



Fat Prophets take remaining profits

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Qantas has been a stellar performer in the Fat Prophets Portfolio since we first recommended the shares are \$1.30, and when the entire broking fraternity was negative on the stock. However, with the airline's turnaround largely complete, we see robust fuel prices as an earnings headwind, which will only dampen the share price from here. The prospect of a slow-down in global growth (and increasing competition) could also indicate that earnings are past their cyclical peak.

Accordingly, we recommend Members sell their remaining holdings in Qantas around \$5.30. This equates to a 300% return on our original recommended buy price.

First Quarter Trading

Qantas delivered its first quarter trading update last week, which revealed that the top line had reached a record, with total revenues up 6.3% to \$4.41 billion. Within the business units, revenues domestically were up 6.8% with strong demand from business and leisure markets, and as the resource sector also firmed. On the international side, Qantas saw revenues rise by 4%, supported by additional routes (particularly Perth to London) and renewed codeshare agreements. The company also reported that the value of forward bookings was up 8% compared to last year and on flat capacity.

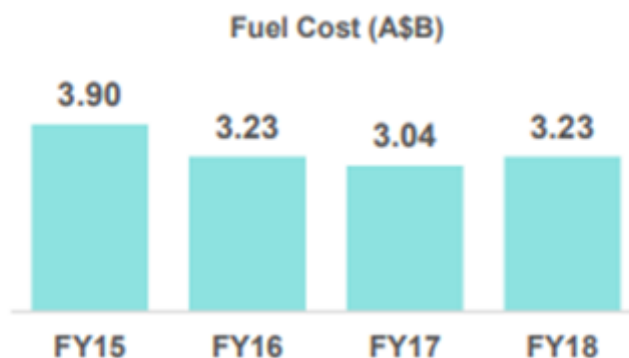
This is all very encouraging, but what was not, were comments that “rising fuel costs substantially offset net passenger revenue growth and capacity discipline.”

A successful cost-out program has been a hallmark of the turnaround of Qantas over the past four years. However, with the 'lemon squeezed' we believe that it will be difficult to offset sustained pressure on the cost side as fuel prices (around 40% of expenditure) remain robust. Oil prices have come off slightly of late, but we don't see a return to \$40 a barrel, with the world's oil producing nations lacking the willingness to open the taps further, and also with non-conventional oil sources (e.g. shale) largely uneconomic below \$50 a barrel.

Qantas has certainly not been immune to rising oil prices, with the company's fuel bill up by almost \$200 million in FY18. Management are expecting an increase of another \$870 million in FY19 to \$4.09 billion (this figure was \$3.92 billion at our last update).

CEO Alan Joyce has previously said the company 'should' be able to recover rising fuel costs in the domestic market, and 'substantially' so in the international market. We however note, that the latter remains highly competitive (the airline itself expects international market capacity to rise 4% in 1H19). Given our view on rising global inflationary pressures, we do not see high jet fuel prices as a problem that will go away.

The fuel bill is also rising significantly despite 87% of costs hedged for the first half of FY19 (and 76% hedged for the whole of FY19). Only 39% of consumption is hedged for FY20. The airline is focusing on efficiency measures to reduce fuel consumption (a 1% impact), but we believe these will prove minimal in context.



