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Speech - When Private Equity Knocks London, 05 March 2007

Address by Margaret Jackson, Qantas Chairman, Citigroup Australia and New Zealand 4th Annual Investment Conference

The Approach

For the Chairman and Board of any company it is definitely a challenge when private equity unexpectedly knocks on your door. It's even more of a challenge when your company is Qantas, an iconic Australian business, a successful global airline and a listed corporation. But that's what happened in mid-November last year.

The Qantas Board has a strong track record in dealing with dramatic events. We've been through many crises. We had 9/11, when aircraft were used in terrorism. In the same week Australia's second airline, Ansett collapsed. We have dealt with war; terrorism, including two separate bomb attacks in Bali; natural disasters such as the Asian tsunami; and the SARs virus. We have seen our fuel costs rise in three years by more than \$2 billion.

But this unsolicited approach to Qantas raised new challenges for us. The initial indicative offer set a price range that was sufficiently compelling that we had no option but to evaluate it. Certainly I can say that the Board has worked diligently and creatively with a strong executive team to grow and strengthen Qantas. Since 2001, Qantas has carried 54 percent more passengers, employed ten percent more employees, and increased the aircraft fleet by 21 percent. We started the groundbreaking Jetstar operation. Our current capital expenditure program involves investment of more than \$10 billion over the next five years and more than \$25 billion over the next ten years. Qantas has been an essential partner in the evacuation and support of Australians in crisis - immediately sending police, medical teams, emergency workers and forensic workers to support and assist rescue efforts in Bali, Thailand and wherever else we are needed. We have done the right thing by our employees and customers; we've also made a big contribution to Australia and Australian tourism.

It has therefore been frustrating that our shareholders have not been equally rewarded. Since a peak of over \$5 in 1999, Qantas shares have generally traded in the \$3 to \$4 band. So when the consortium indicated a compelling price range on offer for existing shareholders, we had to respond. Our options were either to reject the bid, or engage in an evaluation with the objective of being able to put an offer before our shareholders. Having agreed to engage, we then had to work out: How do we manage this process? What are the protocols we should put in place?

Conflicts of Interest

Many takeovers are based on the premise that a company is under-performing. The expectation is that a new management team with a new strategy will be brought in to work the assets harder and better. Not in this case. The consortium said that the current management team was outstanding and that the current Qantas strategy was to be continued. The retention of the Board's two Executive Directors, Managing Director Geoff Dixon and Chief Financial Officer Peter Gregg was considered vital to the consortium's plans.

But this meant that we had to manage serious conflicts of interest. For example, there was no way I could lead an impartial process if I had an interest in its outcome. My job and that of the Independent Board was - and is - to act without fear or favour on behalf of our current shareholders.

To make this process work, the first thing we did was commission independent external financial and legal advisers: UBS and Carnegie Wylie as financial advisers, and Allens Arthur Robinson as lawyers. These were an outstanding team of people who worked effectively alongside the Board on this complex transaction. The Board asked these financial advisers and lawyers to advise us of best practice in relation to private equity takeover processes. Frankly we did not think any of the examples of recent practice were adequate to deal with our situation. So with the help of our advisers we devised our own protocols and processes to ensure confidentiality, and to manage any potential conflicts of interest.

The Protocols

Let me describe to you the protocols we put in place:

- Any discussions between executives and the consortium to be agreed upon in advance by our external advisers.

- No meeting to occur between the consortium and the two Executive Directors without my presence as Chairman.
- No meeting to occur between the Managing Director's direct reports or other identified executives without my presence or that of another Independent Director.
- At all meetings a representative from our financial advisers and a representative from our lawyers to be present.
- No meetings to be held between executives and the consortium to discuss compensation until after the Independent Directors had decided the offering was sufficiently compelling to place before shareholders.
- All the principal debates and decisions to be made by the Independent Directors without the presence of the Executive Directors.
- When significant decisions were taken by the Independent Directors, only then would Executive Directors be invited to concur with our conclusions.

These protocols were agreed to by the consortium and the executives of Qantas. And they were fully adhered to throughout the process.

Let me now describe the process as it unfolded.

The Process

The consortium initially sought a twelve week due-diligence process. Twelve weeks was too long to have the Board and executives of a global airline business tied up: we have a plane taking off somewhere in the world on average once every two minutes. Instead we offered the consortium a limited due diligence that was completed within six weeks. And it was, indeed, rigorously controlled. The due diligence could be described in four quarters or phases, rather like a very long, intense football game.

In the first phase we made information available to the consortium. A data room was established. Those involved were required to sign confidentiality agreements, including a standstill arrangement that no-one involved could trade in Qantas securities for 12 months. One day the Qantas executives made presentations to the consortium. I was present and so were our financial advisers and lawyers. On subsequent days one-on-one sessions were held between Qantas executives and the consortium, again with either me or another Independent Director present, plus our financial advisers and lawyers. The consortium was allowed to ask limited questions and by no means were all their questions answered. The constant presence of our external advisers meant that the consortium was only given the information that was strictly necessary to conduct an effective limited due diligence.

In the second phase the consortium was busy structuring and finalising its own arrangements. It was also reviewing the materials presented, seeking clarification and requesting any additional information. Qantas engaged in that process as we needed a sign-off from our own advisers that any proposal presented to us was capable of implementation within a short time frame without undue completion risk.

In the third phase we undertook negotiations on a proposal.

In the final phase a formal offer was made of \$5.60 per share. The Executive Directors, Geoff Dixon and Peter Gregg, did not participate in the Board's consideration of the terms of the offer. The ultimate decision to recommend the offer to shareholders was made solely by the Independent Directors. We announced that we would put the offer to shareholders. It was only at that phase we permitted the consortium to speak to our executives regarding their future with the company and compensation.

