Qantas Airways Limited

ABN 16 009 661 901

Target's Statement

YOUR INDEPENDENT DIRECTORS UNANIMOUSLY RECOMMEND THAT YOU

ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER

IN THE ABSENCE OF A SUPERIOR PROPOSAL

Joint Financial Advisers

UBS Investment Bank

Carnegie, Wylie & Company

Legal Adviser

Allens Arthur Robinson

THIS IS AN IMPORTANT DOCUMENT AND REQUIRES YOUR IMMEDIATE ATTENTION.

If you are in any doubt about how to deal with this document, you should contact your broker, financial adviser or legal adviser immediately. If you have any questions, please contact the Qantas Shareholder Information Line on 1300 658 942 (if in Australia) or +61 3 9415 4285 (if outside Australia) Monday to Friday between 9.00am and 5.00pm (Sydney time).

QANTAS

Qantas Shareholder Information Line

Qantas has established a Shareholder Information Line which Qantas shareholders may call if they have any queries in relation to Airline Partners Australia's Offer. The telephone number for the Qantas Shareholder Information Line is 1300 658 942 (if in Australia) or +61 3 9415 4285 (if outside Australia) Monday to Friday between 9.00am and 5.00pm (Sydney time).

As required by the Corporations Act, calls to the Qantas Shareholder Information Line will be recorded, indexed and stored.

IMPORTANT INFORMATION

Nature of this document

This document is a target's statement issued by Qantas under Part 6.5 Division 3 of the Corporations Act in response to the Bidder's Statement issued by Airline Partners Australia on 2 February 2007.

A copy of this Target's Statement was lodged with ASIC on 12 February 2007. Neither ASIC nor any of its officers takes any responsibility for the content of this Target's Statement.

A copy of this Target's Statement has also been provided to the ASX. Neither the ASX nor any of its officers takes any responsibility for the contents of this Target's Statement.

Investment advice

This Target's Statement does not take into account your individual objectives, financial situation or particular needs. It does not contain personal advice. Your Directors encourage you to seek independent financial and tax advice before making a decision as to whether to accept Airline Partners Australia's Offer.

Disclaimer as to forward looking statements

Some of the statements appearing in this Target's Statement are in the nature of forward looking statements. You should be aware that such statements are only predictions and are subject to inherent risks and uncertainties. Actual events or results may differ materially from the events or results expressed or implied in any forward looking statement. None of Qantas, any of its officers or any person named in this Target's Statement with their consent or any person involved in the preparation of this Target's Statement makes any representation or warranty (either express or implied) as to the accuracy or likelihood of fulfilment of any forward looking statement, or any events or results expressed or implied in any forward looking statement, except to the extent required by law. You are cautioned not to place undue reliance on any forward looking statement. The forward looking statements in this Target's Statement reflect views held only as at the date of this Target's Statement.

Notice to foreign Qantas shareholders

The distribution of this Target's Statement may, in some jurisdictions, be restricted by law or regulation. Accordingly, persons who come into possession of this Target's Statement should inform themselves of, and observe, those restrictions.

Defined terms

A number of defined terms are used in this Target's Statement. Unless the contrary intention appears, the context requires otherwise or terms are defined in this Target's Statement (including in section 12), words and phrases in this Target's Statement have the same meaning and interpretation as in the Corporations Act.

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KEY DATES

Date of Airline Partners Australia's Offer	5 February 2007
Date of this Target's Statement	12 February 2007
Offer closes (unless extended or withdrawn in accordance with the Corporations Act)	7.00pm (Sydney time) on 9 March 2007

Chairman's Letter to Qantas Shareholders

12 FEBRUARY 2007

Dear Shareholder

Late last year I informed you that Airline Partners Australia had made an offer of $5.60 cash per share for all your Qantas shares (the ***Offer***).

When your Board announced the Offer on 14 December 2006, the recommendation that shareholders accept was conditional on two things:

- that there was no superior proposal; and
- that in an independent expert's opinion, the Offer was fair and reasonable.

No superior proposal has emerged to date and the Independent Expert, Grant Samuel & Associates, has confirmed that the Offer is both fair and reasonable.

Therefore your Board unanimously recommends that you accept Airline Partners Australia's Offer of $5.60 per share (in the absence of a superior proposal emerging).

The key reasons for the Independent Directors' recommendation are:

- it represents very good value for shareholders. The Offer price of $5.60 per share is at a substantial premium to recent trading, being:
  - a 33 per cent premium to the closing price of $4.20 on 6 November 2006, the day before the first speculation about the Offer; and
  - a 61 per cent premium to Qantas' volume weighted average share price of $3.48 over the six months to that date; and
- it is a fair and reasonable price. The Offer price of $5.60 per share is within the Independent Expert's valuation range for a change of control transaction of $5.18 to $5.98 per Qantas share. Grant Samuel notes that "any price above $5.18 would be fair value".

The purpose of this Target's Statement is to provide you with all the information you need to make an informed decision about whether to accept the Offer, including the findings of the Independent Expert, details about Airline Partners Australia and the Australian tax consequences relevant to the Offer. It enables you to see your Board's detailed response to the Bidder's Statement, which you should already have received from Airline Partners Australia.

In my six-and-a-half years as Chairman, working with my fellow Board members, Geoff Dixon as CEO and an outstanding management team, Qantas has performed strongly. We have been aggressive and innovative in pursuit of success and security for the company. We are proud of our record. Qantas has delivered year-on-year profits, growth and diversification. But while the business has prospered, the Qantas share price has not. The three-year average price of Qantas shares before speculation about the takeover was just $3.49.

There has been a lot of commentary about the comparatively new trend of private equity-led offers for Australian companies. In view of the terms of the initial approach by the consortium, we did not consider that it was in shareholders' interests to reject that approach, so your Board entered into an evaluation of the proposal in good faith with appropriate protocols to deal with the conflicts of interest that could have arisen. The final Airline Partners Australia Offer is the result of extensive negotiations and has been carefully considered by all the Independent Directors of your Board, which means all members excluding the Executive Directors Geoff Dixon (Chief Executive Officer) and Peter Gregg (Chief Financial Officer).

The Independent Directors have reviewed all available alternatives to maximise value for Qantas shareholders. The Offer is the best available option to enable Qantas shareholders to realise significant value for their investment. Grant Samuel has noted that: "The fundamental question for shareholders is whether there is a reasonable prospect of obtaining a price higher than $5.60 within the foreseeable future, either in the sharemarket or through an alternative acquirer". The Independent Directors considered that this would not be achievable if Qantas remained a listed company. Indeed, Grant Samuel comments that "there is a possibility that the shares could trade at levels approaching the offer price of $5.60 at some future date but it may take some time and would require a confluence of favourable outcomes".

Beyond our duty to protect the interests of current Qantas shareholders, your Board has recognised the broader shareholder and community concern for the well-being of this company. Qantas is an iconic Australian business, employing many thousands of Australians and serving the interests of Australia in tourism, defence and emergency relief. It has been my privilege as Chairman to witness the dedication and talent of our Qantas staff and to see the high esteem in which Qantas is held in the aviation industry, in Australia and around the world. Qantas is a precious part of Australian history. I am proud of its past and I care deeply about its future.

Airline Partners Australia's bidder's statement and public comments to date show clear support for the immensely capable and dedicated current Qantas senior management team, led by Geoff Dixon. This same team will guide the company in continuing to implement Qantas' existing strategy. The Board also recognises and respects that the Foreign Investment Review Board will be assessing the proposal during the next few weeks and reporting back to the Federal Treasurer.

In our 14 December announcement, we stated that under the terms of the Offer, the interim dividend that would otherwise have been payable in April 2007 would not be available. We also said the Board would evaluate whether a fully franked special dividend could be paid during the bid period, in which case the Offer consideration would be reduced by the dividend amount.

Accordingly, on 8 February 2007 the Directors declared a fully franked special dividend of 15 cents per share, payable whether the Offer succeeds or not. This special dividend will fully utilise all Qantas' available franking credits and in the Board's view is in the best interests of shareholders.

The special dividend will be paid to all Qantas shareholders who are recorded on the Register at 5.00pm (Sydney time) on 19 February 2007. Further details concerning the payment date and the taxation consequences are set out in this Target's Statement. In accordance with the Offer terms, if the Offer succeeds, Qantas shareholders will receive a total of $5.60, comprising the fully franked special dividend of 15 cents per share and the balance of the $5.60 Offer price by way of cash payment from Airline Partners Australia.

With the information, advice and recommendations provided in this document, the sale of your shareholding is now a matter for your individual judgement. However, as I have already stated, it is the recommendation of the Independent Directors of Qantas that you accept Airline Partners Australia's Offer of $5.60 per share, which is what I and my fellow Independent Directors will do, for all our Qantas shares (in the absence of a superior proposal). The proposal is also supported by the Executive Directors.

If the Offer is successful, as we believe it will be, the Independent Directors will retire from the Board and be replaced by Airline Partners Australia's nominated representatives on the Offer becoming unconditional.

On behalf of your Board, I have been greatly honoured to represent your interests.

