Senate Economics Legislation Committee

Inquiry into Qantas Sale Amendment Bill 2014

Response to supplementary Questions on Notice from Senator Xenophon

Qantas notes that in most instances, these questions:

- lack relevance to the Committee's Term of References;
- have been addressed during the course of public hearings at Senate Committee inquiries on 14 and 18 March 2014; or
- have been responded to previously through Qantas' response to Questions on Notice to the Senate's Rural and Regional Affairs and Transport References Committee.

1. **Why did Qantas begin reporting Qantas International financial results as a separate line in the financial results of the Group from June 2011?**
   a. **Was there an accounting standards requirement to begin doing so? If so, when did this standard come into effect?**

The Qantas Group did not report Qantas International as a separate line item in June 2011. Qantas Domestic and International were only formally identified as separate segments from 1 July 2012.

However, Qantas did provide a greater level of detail on the relative performance of the domestic and international networks in June 2011. This decision was taken to enhance transparency to shareholders and other stakeholders so the business could better explain the very different challenges which existed in the domestic and international markets.

2. **Why were Qantas International financial results not previously reported (as a separate line in the financial statement) prior to June 2011?**

Qantas only formally identified Qantas Domestic and International as separate segments from 1 July 2012.

3. **What were Qantas International's financial results (profit) for financial years ending 2010 and 2009?**

Qantas only formally identified Qantas Domestic and International as separate segments from 1 July 2012.

Therefore, Qantas did not release separate financial results for Qantas International in financial years 2010 and 2009. However on 22 June 2011 Qantas did say *"Qantas International is the Group's weakest business – it has achieved required returns only three times in the past 15 years. Clearly the situation is not sustainable"*.

4. **With reference to Jetstar Asia Airways Pte Ltd:**
    a. **Do the operational activities of Jetstar Asia Airways Pte Ltd provide insufficient revenues from which to fund day to day operations?**
    b. **With reference to note 2 to the accounts of Jetstar Asia Airways Pte Ltd dated 30 June 2010 (below): do you agree the intent of this support is to ensure that the airline offered this support is to continue to trade?**

2 **Going concern**

The financial statements have been prepared on a going concern basis, notwithstanding the net current liabilities and net liabilities at 30 June 2010, as Jetstar Asia Holdings Pty Limited has indicated that it will continue to facilitate the provision of additional funding facilities, if and when required, to enable it to continue its operations and meet its liabilities as and when they fall due.

    c. **Would Jetstar Asia Airways Pte Ltd be permitted to continue trading without Qantas through wholly owned subsidiary (Jetstar Asia Holdings Pty Limited (JAHL) providing this financial support?**

Jetstar Asia Airways Pte Ltd together with ValuAir Limited are wholly owned subsidiaries of Orangestar Investment Holdings Pte Ltd which is a wholly owned subsidiary of Newstar Investment Holdings Pte Ltd. Together these entities form the Newstar Group of which Jetstar Asia Holdings Pty Limited and Westbrook Investments Pte Ltd are shareholders.

The Consolidated Statement of Cash Flows for the year ended 30 June 2013 within the audited financial statements of the Newstar Group reported positive cash flows from operations.

The 30 June 2013 audited financial statements for the Newstar Group do not contain disclosure of financial support from shareholders and the financial statements contain an unqualified audit opinion without reference to financial support from shareholders.

5. **With reference to Jetconnect Limited:**
    a. **Is the penalty provision outlined below the only penalty associated with the operations of Jetconnect Limited?**
    b. **Has the New Zealand Inland Revenue Service indicated there are other matters to be investigated?**

Note 10: Contingent liabilities

Tax investigation

The New Zealand Inland Revenue Department issued the Company with Notices of Proposed Adjustment to deny interest deductions claimed in respect of the Optional Convertible Notes (with Qantas Airways Limited) which were used to fund the acquisition of the Qantas Group's former interest in Air New Zealand. During the year ended 30 June 2012, the Inland Revenue Department issued an assessment for shortfall penalties in respect of the ongoing dispute in relation to the Optional Convertible Notes. The Company elected to utilise NZ$10,331,609 of tax losses within the Qantas Group against the shortfall penalties assessment. In the event the Optional Convertible Notes dispute is found in favour of the Company, the losses utilised against the above mentioned shortfall penalties will be reinstated to the Group.

Other than the matters disclosed above, there are no other contingent liabilities at 30 June 2013 (2012: nil, except for matters disclosed above).

