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Qantas bounces back but not quite there yet

Company/ASX Code	Qantas Airways Ltd/QAN
AGM date	Friday 4 November 2022
Time and location	11am AEDT Wesley Conference Centre, 220 Pitt Street Sydney 2000
Registry	Link Market Services
Type of meeting	Hybrid (https://web.lumiagm.com/314769002)
Poll or show of hands	Poll on all items
Monitor	Ian Anderson assisted by Miles Wu
Pre AGM Meeting?	Yes with Chair Richard Goyder, Head of Investor Relations Filip Kidon, Head of ESG and Social Licence Kathryn Franklin, Senior Manager Investor Relations Adam Luc.

Monitor Shareholding: The individuals (or their associates) involved in the preparation of this voting intention have no shareholding in this company.

Summary

Qantas has survived the pandemic induced downturn, but the measures taken during this period have left a legacy which has led to a litany of scheduling, baggage handling and complaints handling issues. Despite announcing a return to work for all employees in December 2021, Qantas has been struck by the speed at which air travel has resumed and has struggled to meet demand. When questioned on these issues, the chairman claimed that they are common to many operators in the industry and Qantas is well on track to resolving these problems with key operational statistics such as on time performance, cancellations and baggage mishandling now at or close to pre-COVID levels (although baggage handling statistics have been assisted by the lengthening of connection times).

The recently announced first quarter results for FY23 support the view that, despite 75% higher fuel costs than pre-COVID, Qantas has “turned the corner” both in performance and profitability. The chairman confirmed that Qantas’ conditions of carriage were updated effective for travel after 28 December 2019 and apply to relevant claims from that date.

Proposed Voting Summary

No.	Resolution description	
1	Consideration of Reports	No vote Required
2.1	Re-election of Richard Goyder as Non-Executive director	For
2.2	Re-election of Maxine Brenner as Non-Executive director	For
2.3	Re-election of Jaqueline Hay as Non-Executive director	For
3.1	Participation of CEO, Alan Joyce, in Recovery Retention Plan	For
3.2	Participation of CEO, Alan Joyce, in Long Term Incentive Plan	For
4	Adoption of Remuneration Report	For

Consideration of accounts and reports - No vote required

Financial performance

Two years into a three-year recovery plan, the programme is starting to show results with over 90% of initiatives completed and $920m in savings achieved to date. However, the Group's overall performance continues to be impacted by the global COVID-19 pandemic with overall revenue still less than half pre-COVID levels, leading to a statutory loss before tax of $1.19Bn and an underlying loss of $1.859Bn. No dividends were declared for the second year running and simple total shareholder return (TSR) was negative 4.1%.

Despite re-opening of international borders and increasing passenger numbers, particularly in the last quarter, none of the operating groups', Domestic, International or Jetstar's operating profit before tax (UPBT) returned to positive figures let alone approached pre-COVID FY19 performance. Only the Loyalty program showed a profit of $292M due to high growth rate in points redemption.

Qantas' $1.4Bn recovery program, started in FY20, has been progressing well, reducing net debt to $3.94Bn vs $5.89Bn a year ago, which is below the company's target range of $4.2 – 5.2Bn. The company reported record high fuel costs, forecast to hit $5Bn in FY23, driven by a combination of higher capacity, increased Brent Crude prices and high refining margins. The board has also approved the largest aircraft order in Qantas' history with a total of forty more efficient and sustainably fuelled Airbus A321XLR and A220 aircraft to be delivered over the next decade.

Given the tax losses accumulated during the pandemic Qantas is unlikely to generate franking credits in the near-term making dividends less attractive than previous fully franked dividends. Whilst the board is focussed on being able to restart dividends, Qantas expects shareholder returns over the next two to three years more likely to be achieved in the form of buybacks rather than dividends.

Key events

There were no capital raisings or buy-backs during the year although the company has recently announced an on-market buy-back of up to $400m to return capital to investors in FY23. In May 2022 the group acquired a 51% controlling equity interest in TAD Holdco Pty Ltd (TripADeal), a company specialising in packaged holidays including flights, hotel accommodation and tours. The company has been focussed on the recovery plan and re-opening of operations but has struggled to ramp up its operations to meet customer demand.