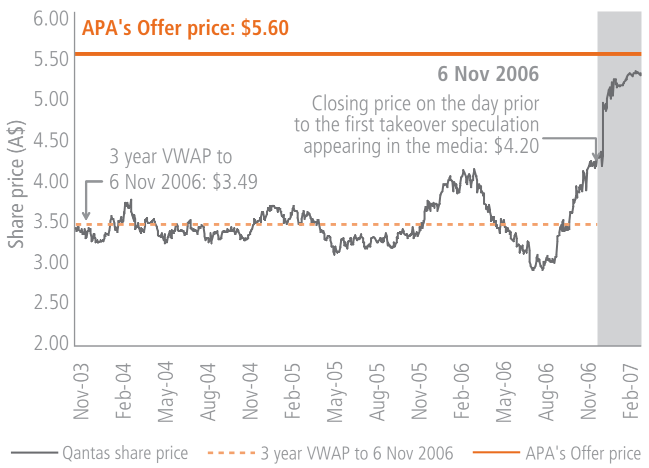
Yours sincerely

Margaret Jackson, AC
Chairman

1. WHY THE INDEPENDENT DIRECTORS RECOMMEND THAT YOU ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER

1. AIRLINE PARTNERS AUSTRALIA'S OFFER VALUES QANTAS SHARES HIGHER THAN QANTAS SHARES HAVE EVER TRADED

The consideration being offered by Airline Partners Australia under the Offer is $5.60 cash per share.[1] This price is higher than Qantas shares have ever traded and is significantly higher than the price at which Qantas shares have traded during the three year period prior to the initial speculation about the Offer.

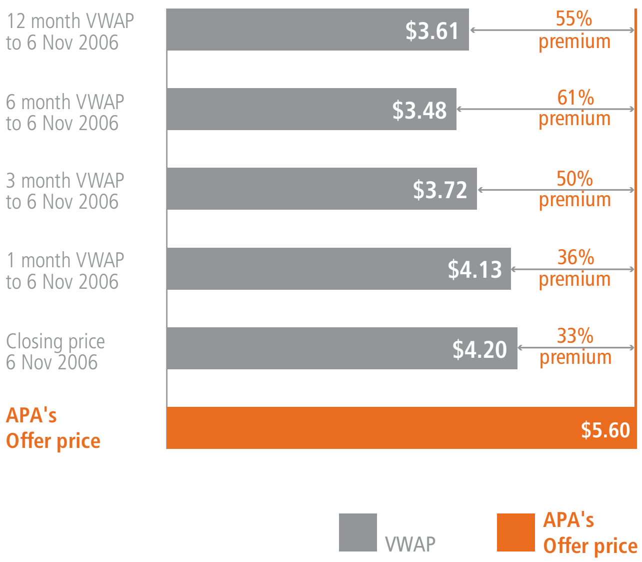


2. AIRLINE PARTNERS AUSTRALIA'S OFFER IS AT A SIGNIFICANT PREMIUM TO RECENT TRADING

Airline Partners Australia's Offer price of $5.60 cash per Qantas share[2] represents:

- a 33% premium to the closing share price of $4.20 on 6 November 2006, the day before the first speculation about the Offer; and
- a 61% premium to Qantas' volume weighted average share price (***VWAP***) of $3.48 over the 6 months to that date.

The Offer consideration premium over and above other recent Qantas share price trading measures is shown below.



3. THE INDEPENDENT EXPERT CONSIDERS THAT AIRLINE PARTNERS AUSTRALIA'S OFFER IS FAIR AND REASONABLE

The report of Grant Samuel & Associates, the Independent Expert appointed by the Board, is set out in Annexure A. The Independent Expert considers that, in its opinion: "the APA Offer of $5.60 per share (inclusive of the special dividend) is fair and reasonable."

The Qantas Board recommends that you read the Independent Expert's Report in full.

1. For Qantas shareholders who receive the Special Dividend of $0.15 on their shares, and for those shareholders who acquire their shares on or after the Ex-Dividend Date, the amount to be received from Airline Partners Australia under the Offer will be reduced by the amount of the Special Dividend. See section 3.4 for details.
2. See footnote 1 above.

4. THE INDEPENDENT EXPERT HAS STATED THAT ANY PRICE ABOVE $5.18 WOULD REPRESENT FAIR VALUE

Your Independent Directors consider that the Independent Expert's valuation range is a useful guide to the value of Qantas shares in the context of Airline Partners Australia's Offer.

The Independent Expert's estimated valuation range for a change of control transaction in relation to Qantas in the current market is $5.18 to $5.98 per share. Further, the Independent Expert has stated that: "Any price above $5.18 would be fair value".

It is important to note that the Independent Expert has stated that: "precision in the valuation of Qantas shares is unrealistic given the inherent volatility of the business, the sensitivity of earnings and cash flows to small changes in key variables (such as load factor, yield or fuel price) and the difficulties of long range and even short term forecasting. Nevertheless, Grant Samuel believes that the APA Offer of $5.60 per share (inclusive of the special dividend) represents fair value for a change of control transaction in the current market".

The Independent Expert goes on to state that: "Qantas' strategic plans and the available growth opportunities could, if realised, ultimately support a value of $5.60 or more but there are significant execution and other risks. It is Grant Samuel's judgement that the balance of potential return and risk suggests that shareholders are likely to be better off accepting $5.60 now rather than waiting for such a price to be achieved over time through other means. In effect, shareholders will capture a reasonable share of the upside potential by accepting the APA Offer."

The Independent Expert's range lies towards the top end of its base case discounted cash flow valuation range. The Independent Expert has stated that: "discounted cash flow analysis (which explicitly captures the capital expenditure requirements of the business) demonstrates that a net present value of $5.60 requires scenarios that reflect a reasonably optimistic set of assumptions."

5. THE OFFER IS THE RESULT OF EXTENSIVE NEGOTIATIONS WITH AIRLINE PARTNERS AUSTRALIA

The Independent Directors have reviewed all available alternatives to maximise value to Qantas shareholders. The proposal from Airline Partners Australia is the result of extensive negotiations and the Independent Directors consider it is the best available alternative to enable Qantas shareholders to realise significant value for their shares.

6. IF AIRLINE PARTNERS AUSTRALIA'S OFFER DOES NOT PROCEED, IT IS LIKELY THAT QANTAS' SHARE PRICE WILL FALL

The share price as at 6 November 2006 (the day before the first media speculation about the Offer) was $4.20. The share price as at 9 February 2007 (being the last closing price prior to the date of this Target's Statement) was $5.37, which is a 4% discount to Airline Partners Australia's Offer price of $5.60 cash per Qantas share.[3] The latest price for Qantas shares is available from the ASX website at www.asx.com.au.[4]

Given the takeover premium represented in Airline Partners Australia's Offer, it is likely that Qantas' share price will fall below current levels if Airline Partners Australia's Offer does not proceed and no superior proposal emerges.

The Independent Expert has stated that: "The share price is likely to fall back towards the pre bid price of around $4.20 if the APA Offer is not successful. It may trade higher than $4.20 given the earnings upgrade and the reductions in fuel price but, in the absence of regulatory change, there is no reason to expect a significant re-rating in the short term." As at the date of this Target's Statement, your Board is not aware of any other bona fide proposal from a third party to acquire control of Qantas.

The Independent Expert has noted that: "The fundamental question for shareholders is whether there is a reasonable prospect of obtaining a price higher than $5.60 within the foreseeable future, either in the sharemarket or through an alternative acquirer. APA has declared its offer to be final. In the absence of regulatory change, there is little prospect of an alternative offer. The question therefore turns on where the shares might be expected to trade if the APA Offer is not successful."

The Independent Expert comments that: "there is a possibility that the shares could trade at levels approaching the offer price of $5.60 at some future date but it may take some time and would require a confluence of favourable outcomes…"

3. See footnote 1 above.

4. Note that prices obtained from www.asx.com.au during trading hours are delayed by at least 20 minutes.

2. FREQUENTLY ASKED QUESTIONS

This section answers some commonly asked questions about Airline Partners Australia's Offer. This section should be read together with all the other parts of this Target's Statement.

1. WHO CURRENTLY OWNS QANTAS?

Qantas listed on the ASX in 1995 following the sale by the Australian Government of its majority stake in the company. The shares in Qantas are currently owned by a range of domestic and foreign shareholders.

2. WHO IS AIRLINE PARTNERS AUSTRALIA?

Airline Partners Australia is an Australian company. The main investors in Airline Partners Australia are Allco Finance Group Limited, Allco Equity Partners Limited, TPG, Onex Partners and Macquarie Bank Limited. Airline Partners Australia has stated that Qantas will remain majority Australian-owned and controlled, as required by the Qantas Sale Act.

For further details about Airline Partners Australia, see section 2 of the Bidder's Statement.

3. WHAT IS AIRLINE PARTNERS AUSTRALIA'S OFFER FOR MY QANTAS SHARES?

Airline Partners Australia is offering $5.60 cash for each Qantas share held by you.[5]

Airline Partners Australia has declared its Offer price to be final (ie. it will not be increased), in the absence of an alternative proposal being announced.

4. WHAT IS THE SPECIAL DIVIDEND?

Airline Partners Australia's Offer of $5.60 cash for each Qantas share was made on the basis that:

- no dividends could be paid after the Announcement Date (14 December 2006) without Airline Partners Australia's consent; *but*
- if Airline Partners Australia consented to payment of a dividend, the amount payable by Airline Partners Australia would be reduced by the amount of the dividend, so that Qantas shareholders would still receive $5.60 cash per share.

On 8 February 2007, Qantas announced a fully franked special dividend of $0.15 for each Qantas share (the ***Special Dividend***), with Airline Partners Australia's consent. Therefore, if the Offer is successful, Qantas shareholders will receive a total of $5.60 per share, comprising:

- the fully franked Special Dividend of $0.15 per share; and
- the balance of the $5.60 Offer price, ie. $5.45, by way of a cash payment from Airline Partners Australia.

Qantas shareholders should note that Qantas' Dividend Reinvestment Plan has been suspended.