The matter outlined in the disclosure above has now been finalised.

Like all other taxation authorities and like all other tax payers, Qantas is subject to regular taxation risk reviews by the New Zealand Inland Revenue Service in relation to our operations as part of usual business practice.

6. **In a media release on 17 February 2011, Mr Joyce stated:** ***"Qantas achieved an Underlying EBIT of $165 million for the half-year. The result is 175 per cent above the prior corresponding period, driven by a $411 million, or 8 per cent, increase in total revenue. Qantas improved yield by 9 per cent and increased capacity by 3.3 per cent demonstrating a strong revenue recovery across both international and domestic business. The result was achieved despite the significant operational and financial challenges of the A380 disruptions and northern hemisphere snow storms during the period."***

   Further, in a media release dated 22 June 2011, Mr Joyce stated: ***"In FY11, Qantas International is forecast to generate a loss before interest and tax of approximately $200 million, on invested capital of over $5 billion, with a weaker result expected next year. Qantas International is the Group's weakest business – it has achieved required returns only three times in the past 15 years. Clearly the situation is not sustainable. However, we are developing a long-term strategy aimed at restoring competitiveness and profitability."***

   a. **On 17 February 2011, the position of the Qantas International business appeared satisfactory. When did responsible decision makers form the opinion that the trading conditions had deteriorated?**
   b. **How often is cash flow monitored and changes in the Qantas International segment notified to the responsible (chief) decision maker(s)?**
   c. **Was deterioration in the cash flow of Qantas International recorded prior to the announcement on 22 June 2011? When were the responsible decision makers first aware that the position of Qantas International was worsening?**

d. **Which measured variable(s) were declining in this period, between February 2011 and June 2011?**
e. **With reference to continuous disclosure requirements, relating to both the Corporations Act 2001 and the ASX listing rules, was it necessary to inform the ASX of deterioration in trading performance prior to your announcement on 22 June 2011?**
f. **A $1000 investment in Qantas shares bought in February 2011 had lost 27% by June 2011. How is this decline explained?**
g. **Did any director, senior executive or responsible decision maker give any briefings, meet or advise, or make available any information in advance of the 22 June 2011 public announcement to any institutional investors?**
h. **Did any director, senior executive or responsible decision maker give any briefings, meet or advise, or make available any information in advance of the 27 February 2014 public announcement to any institutional investors?**
    i. **If so, what was the content of these briefings, meetings or advice?**
i. **Given the $800-$900 million impact of depreciation on Qantas International, what tangible financial benefit do you expect to derive for an amendment to the Qantas Sale Act 1992?**
j. **Would a change to taxation law, applied to depreciation, assist Qantas International and Qantas Airways Limited? Has any modelling been undertaken to consider the respective cases of depreciation changes (taxation law) compared to the case of an amendment to the Qantas Sale Act 1992?**
k. **Why does Qantas International not lease the majority of fleet, resolving the negative impact of depreciation?**

Qantas' meetings with institutional investors are Commercial-in-Confidence. Qantas meets regularly with current and potential investors, this includes during the periods referred to.

Qantas takes its continuous disclosure obligations very seriously. A key tenet of those obligations is that any materially price sensitive information is released first to the Australian Securities Exchange, before being released to any other person. Qantas has at all times complied with that obligation.

Qantas shares did decline between February and June 2011. As with any share price it can be impacted by many factors and is ultimately a matter for the market. It is difficult to know what main drivers contributed to the Qantas share price decline during this period. However, during that period there were a number of unusual external factors which impacted on the financial performance of the Group including the Japanese Tsunami and consequential concerns about that market as a key source market for Australian tourism, to which both Qantas and Jetstar is exposed.

Qantas can clarify that a decision to lease rather than own aircraft would be impacted by lease expense rather than depreciation expense. This would not resolve the negative impact of depreciation.