Key Board or senior management changes

Directors Paul Rayner and Barbara Ward retired during the year leaving the board with one executive director and seven independent non-executive directors, three of whom are women, thus meeting ASA's guideline of a minimum 30% female representation on the board. There were no changes among key management personnel.

However, following recent and possible future retirements there will be a need for board renewal including to maintain gender balance. The chairman confirmed the board is looking for potential members with strong operational experience and did not rule out a foreign resident.

ASA focus issues

Qantas has issued a corporate governance statement and a more detailed climate action plan and generally complies with ASA focus issues including treatment of shareholders, board skills, ESG and remuneration. Whilst Qantas has a target of 42% women in senior management by 2024 it does not have a specific target for board membership.

Summary

(As at FYE)	**2022**	**2021 (Restated)**	**2020**	**2019**	**2018**
Statutory NPAT ($M)	(860)	(1,692)	(1,964)	840	953
UPBT ($M)	(1,859)	(1,774)	124	1,326	1,565
Share price ($)	4.47	4.66	3.78	5.40	6.16
Dividend (cents)	0	0	25	17	14
Simple TSR (%)[1]	(4.1)	23.2	(11)	(8.2)	10.6
EPS (cents)	(45.6)	(89.9)	(129.6)	51.5	54.4
CEO total remuneration, actual ($M)[2]	2.272	2.43	2.63	11.1	10.87

1. Simple TSR is calculated by dividing the change in share price plus dividend paid during the year excluding franking, by the share price at the start of the year.
2. CEO remuneration for 2018-21 includes deferred vesting of previous STI awards

Re-election of directors

Richard Goyder

Richard Goyder was appointed to the Qantas board as an Independent Non-Executive Director (NED) in November 2017 and became chairman in October 2018. He is also chairman of Woodside Energy Group, the Australian Football league, the West Australian Symphony Orchestra and the Channel 7 Telethon Trust as well as serving as chairman of the Qantas Nominations committee.

Mr Goyder is well qualified and experienced for his role at Qantas although ASA has concerns about his workload chairing multiple companies though critical times. However, when questioned, he stated that he is not as busy as he was as a CEO and has sufficient time to meet his responsibilities as chairman as well as his other duties. ASA will vote undirected proxies in his favour.

Maxine Brenner

Ms Brenner was appointed to the Qantas board in August 2013 as an Independent Non-Executive Director and serves on the Remuneration and Audit committees. She is also a director of Origin Energy Ltd, Woolworths Group Ltd and Orica Ltd.

Ms Brenner is well qualified and experienced to serve as a director of Qantas and the board values her strategic, financial and legal experience, so ASA will vote undirected proxies in her favour. However, we note that by the end of this term Ms Brenner will approach the end of the period of twelve years during which ASA considers a director to be independent. The chairman indicated that, if re-elected, Ms Brenner is likely to retire at some point in her next term.

Jaqueline Hay

Ms Hay was appointed as an Independent NED to the Qantas board in August 2013 and serves on the Audit and Nominations committees and as chair of the Remuneration committee. She is also chair of the Bendigo and Adelaide Bank Ltd and a director of the Commonwealth Superannuation Corporation. The chairman considers Ms Hay a very valuable member of the board team.

ASA will vote undirected proxies in favour of Ms Hay but notes that by the end of this term she will be approaching the end of the twelve-year period during which ASA considers a director to be independent.

Grant of Rights to CEO, Alan Joyce

Participation in the Recovery Retention Plan (RRP)

Along with a reduction in staffing levels generally, Qantas has seen a rise in the attrition rate of skilled executives as a result of the demands of the COVID-19 pandemic and the resulting poor financial results leading to no annual incentives for executives for the last two years. Accordingly, Qantas has sought to re-structure the remuneration framework to retain critical talent and has replaced the traditional annual incentive framework in FY22 with an equity-based incentive focussed on achievement of three longer term objectives related to Qantas' recovery from the COVID pandemic.

Provided the CEO remains with the company and achieves these objectives by 30 June 2023, he will be granted a maximum number of 698,000 rights equivalent to 150% of his Fixed Annual Salary (FAR), a total of $3.255M, based on the face value of the shares as at 30 June 2021. The shares will be newly issued shares which therefore require shareholder approval. If shareholder approval is not obtained, then Mr Joyce will receive a cash payment of the equivalent amount due under the scheme.