For further details on the Special Dividend, see section 3.4 and for further details on the tax consequences, see section 10.

5. WILL I RECEIVE THE SPECIAL DIVIDEND?

The Special Dividend will be paid to all Qantas shareholders who are recorded on the Register as at 5.00pm (Sydney time) on 19 February 2007. Payment will be made on the earlier of:

- 19 March 2007; and
- 10 business days after the Offer goes unconditional.

If you are the registered holder of Qantas shares as at 5.00pm (Sydney time) on 19 February 2007, you will receive the Special Dividend whether or not you accept the Offer.

For further details on the Special Dividend, see section 3.4 and for further details on the tax consequences, see section 10.

6. IS AIRLINE PARTNERS AUSTRALIA'S OFFER SUBJECT TO CONDITIONS?

Airline Partners Australia's Offer is subject to conditions which, in summary, are:

- 90% minimum acceptance;
- no court order or final decision of a public authority which restrains or prohibits the Offer;
- no material adverse change to Qantas;
- no termination of the Implementation Deed; and
- no prescribed occurrences.

For further details, see section 8.2 of this Target's Statement and Appendix 2 of the Bidder's Statement.

5. For Qantas shareholders who receive the Special Dividend of $0.15 on their shares, and for those shareholders who acquire their shares on or after the Ex-Dividend Date, the amount to be received from Airline Partners Australia under the Offer will be reduced by the amount of the Special Dividend. See section 3.4 for details.

7. WHAT ARE THE INDEPENDENT DIRECTORS OF QANTAS RECOMMENDING?

The Independent Directors of Qantas unanimously recommend that you accept Airline Partners Australia's Offer, in the absence of a superior proposal. The reasons for this recommendation are set out in section 1.

Furthermore, each Independent Director of Qantas intends to accept Airline Partners Australia's Offer for their Qantas shares, in the absence of a superior proposal.

Qantas' Executive Directors, Mr Geoff Dixon (Chief Executive Officer) and Mr Peter Gregg (Chief Financial Officer and Executive General Manager Strategy) did not participate in the Board's consideration of the terms of the Offer, given that they may be offered opportunities after the Offer Period to invest in a privately held Qantas if the Offer is successful. However, both Executive Directors support the decision of the Independent Directors to unanimously recommend that you accept the Offer, in the absence of a superior proposal.

8. WHAT CHOICES DO I HAVE AS A QANTAS SHAREHOLDER?

As a Qantas shareholder, you have the following choices in respect of your shares:

- to accept the Offer;
- to do nothing; or
- to sell your shares on the ASX (unless you have already accepted the Offer for your Qantas shares), in which case you will not receive the Special Dividend if you sell before 13 February 2007 (being the ex-dividend date of the Special Dividend).

For further details, see section 6.

9. HOW DO I ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER?

See section 9 of this Target's Statement and Appendix 1 of the Bidder's Statement.

10. HOW DO I REJECT THE OFFER?

If you do not wish to accept the Offer, you do not need to do anything in respect of the documents sent to you by Airline Partners Australia.

11. WHAT ARE THE CONSEQUENCES OF ACCEPTING AIRLINE PARTNERS AUSTRALIA'S OFFER NOW?

If you accept Airline Partners Australia's Offer, you will lose the ability to sell your Qantas shares to anyone else including:

- by selling them on the ASX; or
- by accepting any superior proposal that might emerge.

Shareholders should note that as at the date of this Target's Statement your Directors are not aware of any other bona fide proposal to acquire control of Qantas.

12. IF I ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER, CAN I WITHDRAW MY ACCEPTANCE?

You may only withdraw your acceptance if Airline Partners Australia varies the Offer in a way that postpones the time when Airline Partners Australia is required to satisfy its obligations under the Offer by more than 1 month (eg. if Airline Partners Australia extends the Offer Period for more than 1 month while the Offer remains conditional).

13. WHAT ARE THE CONSEQUENCES IF I DO NOT ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER?

If you do not accept Airline Partners Australia's Offer, you are free to deal with your Qantas shares as you wish. However, the share price may fall if the Offer lapses (see Question 16) and/or your shares could be compulsorily acquired (see Question 19). See also section 6.3.

14. WHEN DOES AIRLINE PARTNERS AUSTRALIA'S OFFER CLOSE?

The Offer is presently scheduled to close at 7.00 pm (Sydney time) on 9 March 2007, but the Offer Period can be extended in certain circumstances. For further details, see section 8.7.

15. HOW WILL I KNOW IF THE OFFER BECOMES UNCONDITIONAL?

Airline Partners Australia is required to notify Qantas and the ASX if the conditions to the Offer become satisfied or waived. Such notices from Airline Partners Australia will be available on the ASX website at www.asx.com.au, and you may also receive further correspondence from Airline Partners Australia advising you that the Offer has become unconditional.

2. FREQUENTLY ASKED QUESTIONS

16. WHAT HAPPENS IF THE CONDITIONS OF AIRLINE PARTNERS AUSTRALIA'S OFFER ARE NOT SATISFIED OR WAIVED?

If the conditions are not satisfied or waived before Airline Partners Australia's Offer closes (eg. the 90% minimum acceptance condition is not achieved as a result of insufficient acceptances), the Offer will lapse. You would then be free to deal with your Qantas shares even if you had accepted the Offer.

In that circumstance, Qantas will continue to operate as a stand-alone ASX listed entity focused on its current strategies. The rights of Qantas shareholders will remain unchanged, although the Independent Expert states that: "The share price is likely to fall back towards the pre bid price of around $4.20 if the APA Offer is not successful. It may trade higher than $4.20 given the earnings upgrade and the reductions in fuel price but, in the absence of regulatory change, there is no reason to expect a significant re-rating in the short term."

However, the Special Dividend will be paid by Qantas to shareholders irrespective of the outcome of Airline Partners Australia's Offer.

17. WHEN WILL I RECEIVE PAYMENT IF I ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER?

If you accept the Offer, Airline Partners Australia will pay you the consideration which you are entitled to receive from it on or before the earlier of:

- 1 month after the later of the Offer being validly accepted by you and the Offer (or the contract resulting from acceptance of the Offer) becoming unconditional; and
- 21 days after the end of the Offer Period.

For further details, see Appendix 1 of the Bidder's Statement.

18. WHAT ARE THE TAX CONSEQUENCES OF ACCEPTING AIRLINE PARTNERS AUSTRALIA'S OFFER?

The tax consequences of accepting Airline Partners Australia's Offer depend on a number of factors and will vary depending on your particular circumstances. A general outline of the Australian tax consequences of accepting the Offer is set out in section 10.

19. WILL I BE FORCED TO SELL MY QANTAS SHARES?

You cannot be forced to sell your Qantas shares unless Airline Partners Australia acquires a relevant interest in at least 90% of all the Qantas shares and is able to proceed with compulsory acquisition of the remaining Qantas shares in accordance with the Corporations Act. For further details, see section 7.7 of the Bidder's Statement.

20. WHAT WILL HAPPEN TO QANTAS IF AIRLINE PARTNERS AUSTRALIA'S OFFER IS SUCCESSFUL?

If the Offer is successful, the Independent Directors will retire from the Board when the Offer becomes or is declared unconditional, and at that time Airline Partners Australia intends to appoint new Directors as set out in the Bidder's Statement.

Details of Airline Partners Australia's intentions for Qantas are set out in section 4 of the Bidder's Statement.

Airline Partners Australia has stated in its Bidder's Statement that, if Airline Partners Australia is successful in acquiring at least 90% of the Qantas shares:

- Airline Partners Australia will seek to compulsorily acquire the remaining Qantas shares;
- Airline Partners Australia will invite Geoff Dixon to join the board of Airline Partners Australia and he will be asked to continue as a Director of Qantas; and
- Airline Partners Australia will arrange for Qantas to be removed from the ASX and the ASX Listing Rules will no longer apply to Qantas, though Qantas will remain subject to government regulation, including the Qantas Sale Act.

21. IS THERE A NUMBER I CAN CALL IF I HAVE FURTHER QUESTIONS IN RELATION TO AIRLINE PARTNERS AUSTRALIA'S OFFER?

Yes. If you have further questions in relation to Airline Partners Australia's Offer you can call the Qantas Shareholder Information Line on 1300 658 942 (if in Australia) or +61 3 9415 4285 (if outside Australia) Monday to Friday between 9.00am and 5.00pm (Sydney time).

As required by the Corporations Act, calls to the Qantas Shareholder Information Line will be recorded, indexed and stored.

3. PROFILE OF QANTAS

3.1 OVERVIEW

Qantas is the world's second oldest airline, having been founded in 1920 as Queensland and Northern Territory Aerial Services Limited. Qantas has grown to become Australia's largest domestic and international airline with approximately 37,000 staff and a network that spans 143 destinations around the world (including codeshare services). It is widely regarded as one of the world's leading long-distance airlines and is considered one of the most trusted brands in Australia.

Qantas is a founding member of the **one**world alliance which comprises some of the world's leading airlines, including American Airlines, British Airways and Cathay Pacific.

Qantas listed on the ASX in 1995 following the sale by the Australian Government of its majority stake in the company. The shares in Qantas are currently owned by a range of domestic and foreign shareholders.

3.2 CURRENT BUSINESS ACTIVITIES

Qantas has two major flying businesses and a diverse range of airline-related businesses.

(a) Flying businesses

The flying businesses are split into two major brands: Qantas, the full service brand, and Jetstar, the value-based brand.