7. **Qantas' submission to the ACCC regarding the deal with Emirates stated: *Qantas' stated rationale for the alliance sets out its views on the future of Qantas International without the alliance. Qantas submits: Qantas International is simply unable to compete or operate profitably. For many years, Qantas International has been in terminal decline and has been supported by the other profitable Qantas businesses (Qantas Domestic, Qantas Frequent Flyer (QFF) and Jetstar) but its losses have continued to grow, with a $450 million loss in fiscal year 2012. In addition, unless Qantas has the ability to recover its cost of capital over an appropriate period, it will not be possible to invest in new aircraft for Qantas International. If Qantas International can no longer sustain its network because of low returns, then this has the potential to undermine its ability to compete as a legitimate network airline.***
    a. **What information did you provide to the ACCC to support your rationale of terminal decline of Qantas international?**
    b. **Did the ACCC ask further information to substantiate the claim of 'terminal decline' of Qantas International?**
    c. **Following the draft determination of the approval of the alliance between Qantas Airways and Emirates Airways, did the ACCC request information from Qantas to substantiate the claim of terminal decline?**
    d. **Has Jetstar ever returned its cost of capital? What rate of return is required on capital for both Jetstar and Qantas?**
    e. **Did any directors or senior management purchase shares in Qantas Airways Limited during this period?**
    f. **What do you believe the ACCC dismissed the claim of terminal decline?**
    g. **Why is Jetstar reported as a group only, whilst Qantas is broken into segments? Who determines how segments are organised and reported?**
    h. **Do you agree that it would be easier for an investor to ascertain the contribution of a segment with access to more detailed breakdown of performance?**
    i. **Does Qantas assign costs to its segments on a like for like basis?**
    j. **Does this allocation of costs alter and, if so, who decides?**
    k. **Was a change to allocation of costs between segments and operating units undertaken in the period between 17 February 2011 and 22 June 2011?**

<u>Qantas and Emirates Partnership</u>
Consistent with normal authorisation process, public versions of the material provided to the ACCC are available on the Commission's website. The ACCC's review process included several rounds of public submissions, a pre-decision conference and a comprehensive analysis of the benefits the partnership would deliver to consumers.

In its Final Determination, the ACCC acknowledged the difficulties facing Qantas' European operations. In particular, the ACCC accepted the competitive disadvantages under which Qantas operates compared with our competitors to Europe:

> *"On balance, the ACCC considers that Qantas is likely to be at a competitive disadvantage in its operations between Australia and UK/Europe (i.e. Frankfurt and London), compared to mid-point carriers based in the Middle East and Asia".*
> (ACCC Determination in respect of a Master Coordination Agreement to coordinate air passenger and cargo transport operations and other related services, 27 March 2013).

QANTAS

Qantas has consistently argued that while a small number of international routes remain structurally sound, a majority (especially into Asia and Europe) are characterised by competitors with significant structural advantages. In the absence of the Emirates partnership, Qantas made clear that withdrawal from a number of routes was possible.

Jetstar and Cost Allocation

Jetstar has been a highly successful business within the Qantas Group which has succeeded both in growing new markets and in protecting the Qantas Group's market share from other low cost carriers. As advised in evidence to the Senate on 18 March 2014, each business within the Qantas Group is responsible for its own costs, as detailed in our Annual Report.

The Qantas Group's financial statements, which include the segment results presented in accordance with Australian Accounting Standard AASB 8, are subject to an annual independent audit and an independent review at each half year.

The Qantas Group's financial statements contain an unqualified audit opinion from the independent auditor that the Financial Report is in accordance with the Corporations Act 2001 including giving a true and fair value of the financial position and the financial performance, and complying with Australian Accounting Standards and Australian Corporations Regulations 2001.

8. **On 4 November 2011, Mr Joyce stated: *"We submitted a proposal to the ACTU saying that we are happy for an independent audit to take place of the books, to clarify this once and for all, because I am very comfortable that there is the $200 million loss. One of our only requirements is that we ask for one of the big four auditing companies to do the audit. We said we would even pay for the audit, because it will be an expensive audit."***
    a. **Did that audit ever take place? Would Qantas allow an audit, similar in scope to ASRS 4400, 'agreed upon procedures audit' to be undertaken addressing cost allocation and materiality?**
    b. **If such an audit were to take place are you confident that matters of materiality would confirm there is no prejudicial cost allocation in favour of Jetstar?**
    c. **I refer you to the testimony of your former colleague Bruce Buchanan, 4 November 2011, when he stated "It is not about shifting costs or using services from Qantas". Do you agree that Jetstar borrow no services from Qantas? Are you confident that an audit assigning materiality to matters of cost allocation would show that no services are in fact borrowed?**
    d. **Mr Joyce also stated on 4 November 2011 that it is a 'user pays system'. Do all users pay exactly the same price for a service?**

Qantas made this proposal to the unions on the basis that when the audit confirmed that no segment of the group was being made to look artificially strong or weak, that the unions would cease making these claims. They did not agree to this request so the audit was not conducted.

Please see response to Question 7 regarding the independent auditing of the Qantas Group's financial statements.