Source: Investor Presentation

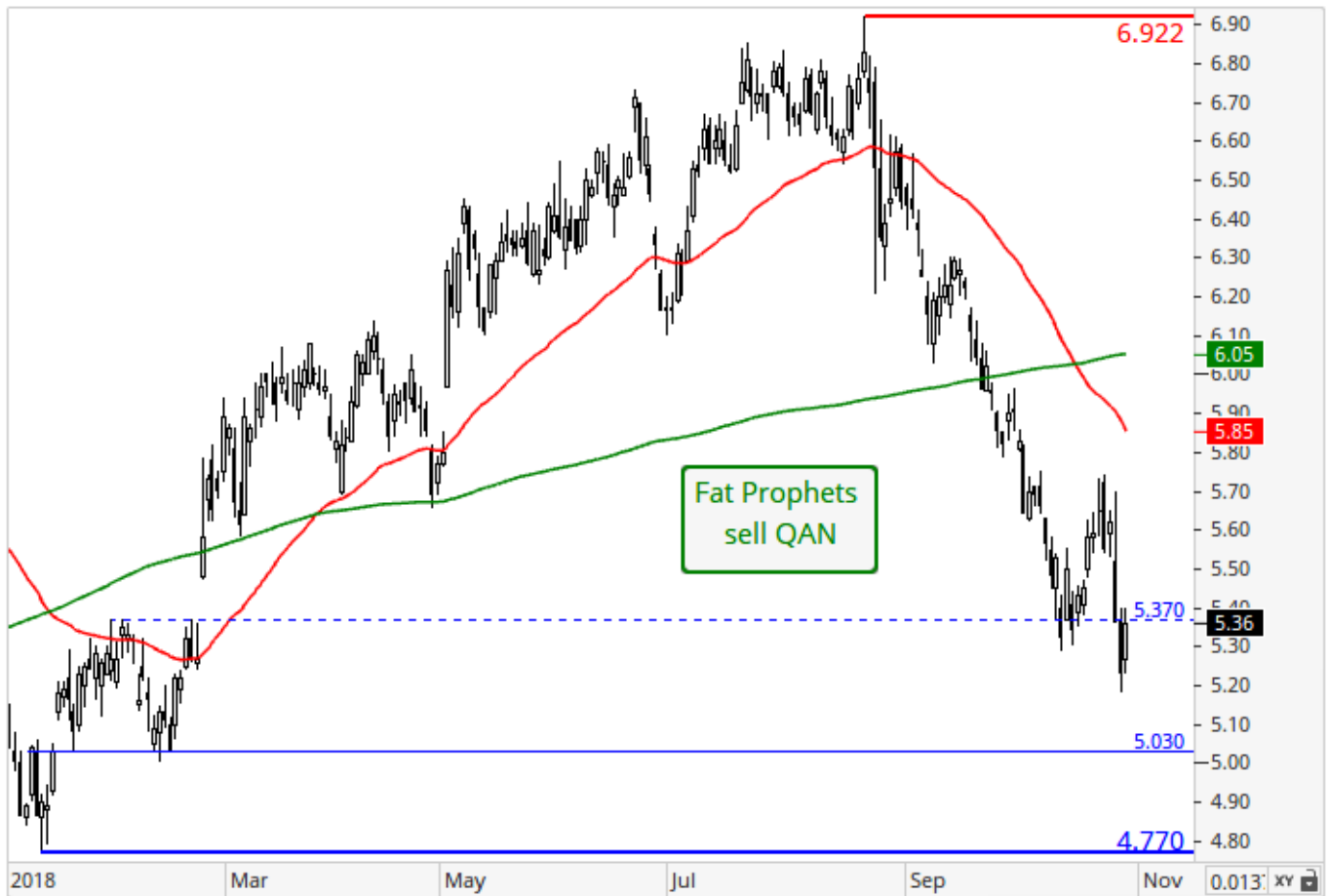
For 2019, the Group's full year fuel cost is expected to be some \$4.09 billion, compared with \$3.23 billion for financial year 2018. The Group is on track to deliver at least \$400 million in transformation benefits in FY19, but this will not be sufficient to breach the gap, and in any event has been priced in by the market.

Qantas itself remains in as good a shape as ever, with a modern fleet, and with an earnings turnaround that has been passed onto shareholders. Buybacks have been ramped up, as have dividends. We do however believe that further out the level of growth in shareholder returns may be moderated by rising fuel costs. As an aside, we also note that Qantas has used up the last of its tax losses.

We also note that Chairman Leigh Clifford is retiring this year after 11 years in the position. We wonder if the timing is prescient and will signify the last few years as being as 'good as it gets' for the airline for a while.

Turning to the charts, and on the daily chart, the technical picture has weakened further. Prices have dipped further below the 50-day and 200-day moving averages (red and green lines respectively). Support at \$5.37 has given way, with the next buttress is around the \$5 mark.

Qantas Airways Ltd - QAN (ASX) - 1 Day CandleStick Chart - AUD



With reference to the monthly chart, support at the 2008 high of \$6.06 has given way, and the 38.2% Fibonacci retracement of \$5.02 (blue set of retracements) looks set for a stern test. A break below here could open up levels toward \$4.



Summary

Qantas shares have continued to lose altitude since our sell half recommendation in late August. In fact, the stock has lost almost 20%, with the market pullback not helping, but also as the company issued a mixed trading update last week. Revenue growth was strong in the first quarter, but rising fuel costs appear to be taking their toll. This is something we warned of at our last update, and we expect it to be an ongoing issue for Qantas and the industry generally, as fuel price hedges wear off.

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Snapshot QAN

Qantas

Latest Closing Price: \$5.34

Qantas Airways Ltd is an Australia-based airline, which operates in the domestic and international space. The Company is engaged in the operation of international and domestic air transportation services, the provision of freight services and the operation of a frequent flyer loyalty program. Its segments include Qantas Domestic, Qantas International, Jetstar Group, Qantas Freight, Qantas Loyalty and Corporate.

The Qantas Domestic, Qantas International and Jetstar Group segments include passenger flying businesses. The Qantas Freight segment is engaged in the air cargo and express freight business. The Qantas Loyalty segment is engaged in the customer loyalty recognition programs. Its main business is the transportation of customers using two airline brands, which include Qantas and Jetstar. It also operates subsidiary businesses, including other airlines and businesses in specialist markets, such as Q Catering. Its airline brands operate regional, domestic and international services.

Market Capitalisation: \$8.90b

	FY1	FY2
Price to Earnings	11.0	8.7
Dividend Yield (%)	2.3	3.8
Price to Book	2.6	2.1
Return on Equity (%)	26.2	24.6
EV/EBITDA	3.3	3.6