STOCKS DOWN UNDER

25 JULY 2022

ASX Top 200 Stocks Down Under

There's no one I'd rather have in control than a Qantas pilot.

- John Travolta (b. 1954), Qantas ambassador, actor & Boeing pilot

ASX

EXCHANGE CENTRE

QANTAS

The Red Roo is getting Back in Black

QANTAS

The Red Roo is getting Back in Black

Stocks Down Under rating: ★★★★

ASX: QAN
Market cap: A$8.5BN

52-week range: A$4.20 / A$5.97
Share price: A$4.51

After COVID-19 literally eliminated demand for air travel, it was going to be a long road back for Qantas. However, we believe it is well and truly getting there. Australia's flag carrier has resumed most of its routes, announced several new ones, resumed hiring staff and is expecting to record positive EBITDA again in 2HY22. But will uncertain oil prices, potential engineering strikes and angry customers bring it down? We think they won't – otherwise, we wouldn't have made it a Concierge Stock just recently. We have already outlined our thesis on our Concierge page so will only briefly repeat it here. In this report, we will address some reasons why you might argue against an investment in Qantas.

Share price chart

Source: Tradingview

Writing another chapter in its history

Qantas began in 1920 in regional Queensland and until the 1990s was government-owned. Today, it operates over 200 aircraft across Qantas-branded aircraft and low-cost subsidiary Jetstar in Australia, Singapore and Japan. Compared to the airline industry in Europe and North America, Qantas has less competition domestically and despite higher competition internationally, still has a significant market presence given Australia's isolation and consequential need for air travel. It has also been able to foster long-term connections with its customers through their individual experiences and its famous marketing campaigns. Who can't recall 'I Still Call Australia Home'?

You probably know all that. You probably also know that the pandemic wiped out demand for air travel, but it has been resuming – albeit later than in overseas markets. And Qantas' big project is non-stop flights from Sydney and Melbourne to New York and London. After toying with the idea, running test flights, a competitive tender between Airbus and Boeing and the pandemic, it placed a firm order for dedicated aircraft (Airbus A350s) in early May. It also placed an order for aircraft to begin refreshing its domestic fleet. If Qantas' Sydney to Dallas and Perth to London services are any guide, people may well say they won't do it. But the balance sheet suggests they're saying one thing and doing another, because these routes are among the most profitable in the group. CEO Alan Joyce has declared that this represents 'the final frontier in aviation'.

But don't they say, 'never invest in airlines'?

As we outlined on our Concierge page, we believe Qantas is a buy because of the strong, pent-up demand for travel that still hasn't been fully unleashed as well as its low multiples and healthy balance sheet. We also thought it could manage the impact of high oil prices, but we observe that prices have begun to fall in recent days. However, sharp investors might argue there's a few things about Qantas that might put you off an investment in the stock.

The first is the commonly held belief that airlines should be a no-go zone for investors. This is because of high capex requirements and the range of factors out of airlines' control. Indeed, we've seen plenty of the latter this decade, with huge swings in oil prices, the pandemic and border restrictions. We certainly accept that airlines aren't the kind of company you can sleep well with at night, knowing it will perform in all conditions. Even among airlines, while Qantas has some unique advantages, it has some disadvantages too. Qantas is end of line carrier rather than a transit. It will never be able to invest to the extent that state-owned carriers can and do (most notoriously Emirates and Qatar Airways).

But we believe the opportunity it presents right now is still appealing. This is considering that the company is still yet to reach profitability (expected soon, though) and that global travel is still to reach pre-COVID levels. We accept there is merit to the argument that business travel may not return to pre-COVID levels, but for now premium leisure travel is more than making up for it.

What about its balance sheet and logistical problems?

A second argument to be mindful of an investment in Qantas right now is its customer service. Qantas has been struggling to handle the surge in passenger demand, with higher than usual cancellations and higher waiting times at call centers. All airlines have faced this, but Qantas has done itself no favors with the way it has handled certain incidents and some of its PR – Alan Joyce's infamous 'match-fit' comments appeared to blame travelers for their own predicaments. Even if that was true, sometimes those things are best left unsaid. But, as we observed above, sometimes people say one thing and do another. Low-cost airlines, such as Ryanair, cop significant criticism, yet still deliver for shareholders because even if people love to hate them, they give in when they see they're the only carrier operating the exact route they want at the time they want, and at bargain basement prices.

Lastly, Qantas' financials. The market is assuming that Qantas will return to profitability. But you could argue it will bear the scars of COVID losses for some time and that now is not the time to be committing billions of dollars to new planes. But given the solid financial state it was in at the start of COVID, Qantas was in a position to take on new debt and equity capital to survive through the crisis. We expect the FY22 results will show net debt will amount to ~$4bn per the end of June – down from $6.4bn at the height of the pandemic. We acknowledge Qantas will have to take onboard further debt for Project Sunrise. Qantas estimates much of the capex burden will fall between FY25 and FY27, with a peak of $1.2bn in FY26.

Why we think it's set to soar

As we said above, we back the company because we think it will continue to pounce on the demand for travel. Qantas' results, due in mid-August, will give an indication of just how well it is going.

Don't expect a profit for FY22, but for 2HY22 the Red Roo expects to be EBITDA positive to the tune of $450-$550m. Don't expect the company to issue formal guidance for FY23 either. However, consensus estimates call for $16.9bn in revenue, just over double FY22, and $3bn in EBITDA. For comparison's sake, in FY19 (the last COVID-free financial year) it generated $18bn in revenue, $3.4bn in EBITDA and achieved a pre-tax profit of ~$1.3bn.

For FY24, consensus estimates expect Qantas to do even better, with $19bn in revenue and $3.9bn in EBITDA, up 12% and 31% respectively from FY23, and in both cases ahead of pre-COVID levels.

We believe a lot of potentially bad news is currently priced into the share price. And with the travel recovery in full swing, but not yet complete, we think Qantas is four stars and deserves its place as one of our Concierge stocks.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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