Qantas

Qantas' domestic operations conduct an average of 330 domestic flights per day and serve 18 destinations throughout Australia. Qantas Domestic operates two class aircraft on all routes and focuses largely on routes with a strong business travel component.

In addition to the core domestic airline, the QantasLink brand operates an extensive regional network of 49 destinations within Australia through three wholly-owned subsidiaries of Qantas: Airlink Pty Limited, Eastern Australia Airlines Pty Limited and Sunstate Airlines (Qld) Pty Limited. Services in New Zealand are operated under the Qantas brand through the wholly-owned subsidiary Jetconnect Limited.

The total domestic market share of Qantas Domestic, QantasLink and Jetstar (see below) is approximately 67%.

Qantas' international operations account for approximately 27% of all flights departing from Australia each week. Its principal routes are to the United Kingdom and Europe, North America, Asia, New Zealand and South Africa.

Qantas is a member of the **one**world alliance and, as a result, links into 135 countries with over 600 destinations via alliances with its **one**world partners.

Jetstar

Jetstar was formed to provide lower cost services predominantly to leisure travellers. It currently operates to 21 destinations in Australia and New Zealand and recently commenced services to Indonesia, Thailand, Vietnam and Hawaii.

Jetstar Asia

Qantas owns 45.04% of Orangestar Investment Holdings Pte Limited, a Singaporean company which operates two value-based carriers, Jetstar Asia and Valuair. Together, Jetstar Asia and Valuair service 12 destinations in nine countries in Asia.

(b) Airline-related businesses

Below is a description of Qantas' key airline-related businesses.

Qantas Engineering

Qantas Engineering is one of the largest aircraft engineering and maintenance businesses in the Asia Pacific region. Qantas Engineering operates from five major maintenance facilities plus line stations in Australia and several locations overseas. Qantas Engineering provides its services principally to Qantas but also to other airlines.

Within Qantas Engineering, Qantas Defence Services provides aviation maintenance services to the Australian Defence Force.

Qantas Freight

Qantas Freight offers a range of services in three main areas: linehaul (bellyspace), freighter and terminal operations. Qantas Freight also operates international freight ground handling facilities in Sydney, Melbourne, Brisbane, Perth and Los Angeles.

Domestic freight is marketed by Australian air Express Pty Limited and Star Track Express Holdings Pty Limited, two 50%-owned joint venture companies with Australia Post. Australian air Express offers express air services throughout Australia and Star Track Express offers express road services throughout Australia.

Qantas Airports

Qantas Airports provides services ranging from customer service and baggage check-in to ramp services for Qantas, QantasLink and other client airlines. Wholly-owned subsidiary

3. PROFILE OF QANTAS

Express Ground Handling Pty Limited provides ramp and baggage handling services to Jetstar.

Qantas Flight Catering

Qantas Flight Catering Holdings Limited is a wholly-owned subsidiary of Qantas which operates two catering businesses: Qantas Flight Catering and Caterair Airport Services. Together, the businesses operate seven catering centres in six Australian ports. In addition, Qantas owns Snap Fresh Pty Limited, a frozen food manufacturing facility.

Qantas Holidays

Qantas Holidays is a major wholesaler in Australia of international and domestic holidays for independent travellers and small groups. Qantas Holidays also has a 75% interest in Singapore-based Holiday Tours and Travel Pte Limited, which sells wholesale land packages from Asia to Australia and provides tours, travel and transfer services throughout Asia.

Qantas Holidays also operates ReadyRooms 365, an internet booking service for hotel accommodation in Australia and New Zealand.

3.3 FINANCIAL INFORMATION

On 8 February 2007, Qantas released its results for the 6 months ended 31 December 2006. A copy of those results are annexed to this Target's Statement (see Annexure B). The results are summarised below.

The summarised financial information presented below should be read in conjunction with the Qantas results for the 6 months ended 31 December 2006 included in Annexure B.

Except as disclosed in this Target's Statement, in the half-yearly results to 31 December 2006 or in any other announcement to the ASX in accordance with Qantas' continuous disclosure obligations, the financial position of Qantas has not, within the knowledge of the Qantas Directors, materially changed since 31 December 2006. The Qantas Directors note, however, that the financial position of Qantas is from time to time affected by a range of external factors such as changes in fuel prices.

3.4 SPECIAL DIVIDEND

Airline Partners Australia has stated in its Bidder's Statement that, under the Offer terms, the amount of consideration that you receive directly from Airline Partners Australia will be reduced by the amount or value of any 'rights' attaching to Qantas shares, on or after 14 December 2006 (being the Offer announcement date), which Airline Partners Australia does not receive, including any dividend (special, interim or otherwise) declared by Qantas.

In other words, Airline Partners Australia's Offer of $5.60 cash for each Qantas share was made on the basis that:

- no dividends could be paid after the Announcement Date (14 December 2006) without Airline Partners Australia's consent; *but*

	Half-year ended 31 Dec 2006 $m	Half-year ended 31 Dec 2005 $m	Variance to comparative half-year $m	Variance to comparative half-year %
Sales and other income	7,727	6,857	870	12.7
Total expenditure	7,180	6,346	833	13.1
Profit before related income tax and net finance costs	547	511	37	7.2
Net finance costs	(24)	(27)	3	(11.1)
Profit before related income tax	523	484	40	8.3
Income tax expense	(165)	(131)	(34)	26.0
Net profit	**359**	**353**	**6**	**1.7**

- if Airline Partners Australia consented to payment of a dividend, the amount payable by Airline Partners Australia would be reduced by the amount of the dividend, so that you would still receive $5.60 cash per share.

On 8 February 2007, Qantas announced a fully franked special dividend of $0.15 for each Qantas share (the ***Special Dividend***), with Airline Partners Australia's consent. Therefore, if the Offer is successful, each Qantas shareholder will receive a total of $5.60 per share, comprising:

- the fully franked Special Dividend of $0.15 per share (assuming the shareholder is registered on the Record Date – see below); and
- the balance of the $5.60 Offer price, ie. $5.45, by way of a cash payment from Airline Partners Australia (assuming the Offer becomes or is declared unconditional).

The Special Dividend will be paid to all Qantas shareholders who are recorded on the Register as at 5.00pm (Sydney time) on 19 February 2007 (the ***Record Date***). Payment will be made on the earlier of:

- 19 March 2007; and
- 10 business days after the Offer becomes or is declared unconditional.

If you are the registered holder of Qantas shares on the Record Date, you will receive the Special Dividend whether or not you accept the Offer. The Special Dividend will be paid irrespective of the outcome of the Offer.

As foreshadowed by Qantas' announcement on 14 December 2006, the Special Dividend is to be paid in substitution for any interim dividend that may otherwise have been paid in April 2007. It will fully utilise all of Qantas' available franking credits.

Timetable

As described previously, the timetable for the Special Dividend is as follows.

Date	Event
8 February 2007	Announcement of Special Dividend
13 February 2007	Ex-Dividend Date for Special Dividend. To be entitled to the Special Dividend, a person must have purchased Qantas shares prior to the Ex-Dividend Date.
5.00pm (Sydney time) on 19 February 2007	Record Date to determine shareholders who are entitled to be paid the Special Dividend
The earlier of • 19 March 2007; and • 10 business days after the Offer becomes or is declared unconditional.	Payment date

Suspension of Dividend Reinvestment Plan

At the same time as announcing the Special Dividend, Qantas announced the Qantas Board's decision to suspend the company's Dividend Reinvestment Plan (***DRP***). The suspension has been effected pursuant to Rule 12(a) of the DRP, which entitles the Qantas Directors to terminate or suspend the DRP at any time on giving notice to DRP participants of the termination or suspension. For the purposes of Rule 12(a), the Qantas Directors hereby give formal notice to all DRP participants that the DRP is suspended. The effect of the suspension is that the Special Dividend cannot be applied to acquire further Qantas shares under the DRP.

Shares purchased on or after the Ex-Dividend Date

If you have purchased Qantas shares on or after the Ex-Dividend Date of 13 February 2007, you will not receive the Special Dividend on those shares. This is because the Special Dividend will have been paid to the previous holder of your shares who was registered as the shareholder on the Record Date. If you accept the Offer for those Qantas shares, and the Offer becomes or is declared unconditional, you will receive $5.45 by way of a cash payment from Airline Partners Australia.

3. PROFILE OF QANTAS

Shares issued to you after the Record Date

If, as a result of the conversion of a Right or Entitlement under Qantas' employee incentive plans (see section 11.1), you are issued shares after the Record Date, you will not receive the Special Dividend on those shares. If you accept the Offer for those Qantas shares, and the Offer becomes or is declared unconditional, you will receive $5.60 by way of a cash payment from Airline Partners Australia.

Tax consequences

A general outline of the Australian tax consequences of receiving the Special Dividend is set out in section 10.

3.5 QANTAS SALE ACT

Qantas' Constitution contains the following provisions required by the Qantas Sale Act to ensure the independence of the Qantas Board and to protect the airline's position as Australia's national flag carrier:

- the head office must be located in Australia;
- two-thirds of the Qantas Directors must be Australian citizens;
- the Chairman must be an Australian citizen;
- maximum 49% aggregate foreign ownership;
- maximum 35% aggregate foreign airline ownership; and
- maximum 25% ownership by one foreign person.

These provisions will continue to apply to Qantas if the Offer is successful and Qantas becomes a wholly-owned subsidiary of Airline Partners Australia. These provisions cannot be removed or amended without corresponding amendments to the Qantas Sale Act. The Australian Government has publicly stated that the restrictions on foreign ownership of Qantas will remain in place.