ASA is normally reluctant to favour pure retention arrangements but, in this instance, given the circumstances, the suspension of other short-term awards and the hurdles incorporated in the plan, we will vote undirected proxies in favour of this resolution.

<u>Participation of CEO in Long Term Incentive Plan (LTIP)</u>

This resolution is for the grant to the CEO of 898,000 rights to Qantas shares in accordance with the company's long term incentive plan based on 185% of his FAR, divided by the face value of the shares of $4.47 as at 30 June 2021.

As ASA is supporting the remuneration report incorporating this incentive, we will also support this resolution.

Adoption of Remuneration Report

Qantas has provided a very clear remuneration report outlining a fairly conventional remuneration structure of base pay (FAR) plus short (STI) and long (LTI) term incentives with well-defined hurdles aligned with shareholder interests. Whilst no reductions in FAR were implemented this year, the board determined that the STI plan would not operate in FY22 despite many of the targets being achieved. Similarly, despite 50% vesting of LTI being achieved, the CEO offered, and the board agreed, to defer any decision on whether his rights will vest or be forfeited until August 2023.

However, in view of strong competition for executive talent, the board implemented a Recovery Retention Plan designed to reward and retain executives employed on 1 July 2021 who remain employed in August 2023, consisting of an upfront grant of rights to participants. Rights issued under the RRP will vest and convert to Qantas shares only if full performance and service conditions are achieved over the two-year performance period up to 30 June 2023.

It is anticipated that variable remuneration in FY23 will revert to its pre-pandemic structure of annual STIP and LTIP grants with underlying profit before tax as the primary financial measure having a 50% weighting in the STIP scorecard.

Although noting that the proposed remuneration structure results in a potentially relatively high award to Mr Joyce in FY23, we believe this can be justified by the restraint shown over the previous three years and so will vote undirected proxies in favor of this resolution.

Appendix 1
Remuneration framework detail

Fixed Annual Remuneration

In line with the Group's two-year wage freeze, there were no increases in FAR during FY22.

Short Term Incentive

Target and maximum opportunity STI for the CEO is 100% and 200% respectively of FAR delivered two thirds in cash and one third in shares subjected to a two-year deferral period. Scorecard objectives and weightings include financial measures (30% - partially achieved FY22), recovery plan and growth (20% - achieved FY22), customer satisfaction (15% - not achieved FY22), domestic market position (20% - achieved FY22), safety (15% - achieved FY22).

Despite these assessments, no STI awards were made in FY22.

Long Term Incentive

Target and maximum opportunity for the CEO is 185% of FAR delivered as rights which, provided performance and service conditions are met over a three-year period, convert to Qantas shares which are then subject to a further one-year trading restriction. Performance conditions are 50% based on Qantas' rTSR against a global airline peer group and 50% against ASX100 companies. In FY22, only the component measured against the airline peer group was achieved.

In the case of the CEO, on the basis of Mr Joyce's offer, the board agreed to defer a decision on vesting of his FY22 LTI component until at least August 2023.

Recovery Retention Plan

The RRP consists of an upfront award of rights which will vest and convert to unrestricted Qantas shares provided performance and service conditions are met over the two-year performance period from July 2021 to 30 June 2023. In the case of the CEO, the number of shares awarded is equivalent to 150% of his FAR divided by $4.66, being the face value of Qantas shares as at 30 June 2021.

The award will only vest if all the following conditions are met by the Qantas Group by 30 June 2023:

1. The $1Bn recovery program target is met
2. Net debt is below the top of the target range approved by the board.
3. The Group is profitable on a UBPT basis for FY23.

CEO REM Framework for FY23[1]	**Target**[2] **$m**	**% of Total**	**Max. Opportunity $m**	**% of Total**
Fixed Remuneration	2.170	18.7%	2.170	15.8%
STI - Cash	1.447	12.5%	2.893	21.0%
STI - Equity	0.7233	6.2%	1.447	10.5%
RRP	3.255	28.0%	3.255	23.6%
LTI[3]	4.0145	34.6%	4.0145	29.1%
Total	11.61	100.0%	13.78	100%

1. The amounts in the table are the amounts that are envisaged in the design of the remuneration plan.
2. Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting.
3. Excludes potential vesting of LTI awards deferred from previous years