Once again it is worth emphasising that at all times during this process, interactions between Qantas executives and the consortium members were strictly controlled. To the credit of management and the consortium the stringent conditions were fully complied with.

The Board

A lot can and no doubt will be written and said about the protocols and processes for this kind of complex situation.

But nothing can replace the fundamental quality of the Board. At Qantas we have a Board of the highest ethics and integrity, with the wisdom and judgement necessary for the task.

And all of this was needed because handling this takeover bid was definitely not a job for the faint hearted.

Our protocols required a huge time commitment. Either myself as Chairman or another Independent Director was required to attend all meetings with the consortium. We had numerous Board meetings at short notice - as often as possible face to face - and usually early in the

mornings or in the evenings to give everyone the maximum opportunity to attend. And we had regular email updates. At key Board meetings we excluded the Executive Directors and often excluded all Qantas executives. But we did keep our financial and legal advisors close by.

There was and is a very high degree of interest in the process and in the outcome of this takeover bid. As I said, Qantas is an iconic Australian company. Qantas will remain Australian - successive Governments have retained the Qantas Sale Act which specifically limits foreign ownership in Qantas. The consortium structured its arrangements so that it complied with the requirement that Qantas remain majority Australian-owned and controlled, and it needed to work through the other statutory ownership limitations. Recognising the sensitivity of the issue, the consortium is still addressing these matters with the various regulators who have an interest.

The Australian Parliament also takes a great interest in Qantas because of the company's role in emergency relief, defence maintenance and support, the rescue and repatriation of Australians in crisis, and the promotion of Australian identity and tourism overseas.

The Decision

The lead up to the Independent Directors' decision to recommend Airline Partners Australia's offer was interesting. Although the initial proposal was confidential, indicative and incomplete, it was also put on the basis it could be withdrawn if confidentiality was lost. However, in mid-November, following media speculation, we announced we had received a proposal from a consortium led by Macquarie Bank and Texas Pacific Group the terms of which were confidential.

Given the intensity of the political, media and regulatory focus, the process needed finality. On Sunday 10 December I gave Airline Partners Australia 48 hours to make a formal offer to acquire 100 per cent of Qantas. If they were serious, now was the time for them to act.

At 7.21am on Wednesday 13 December, Airline Partners Australia put in an offer to purchase Qantas- at \$5.50 per share subject to a range of conditions. The Board gathered rapidly and deliberated carefully.

We concluded that the offer as it stood was not acceptable. We rejected both the offered price and the conditions attached, and we stated this clearly, publicly and immediately. Some may think that once this sort of process has started, it can only have one ending. However, we had a business to direct and needed to move quickly to prevent any fallout and limit brand damage.

The consortium also responded quickly and by late Wednesday, intense negotiations were underway. These were hard and challenging.

Wednesday night was again sleepless but by Thursday morning we had a deal, one that Qantas' Independent Directors could not only accept but feel delighted to recommend to our shareholders. The offer of \$5.60 was 61 percent above Qantas's volume weighted average share price of \$3.48 over the previous six months. It was clear that the capital markets had failed to give an adequate measure of the value to Qantas. And the attached conditions were now fully acceptable. This was a fantastic opportunity to reward loyal shareholders. And I trust and believe it represents a great deal for the future of Qantas as well. I should add that, while it was the Independent Directors who made the decision to recommend the offer, the Executive Directors Geoff Dixon and Peter Gregg wholeheartedly supported this decision.

Conclusion

Today the decision is with the shareholders. They have the Board's recommendation, independent advice, and detailed information from both Qantas and the bidder. They have a very good price indeed on offer. And shareholders can be sure that the process which got us to this point has been resolutely fair, ethical, transparent and effective.

In fact, I believe the process has been exemplary. The protocols and processes that we put in place to manage this private equity bid for Qantas have set a new standard. I think our Board has rewritten the rule book on private equity takeovers. We have been fiercely independent and always acted in the best interests of shareholders.

There has been a lot of talk about the compensation Qantas executives will receive if the deal goes ahead. Not much has been said about the Board. If the deal goes ahead all our current Independent Directors will resign. They will receive no cash retirement payment. Their fees will just stop.

On the front pages of Australian newspapers the day after the announcement, there were prominent photos of Geoff Dixon and I embracing. Some people assumed we were in a mood of self-congratulation. Nothing could be further from the truth. Because, in achieving this great outcome for shareholders, I was also giving away the best job of my life so far.

My dramatic week ended on the Saturday, when I was part of a group that welcomed home the

first Qantas Boeing 707 aircraft after extensive restoration by numerous volunteers. It had been the first jet aircraft in the Qantas fleet, the first jet to arrive in Australia, the first Boeing jet aircraft sold outside of the United States and the first jet to fly around the world. The B707 was the landmark aircraft of its age and - modified to Qantas specifications - a marvel of engineering and design excellence. The aircraft symbolises everything I cherish about Qantas - the history, professionalism and nation-building contribution of this great Australian company.

Qantas started as a private equity business nearly 87 years ago. Then it went into government hands. It is currently a listed public company. And now, if shareholders accept the offer, it will become a private equity business again. In all its incarnations Qantas has gone from strength to strength. It has represented the best of Australia. And it has been shaped by a large and loyal Qantas family. Whatever happens at Qantas, none of this will change.

And now the decision is in the shareholders' hands, as it should be.

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Email: qantasmedia@qantas.com.au

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