3.6 ISSUED CAPITAL

As at the date of this Target's Statement, Qantas' issued capital consisted of 1,984,027,311 Qantas ordinary shares (this includes 9,624,536 Deferred Shares allocated under the DSP – see section 11.1).

3.7 SUBSTANTIAL HOLDERS

As at 9 February 2007, Qantas had 3 substantial shareholders (based on substantial holding notices filed with the ASX), in addition to Airline Partners Australia (see section 4.3).

Shareholder	Number of shares	% voting power
UBS Nominees Pty Ltd[6]	177,429,406	8.94%
The Capital Group of Companies Inc[7]	134,974,699	6.80%
Barclays Group[8]	102,796,232	5.20%

6. Substantial shareholder notice dated 5 October 2006.
7. Substantial shareholder notice dated 25 January 2007.
8. Substantial shareholder notice dated 29 December 2006.

4. IMPORTANT MATTERS FOR QANTAS SHAREHOLDERS TO CONSIDER

4.1 MANAGEMENT OF POTENTIAL CONFLICT ISSUES

On 14 December 2006, Airline Partners Australia announced its Offer to acquire 100% of the Qantas shares for $5.60 cash per share.[9] The Offer was announced following negotiations between the Independent Directors and Airline Partners Australia after the Independent Directors rejected Airline Partners Australia's initial proposal. These negotiations resulted in the removal of a number of unacceptable conditions and a substantial break fee, as well as an increase in the offer price from $5.50 to $5.60 cash per share.

Earlier, on 1 November 2006, Macquarie Bank Limited and Texas Pacific Group (on behalf of a consortium of investors) had submitted to Qantas a confidential, indicative and incomplete proposal to acquire all of the Qantas shares (the ***Indicative Proposal***). The Indicative Proposal was expressed to be conditional upon satisfactory due diligence (among other things) and also indicated that certain key executives, including Qantas' Executive Directors, would be able to participate in the continued management of Qantas following a change of control.

The Qantas Board undertook a preliminary investigation of the Indicative Proposal and concluded that it was bona fide with the potential to enable Qantas shareholders to realise significant value for their shares if an offer were to be put on appropriate terms. On that basis, the Board granted due diligence and management access to the consortium investors after obtaining confidentiality undertakings and setting up protocols to manage any potential conflicts of interest. In giving such authorisation, the Board recognised that Qantas' senior management were in a position of potential conflict in any formal proposal from the consortium investors. The Board managed this potential conflict in 3 ways.

First, Qantas' Executive Directors, Mr Geoff Dixon and Mr Peter Gregg, did not participate in the Board's consideration of the terms of the Indicative Proposal or the Offer. The decision to recommend the Offer to Qantas shareholders (in the absence of a superior proposal and subject to the receipt of an independent expert's report concluding that the Offer is fair and reasonable) was one made solely by the Independent Directors.

Second, strict protocols were established to govern the interaction between Qantas' executives and the consortium investors and in the conduct of due diligence. Broadly, these protocols provided that any discussions between Qantas' key executives and consortium investors needed to be agreed in advance by Qantas' external advisers, always include a representative from Qantas' legal adviser and, depending on which Qantas executive was involved, always have present the Chairman or another Independent Director or, for more routine matters, a representative from Qantas' financial advisers.

Third, the Independent Directors appointed external financial and legal advisers.

If the Offer is successful, the Independent Directors will retire from the Board when the Offer becomes or is declared unconditional, and at that time Airline Partners Australia intends to appoint new Directors as set out in the Bidder's Statement.

4.2 INDEPENDENT EXPERT'S REPORT

This Target's Statement includes, in Annexure A, a copy of a report by Grant Samuel & Associates (an independent expert not associated with either Qantas or Airline Partners Australia) stating whether, in its opinion, Airline Partners Australia's Offer is fair and reasonable and giving reasons for forming that opinion.

The Independent Expert has concluded that Airline Partners Australia's Offer is fair and reasonable.

The Qantas Board recommends that you read the Independent Expert's Report in full.

4.3 MINORITY OWNERSHIP CONSEQUENCES

As at 9 February 2007, Airline Partners Australia has (based on a substantial holding notice filed with the ASX):

- a relevant interest in 5,391,376 Qantas shares; and
- 0.27% voting power in Qantas.

The Offer is presently subject to a 90% minimum acceptance condition. This condition, like all other conditions to the Offer, may be waived by Airline Partners Australia.

In section 4 of the Bidder's Statement, Airline Partners Australia sets out its intentions in the event that it does not become entitled to at least 90% of the Qantas shares but proceeds with the Offer and acquires a majority shareholding in Qantas. If this were to occur, those Qantas shareholders

9. See footnote 1 above.

4. IMPORTANT MATTERS FOR QANTAS SHAREHOLDERS TO CONSIDER

who do not accept the Offer will become minority shareholders in Qantas. This has a number of possible implications including the following:

- Airline Partners Australia will be in a position to cast the majority of votes at a general meeting of Qantas. This will enable Airline Partners Australia to control the composition of the Qantas Board and senior management, determine Qantas' dividend policy and control the strategic direction of the businesses of the Qantas Group;
- Airline Partners Australia intends to replace some of the members of the Qantas Board with nominees of Airline Partners Australia so that the number of Airline Partners Australia's nominees will be approximately proportionate to Airline Partners Australia's holding of Qantas shares;
- the Qantas share price may fall immediately following the end of the Offer Period. Such an outcome is consistent with the proposition that (in the absence of the Offer or another takeover offer being outstanding), the price for a Qantas share on the ASX reflects the value of that share on a portfolio basis while the price payable under a takeover should be higher to reflect the value of the Qantas share on a 100% controlling interest basis;
- it is likely that the liquidity of Qantas shares would be significantly lower than at present, with the result that it will be more difficult to buy and sell Qantas shares on the ASX. Airline Partners Australia has stated that, subject to maintaining a sufficient spread of Qantas shareholders, it will retain the listing of Qantas on the ASX; however, if a sufficient spread of Qantas shareholders is not achieved, Airline Partners Australia may seek to terminate Qantas' listing on the ASX (or ASX may initiate a termination of that listing). If Qantas is de-listed, Qantas shares will not be able to be bought or sold on the ASX;
- if Airline Partners Australia acquires 75% or more of the Qantas shares, it will be able to pass special resolutions of Qantas. This will enable Airline Partners Australia to, among other things, change Qantas' Constitution (subject to the provisions of the Qantas Sale Act); and
- the change of control provisions in the contracts referred to in section 11.2 will or may be triggered. Depending on the action taken by the parties who have the benefit of those provisions, it is possible that this will have a material adverse effect on Qantas, and therefore on the value of your Qantas shares.

In section 4.7.5 of its Bidder's Statement, Airline Partners Australia has stated that, to the extent that Qantas is not a wholly-owned subsidiary of Airline Partners Australia, and there are Qantas minority shareholders, Airline Partners Australia intends that the Directors of Qantas appointed by it will act at all times in accordance with their fiduciary duties as required by law and that all legal requirements are complied with in pursuing any of the intentions outlined in section 4.7 of the Bidder's Statement.

4.4 QANTAS SHARE PRICE IF AIRLINE PARTNERS AUSTRALIA'S OFFER IS UNSUCCESSFUL

The Independent Expert considers that, in its opinion: "The share price is likely to fall back towards the pre bid price of around $4.20 if the APA Offer is not successful. It may trade higher than $4.20 given the earnings upgrade and the reductions in fuel price but, in the absence of regulatory change, there is no reason to expect a significant re-rating in the short term."

4.5 TAX CONSEQUENCES OF ACCEPTING AIRLINE PARTNERS AUSTRALIA'S OFFER

The tax consequences of accepting Airline Partners Australia's Offer depend on a number of factors and will vary depending on your particular circumstances. A general outline of the Australian tax consequences of accepting the Offer is set out in section 10. The outline provided is of a general nature only and you should seek your own specific professional advice as to the tax consequences applicable to your circumstances.

5. INDEPENDENT DIRECTORS' RECOMMENDATION AND DIRECTORS' INTERESTS

5.1 DIRECTORS OF QANTAS AND THEIR INTERESTS IN QANTAS SHARES

As at the date of this Target's Statement, the Directors of Qantas and their relevant interests in Qantas shares[10] are:

Name	Position	Relevant interests in Qantas shares
Ms Margaret Jackson, AC	Chairman, Independent Non-Executive Director	122,997
Mr Geoff Dixon	Chief Executive Officer	1,720,517 (of which 749,500 are Deferred Shares)
Mr Peter Gregg	Chief Financial Officer and Executive General Manager Strategy	1,105,529 (of which 620,500 are Deferred Shares)
Mr Paul Anderson	Independent Non-Executive Director	25,000
Mr Mike Codd, AC	Independent Non-Executive Director	13,408
General Peter Cosgrove, AC, MC	Independent Non-Executive Director	2,124
Mrs Patricia Cross	Independent Non-Executive Director	2,163
Mr Garry Hounsell	Independent Non-Executive Director	33,811
Mr James Packer	Independent Non-Executive Director	53,101
Dr John Schubert	Independent Non-Executive Director	34,753
Mr James Strong, AO	Independent Non-Executive Director	28,158

Each of the Independent Non-Executive Directors desires to make, and considers himself or herself justified in making, a recommendation to Qantas shareholders. The Independent Non-Executive Directors are referred to in this section and elsewhere in this Target's Statement as the ***Independent Directors***.

