 38