As part of Qantas' senior management team, Mr Geoff Dixon and Mr Peter Gregg may be offered opportunities via a Management Rollover Offer after the Offer Period to invest in a privately held Qantas should the Offer be successful. For this reason, Mr Geoff Dixon and Mr Peter Gregg do not consider it is appropriate for them to make, and they have not made, a recommendation to Qantas shareholders. However, both of them support Airline Partners Australia's Offer and agree with the decision of the Independent Directors to unanimously recommend that you accept the Offer, in the absence of a superior proposal.

5.2 INDEPENDENT DIRECTORS' RECOMMENDATION

After taking into account each of the matters in this Target's Statement (including the Independent Expert's Report) and in the Bidder's Statement, **each Independent Director recommends that you accept Airline Partners Australia's Offer, in the absence of a superior proposal**. The reasons for that recommendation are set out in section 1.

In considering whether to accept the Offer, the Independent Directors encourage you to:

- read this Target's Statement (including the Independent Expert's Report) and the Bidder's Statement;
- have regard to your individual risk profile, portfolio strategy, tax position and financial circumstances; and
- obtain financial advice from your broker or financial adviser upon the Offer and obtain tax advice on the effect of accepting the Offer.

10. As at the date of this Target's Statement, Mr Geoff Dixon also holds 750,000 Rights and 483,688 Entitlements, and Mr Peter Gregg holds 280,000 Rights and 78,100 Entitlements.

5. INDEPENDENT DIRECTORS' RECOMMENDATION AND DIRECTORS' INTERESTS

5.3 INDEPENDENT DIRECTORS' INTENTIONS IN RELATION TO PERSONAL SHAREHOLDINGS

Each Independent Director intends to accept Airline Partners Australia's Offer in respect of their Qantas shares, in the absence of a superior proposal.

5.4 EXECUTIVE DIRECTORS' INTENTIONS IN RELATION TO PERSONAL SHAREHOLDINGS

(a) Geoff Dixon

Under a Pre-Bid Agreement signed with Airline Partners Australia, Mr Geoff Dixon has agreed not to dispose of:

- 749,500 Deferred Shares;
- 750,000 shares which will be allocated to him if his Rights are converted in the circumstances described in section 11.1(b); and
- 100,232 shares otherwise currently held by him or on his behalf,

during the Offer Period or for 2 weeks thereafter. The disposal restriction does not apply if Airline Partners Australia makes a Management Rollover Offer after the Offer Period and Mr Dixon accepts that offer.

Mr Dixon intends to accept Airline Partners Australia's Offer, in the absence of a superior proposal, in respect of:

- 870,785 shares currently held by him or on his behalf; and
- all Qantas shares which will be allocated to him if his Entitlements are converted in the circumstances described in section 11.1(c).

For further details, see section 7.3 of the Bidder's Statement.

(b) Mr Peter Gregg

Under a Pre-Bid Agreement signed with Airline Partners Australia, Mr Peter Gregg has agreed not to dispose of:

- 620,500 Deferred Shares;
- 280,000 shares which will be allocated to him if his Rights are converted in the circumstances described in section 11.1(b); and
- 485,029 shares otherwise currently held by him or on his behalf,

during the Offer Period or for 2 weeks thereafter. The disposal restriction does not apply if Airline Partners Australia makes a Management Rollover Offer after the Offer Period and Mr Gregg accepts that offer.

Mr Gregg intends to accept Airline Partners Australia's Offer, in the absence of a superior proposal, in respect of all Qantas shares which will be allocated to him if his Entitlements are converted in the circumstances described in section 11.1(c).

For further details, see section 7.3 of the Bidder's Statement.

5.5 DIRECTORS' DEALINGS IN QANTAS SHARES

No Director of Qantas has acquired or disposed of a relevant interest in any Qantas shares in the 4 month period ending on the date immediately before the date of this Target's Statement.

5.6 NO INTERESTS AND DEALINGS IN AIRLINE PARTNERS AUSTRALIA SECURITIES

No Director of Qantas:

- has a relevant interest in any securities issued by Airline Partners Australia; or
- acquired or disposed of a relevant interest in any securities issued by Airline Partners Australia in the 4 month period ending on the date immediately before the date of this Target's Statement.

5.7 BENEFITS AND AGREEMENTS

(a) Retirement benefits as a result of the Offer

As a result of Airline Partners Australia's Offer, no person has been or will be given any benefit in connection with the retirement of that person, or someone else, from a board or managerial office of Qantas or a subsidiary of Qantas.

(b) Agreements connected with or conditional on Airline Partners Australia's Offer

Except as described in section 5.4, there are no agreements or arrangements between any Director of Qantas and any other person in connection with, or conditional upon, the outcome of Airline Partners Australia's Offer.

(c) Interests of Directors in contracts with Airline Partners Australia

Except as described in section 5.4, none of the Directors of Qantas has any interest in any contract entered into by Airline Partners Australia.

5.8 INSURANCE AND INDEMNITIES

Each Director, each Secretary and certain senior officers of Qantas have signed Protection Deeds with Qantas under which each such person is protected to the fullest extent permitted by law against:

- any liability incurred by the person as an officer of Qantas or another relevant company; and
- any legal costs reasonably incurred in connection with a claim brought against the person as an officer of Qantas or another relevant company.

The standard form Protection Deed for Directors also permits the Director access to Board papers and documents, and imposes on Qantas certain obligations to procure insurance cover for the benefit of the Director in respect of liabilities incurred by the Director as a Director of Qantas or another relevant company.

In addition, under the Qantas Constitution, Qantas indemnifies, to the extent permitted by law, each Director, Secretary and Assistant Secretary against any liability incurred by that person as an officer of Qantas or another relevant company.

Qantas is the policyholder of directors' and officers' liability insurance policies. The current policy period runs from 31 October 2006 to 31 October 2007. In certain circumstances, including where Qantas becomes a subsidiary of another entity, cover under the policies applies only to claims arising from matters occurring prior to the effective time of change of control and which are notified to insurers prior to the expiration of the claims notification period applicable to the policies.

Under the terms of the Protection Deeds, Qantas is legally obliged to use its best endeavours to procure that each Director and Secretary is insured for a period of seven years from the date on which he or she ceases to be a Director or Secretary. Qantas must also use its best endeavours to ensure that the terms on which each Director and Secretary is insured are not materially less favourable to that person than those in force at the time the person ceased to be a Director or Secretary. Qantas will discharge this obligation by arranging 'run-off' insurance cover which will enable claims to be notified to insurers under the current policies during an extended claims notification period of 7 years after the end of the current policy period.

6. YOUR CHOICES AS A QANTAS SHAREHOLDER

As a Qantas shareholder you have three choices currently available to you.

6.1 ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER

You can accept Airline Partners Australia's Offer. **Each of the Independent Directors of Qantas recommends that you accept the Offer, in the absence of a superior proposal**.

If you accept the Offer, you will lose the ability to sell your Qantas shares to anyone else, including:

- by selling them on the ASX; or
- by accepting any superior proposal that might emerge.

Further, you will only have limited rights to withdraw your acceptance (see section 8.9).

In respect of each of your Qantas shares, the cash amount which you receive from Airline Partners Australia, and whether or not you receive the Special Dividend, will depend on whether you are registered as the holder of that share on the Record Date or whether the share was issued to you after the Record Date (see section 3.4).

If you accept the Offer and you are an Australian shareholder, you may be liable for capital gains tax on the disposal of your shares (see section 10). However, you will not incur a brokerage charge.

6.2 SELL YOUR QANTAS SHARES ON MARKET

During a takeover, shareholders in a target company can still sell their shares on the ASX for cash provided that they have not accepted the takeover offer.

On 9 February 2007, the Qantas share price closed at $5.37, which is lower than Airline Partners Australia's Offer price of $5.60 cash per share.[11] The latest price for Qantas shares may be obtained from the ASX website at www.asx.com.au.[12]

If you sell your shares on-market:

- you will lose the ability to accept Airline Partners Australia's Offer or any other proposal that may emerge;
- you may receive more or less for your Qantas shares than the Offer price of $5.60 cash per share[13];
- you will not receive the Special Dividend on those shares if the sale occurs before the Ex-Dividend Date; and
- you may incur a brokerage charge.

In respect of each of your Qantas shares, whether or not you receive the Special Dividend will depend on whether you are registered as the holder of that share on the Record Date or whether the share was issued to you after the Record Date (see section 3.4).

If you wish to sell your shares on the ASX, you should contact your Broker. If you are an Australian shareholder and sell your shares on the ASX for cash, you may be liable for capital gains tax on the disposal of your shares (as you as an Australian shareholder may be if you accept the Offer – see sections 6.1 and 10).

6.3 DO NOTHING

If you do not wish to accept Airline Partners Australia's Offer and do not wish to sell your Qantas shares on market, you should do nothing.

In respect of each of your Qantas shares, whether or not you receive the Special Dividend will depend on whether you are registered as the holder of that share on the Record Date or whether the share was issued to you after the Record Date (see section 3.4).

However, you should note that if Airline Partners Australia acquires:

- at least 90% of the Qantas shares, it will be entitled to compulsorily acquire the shares that it does not already own (see section 7.7 of the Bidder's Statement for further details); or
- more than 50% and less than 90% of the Qantas shares, and the other defeating conditions of the Offer are either satisfied or waived, shareholders who do not accept the Offer will become minority shareholders in Qantas which in those circumstances is controlled by Airline Partners Australia (see section 4.3 for further details).

You should also note that if Airline Partners Australia acquires less than 90% of the Qantas shares and the 90% minimum acceptance condition is not waived, then the Offer will lapse. The Independent Expert considers that, in its opinion: "The share price is likely to fall back towards the pre bid price of around $4.20 if the APA Offer is not successful. It may trade higher than $4.20 given the earnings upgrade and the reductions in fuel price but, in the absence of regulatory change, there is no reason to expect a significant re-rating in the short term."

11. See footnote 1 above.
12. Note that prices obtained from www.asx.com.au during trading hours are delayed by at least 20 minutes.
13. See footnote 1 above.

7. PROFILE OF AIRLINE PARTNERS AUSTRALIA

The information below concerning Airline Partners Australia has been prepared based on a review of publicly available information (including the Bidder's Statement) which has not been independently verified. Qantas does not make any representation or warranty, express or implied, as to the accuracy or completeness of such information. The information on Airline Partners Australia in this Target's Statement should not be considered comprehensive. Detailed information relating to Airline Partners Australia and its owners is set out in section 2 of the Bidder's Statement.

Airline Partners Australia is a company incorporated in Australia for the specific purpose of making the Offer. The company has not undertaken any business other than in connection with the Offer.

The investors which own Airline Partners Australia, through their holdings of special warrants in Airline Partners Australia or units in the APA Fund (defined below), held directly or through wholly-owned subsidiaries or special purpose vehicles, will include Allco Finance Group Limited, Allco Equity Partners Limited, TPG, Onex Partners and Macquarie Bank Limited (the ***Investor Group Members***) and the Take-Up Investors (see section 5.4.1 of the Bidder's Statement). The ***APA Fund*** is Airline Partners Australia Fund, a unit trust proposed to be established by the Investor Group Members.

The ownership structure of the APA Fund and Airline Partners Australia immediately preceding payment of consideration to Qantas shareholders who accept the Offer is set out in section 2 of the Bidder's Statement.

8. KEY FEATURES OF AIRLINE PARTNERS AUSTRALIA'S OFFER

8.1 OFFER PRICE

Airline Partners Australia is offering $5.60 cash for each Qantas share.[14] This will only be payable if all the conditions of the Offer are satisfied or waived. Airline Partners Australia has declared its Offer price of $5.60[15] to be final, in the absence of an alternative proposal being announced.

The Offer relates to Qantas shares that exist at 2 February 2007 and extends to any Qantas shares issued between 2 February 2007 and the end of the Offer Period as a result of any conversion of Rights or Entitlements.

You may only accept the Offer in respect of **all** your Qantas shares.

8.2 CONDITIONS OF AIRLINE PARTNERS AUSTRALIA'S OFFER

In broad summary, Airline Partners Australia's Offer is subject to the following conditions:

- (**90% minimum acceptance**) that during, or at the end of the Offer Period, Airline Partners Australia and its associates have a relevant interest in at least 90% of all Qantas shares;
- (**no injunction**) that before the end of the Offer Period, there is not in effect any court order or final decision of a public authority (other than ASIC or the Takeovers Panel) which restrains or prohibits the Offer or the acquisition of Qantas shares under the Offer;
- (**no material adverse change**) that during the Offer Period, no event (or series of related events) occurs which has or is likely to have the effect of reducing the consolidated net profits after tax of Qantas and its subsidiaries (as a group) by at least $100 million (after taking into account any matters which offset the impact of the events giving rise to the adverse effect). This condition will not be breached by any events resulting from:
  - changes in general economic or political conditions or the securities, credit or financial markets in general (excluding acts of terrorism against any airline or airport);
  - changes in generally accepted accounting principles or the interpretation of them;
  - a change in the price of jet fuel;
  - normal seasonal changes in Qantas' results of operations; or
  - any weather-related event or natural disaster;
- (**no termination of Implementation Deed**) that there is no breach of the Implementation Deed by Qantas which entitles Airline Partners Australia to terminate that deed and Airline Partners Australia has terminated that deed within 5 business days of becoming aware of that entitlement; and
- (**no prescribed occurrence**) that no 'prescribed occurrence' (eg. issue of new securities by a Qantas Group entity, or winding-up of a Qantas Group entity) occurs from the date the Bidder's Statement is given to Qantas until the end of the Offer Period, except with the prior written consent of Airline Partners Australia or as disclosed to Airline Partners Australia prior to the date of the Implementation Deed (ie. prior to 14 December 2006) or in connection with a solvent winding-up, reconstruction or amalgamation of a subsidiary of Qantas.

Those conditions are set out in full in Appendix 2 of the Bidder's Statement.

8.3 LIKELIHOOD OF CONDITIONS BEING SATISFIED

As at the date of this Target's Statement, Qantas is not aware of any act, omission, event or fact that would result in the breach or non-satisfaction of a condition of Airline Partners Australia's Offer. Qantas is not in a position to state whether the conditions of the Offer will be satisfied.

8.4 CONSEQUENCES OF CONDITIONS NOT BEING SATISFIED

Any conditions of Airline Partners Australia's Offer which are not satisfied (or triggered, as appropriate) may be waived by Airline Partners Australia.

If any condition is unsatisfied (or has been triggered) and has not been waived, Airline Partners Australia will have a choice either to proceed with the acquisition of Qantas shares under the Offer or to allow the Offer to lapse with unsatisfied conditions. In those circumstances, generally speaking, Airline Partners Australia would not have to decide whether to proceed with the acquisition of Qantas shares under the Offer until the last date it is required to give a notice of status of conditions as required by section 630(1) of the Corporations Act (see section 8.5).

14. See footnote 1 above.
15. See footnote 1 above.

8.5 NOTICE OF STATUS OF CONDITIONS

Appendix 1 of the Bidder's Statement indicates that, as required by section 630(1) of the Corporations Act, Airline Partners Australia will give a notice of status of conditions (the ***Conditions Notice***) to the ASX and Qantas on 1 March 2007.

Airline Partners Australia is required to set out in its Conditions Notice:

- whether the Offer is free of any or all of the conditions;
- whether, so far as Airline Partners Australia knows, the conditions have been fulfilled on the date the Conditions Notice is given; and
- Airline Partners Australia's voting power in Qantas (including voting power acquired as a result of acceptances received under the Offer).

If the Offer Period is extended by a period before the time by which the Conditions Notice is to be given, the date for giving the Conditions Notice will be taken to be postponed for the same period. In the event of such an extension, Airline Partners Australia is required, as soon as practicable after the extension, to give a notice to the ASX and Qantas that states the new date for the giving of the Conditions Notice.

If a condition is fulfilled (so that Airline Partners Australia's Offer becomes free of that condition) during the bid period but before the date on which the Conditions Notice is required to be given, Airline Partners Australia must, as soon as practicable, give the ASX and Qantas a notice that states that the particular condition has been fulfilled.

8.6 OFFER PERIOD

Unless Airline Partners Australia's Offer is extended or withdrawn, it is open for acceptance from 5 February 2007 until 7.00pm (Sydney time) on 9 March 2007.

The circumstances in which Airline Partners Australia may extend or withdraw its Offer are set out in section 8.7 and section 8.8 respectively.

8.7 EXTENSION OF THE OFFER PERIOD

Airline Partners Australia may extend the Offer Period at any time before giving the Conditions Notice (referred to in section 8.5) while the Offer is subject to conditions. However, if the Offer is unconditional (ie. all the conditions are fulfilled or freed), Airline Partners Australia may extend the Offer Period at any time before the end of the Offer Period.

In addition, there will be an automatic extension of the Offer Period if, within the last seven days of the Offer Period:

- Airline Partners Australia improves the consideration under the Offer; or
- Airline Partners Australia's voting power in Qantas increases to more than 50%.

If either of these two events occurs, the Offer Period will be automatically extended so that it ends 14 days after the relevant event occurs.

8.8 WITHDRAWAL OF AIRLINE PARTNERS AUSTRALIA'S OFFER

Airline Partners Australia may not withdraw the Offer if you have already accepted it. Before you accept the Offer, Airline Partners Australia may withdraw the Offer only with the written consent of ASIC and subject to the conditions (if any) specified in such consent.

8.9 YOUR ABILITY TO WITHDRAW YOUR ACCEPTANCE

You only have limited rights to withdraw your acceptance of Airline Partners Australia's Offer. You may only withdraw your acceptance of the Offer if Airline Partners Australia varies the Offer in a way that postpones for more than 1 month the time when Airline Partners Australia needs to meet its obligations under the Offer. This will occur if Airline Partners Australia extends the Offer Period by more than 1 month and the Offer is still subject to conditions.

8. KEY FEATURES OF AIRLINE PARTNERS AUSTRALIA'S OFFER

8.10 WHEN YOU WILL RECEIVE PAYMENT IF YOU ACCEPT THE OFFER

In its Bidder's Statement, Airline Partners Australia has stated that if you accept the Offer, Airline Partners Australia will pay you the consideration which you are entitled to receive from it on or before the earlier of:

- 1 month after the later of the Offer being validly accepted by you and the Offer (or the contract resulting from acceptance of the Offer) becoming unconditional; and
- 21 days after the end of the Offer Period.

8.11 LAPSE OF AIRLINE PARTNERS AUSTRALIA'S OFFER

Airline Partners Australia's Offer will lapse if the Offer conditions are not satisfied or waived by the end of the Offer Period, in which case all contracts resulting from acceptance of the Offer and all acceptances that have not resulted in binding contracts are void. In that situation, you will be free to deal with your Qantas shares as you see fit.

8.12 COMPULSORY ACQUISITION

Airline Partners Australia has indicated in section 7.7 of its Bidder's Statement that if it satisfies the required thresholds, it intends to compulsorily acquire any outstanding Qantas shares (which will include any outstanding Deferred Shares) and may also acquire outstanding Entitlements.

Broadly, Airline Partners Australia will be entitled to compulsorily acquire:

- all outstanding Qantas shares (which will include any outstanding Deferred Shares) if Airline Partners Australia and its associates have a relevant interest in at least 90% (by number) of the Qantas shares; and
- all outstanding Entitlements if Airline Partners Australia's voting power in Qantas is at least 90% and Airline Partners Australia (either in its own right or through related bodies corporate) holds full beneficial interests in at least 90% (by value) of the aggregate of all the securities of Qantas that are Qantas shares or convertible into Qantas shares.

For further details, see section 7.7 of the Bidder's Statement.

8.13 NOTIFICATION UNDER FOREIGN ACQUISITIONS AND TAKEOVERS ACT

On 7 February 2007, Airline Partners Australia lodged a Supplementary Bidder's Statement with ASIC and ASX, in accordance with section 647(3) of the Corporations Act. According to the Supplementary Bidder's Statement, on 5 February 2007 Airline Partners Australia lodged a voluntary notification under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (the ***FATA***).

Airline Partners Australia is of the view that the FATA does not apply because it is majority Australian-owned and controlled. However, it has chosen to lodge a voluntary notification under the FATA in order to most effectively give accountable undertakings to the Australian Government regarding its plans for Qantas. If not extended, the period for review under the FATA is 30 calendar days.

9. HOW TO ACCEPT AIRLINE PARTNERS AUSTRALIA'S OFFER

Before making a decision on whether to accept Airline Partners Australia's Offer you should read the whole of this Target's Statement, which contains your Independent Directors' unanimous recommendation to accept the Offer, in the absence of a superior proposal. You should also read the Independent Expert's Report (prepared by Grant Samuel & Associates and included as Annexure A to this Target's Statement) and the Bidder's Statement (prepared by Airline Partners Australia). If you are in any doubt as to whether to accept the Offer, you should seek independent professional advice.

If you decide to accept the Offer, your acceptance must be received before the end of the Offer Period (7.00pm (Sydney time) on 9 March 2007, unless the Offer Period is extended in accordance with the Corporations Act). Depending on the nature of your holding, you may accept the Offer in the following ways:

If your Qantas shares are in an Issuer Sponsored Holding *(ie. your Securityholder Reference Number commences with an "I" – please refer to your personalised Acceptance Form)*	Complete and sign the Acceptance Form (included with the Bidder's Statement) in accordance with the instructions on the form. Once completed and signed, lodge it by either: • returning it to an address set out in the Acceptance Form; or • faxing or emailing it to the fax number or email address set out on the Acceptance Form and sending the original to the postal address set out on the Acceptance Form.
If your Qantas shares are held in a CHESS Holding *(ie. your Holder Identification Number commences with an "X" – please refer to your personalised Acceptance Form)*	Do one of the following: • call your Broker and instruct your Broker to initiate acceptance of the Offer in accordance with Rule 14.14 of the ASTC Settlement Rules; • complete, sign and send the Acceptance Form directly to your Broker; or • complete and sign the Acceptance Form and lodge it by either: – returning it to an address set out on the Acceptance Form; or – faxing or emailing it to the fax number or email address set out on the Acceptance Form and sending the original to the postal address set out on the Acceptance Form, (which will authorise Airline Partners Australia to instruct your Broker to initiate acceptance of the Offer on your behalf).

Full details on how to accept the Offer are set out in Appendix 1 of the Bidder's Statement.

10. AUSTRALIAN TAX CONSEQUENCES

10.1 INTRODUCTION

The following is a general description of the Australian income tax and capital gains tax (***CGT***) consequences to Qantas shareholders on receipt of the Special Dividend and disposing of their shares (through acceptance of Airline Partners Australia's Offer) in return for cash consideration. The comments set out below in relation to Australian tax are relevant only to those shareholders who hold their Qantas shares as capital assets for the purpose of investment and who do not (or would not) hold those shares in connection with the conduct of a business.

Certain Australian resident shareholders (such as those engaged in a business of trading or investment, those who acquired their Qantas shares for the purpose of resale at a profit or those which are banks, insurance companies, tax exempt organisations, superannuation funds, or persons who acquired their Qantas shares in their employment) will or may be subject to special or different tax consequences peculiar to their circumstances.

Qantas shareholders who are not resident in Australia for tax purposes should also take into account the tax consequences under the laws of their country of residence, as well as under Australian law, of the receipt of the Special Dividend and disposal of Qantas shares under Airline Partners Australia's Offer.

The following description is based upon tax law and practice in effect as at the date of this Target's Statement. It is not intended to be an authoritative or complete statement or analysis of the tax laws applicable to the particular circumstances of every shareholder. Qantas shareholders should seek independent professional advice regarding the tax consequences of disposing of Qantas shares in the light of their own particular circumstances.

10.2 AUSTRALIAN RESIDENT QANTAS SHAREHOLDERS

Acceptance of Airline Partners Australia's Offer will involve the disposal by Qantas shareholders of their shares, by way of transfer to Airline Partners Australia.

The disposal of Qantas shares held on capital account will generally have CGT implications. Such disposal will constitute a CGT event for CGT purposes.

Australian resident shareholders may make a capital gain or capital loss on the disposal of their Qantas shares under Airline Partners Australia's Offer.

Capital gains and capital losses of a taxpayer in a year of income are aggregated to determine whether there is a net capital gain. If so, that net capital gain is included in assessable income and is subject to income tax. However, a 'CGT Discount' may be available to reduce the taxable gain for certain shareholders (see further below).

Capital losses may not be deducted against other income for income tax purposes, but may be offset against capital gains realised in the same income year or be carried forward to be offset against future capital gains.

In general, the capital gain or loss on disposal of a Qantas share under Airline Partners Australia's Offer will be calculated on the basis of the difference between the value of the capital proceeds (ie. the cash consideration received from Airline Partners Australia) and the cost base of the share.

The cost base of Qantas shares is generally their cost of acquisition or deemed cost of acquisition. Certain other amounts associated with acquisition and disposal, such as brokerage or stamp duty, may be added to the cost base. The capital loss will be calculated on the basis of the difference between the capital proceeds and the cost base of the share.

However, if the Qantas share was acquired (or deemed to be acquired) *at* or *before* 11.45 am on 21 September 1999, the cost base may be indexed for inflation, by reference to changes in the Consumer Price Index from the calendar quarter in which the Qantas share was acquired (or deemed to be acquired) until the calendar quarter ended 30 September 1999. Qantas shareholders who are individuals, complying superannuation entities or trustees of a trust must make an election if they wish to rely on indexation. Companies will be entitled to include the indexation without making an election. Indexation adjustments are taken into account only for the purposes of calculating a capital gain, and not a capital loss.

On the other hand, if the Qantas share was acquired (or deemed to be acquired) *after* 11.45 am on 21 September 1999, the capital gain or loss is generally calculated on the difference between the capital proceeds and the cost base for the share, with no indexation.

A Qantas shareholder who is an individual, complying superannuation entity or trustee of a trust, and who does not or cannot elect to adjust their cost base for indexation (as described above), may choose to claim a 'CGT Discount' if they acquired (or are deemed to have acquired) their shares 12 months or more before accepting Airline Partners Australia's Offer. This means that:

- in the case of an individual (and, generally speaking, a trustee of a trust), only one half of their net capital gain (after deducting available capital losses) will be taxable; and
- in the case of a complying superannuation entity, only two thirds of their net capital gain (after deducting available capital losses) will be taxable.

However, the methodology for trustees is complex, and such Qantas shareholders should obtain specific advice in this regard, including in relation to the tax consequences of distributions attributable to discounted capital gains.

Whether it is better for any given Qantas shareholder to make the indexation election or not will depend upon the particular shareholder's individual circumstances, including the cost base of the Qantas shares and whether the shareholder has any available losses. Shareholders should consult their own tax advisers in this regard.

The 'CGT Discount' is not available to companies, nor does it apply to Qantas shares owned (or deemed to be owned) for less than the relevant 12 month period.

10.3 NON AUSTRALIAN RESIDENT QANTAS SHAREHOLDERS

The Australian Government recently enacted legislation that changes the CGT rules that apply to non-residents by narrowing the current range of assets to which those rules apply. The CGT rules continue to apply to non-residents who hold an interest in shares in an Australian company only if that company has direct and/or indirect interests in Australian real property and Australian mining, quarrying or prospecting rights the total value of which is greater than 50% of the value of all of the company's assets (ie. the company is "land rich"), provided that the interest (together with those of associates) in such shares carries 10% or more of the rights to vote or participate in distributions, or did carry 10% or more of those rights, throughout a 12 month period within 2 years before the date of disposal.

On the basis that Qantas is not a "land rich" entity, any capital gain by a Qantas shareholder who is a non-resident holding on capital account will be disregarded unless that shareholder has, at any time, used those Qantas shares in carrying on business through a permanent establishment in Australia.

Any Qantas shareholder who holds their Qantas shares otherwise than on capital account should seek specific tax advice on their position, having regard to any applicable double taxation treaty between their country of residence and Australia.

10.4 PARTICIPANTS IN QANTAS' EMPLOYEE INCENTIVE PLANS

Any Qantas shareholder who acquired their Qantas shares directly or indirectly under a Qantas Group employee incentive plan should seek specific tax advice pertaining to their own circumstances since the applicable tax treatment may be different from that outlined above.

10. AUSTRALIAN TAX CONSEQUENCES

10.5 SPECIAL DIVIDEND

The consideration to be paid by Airline Partners Australia under the Offer for a Qantas share, and therefore to be taken into account in calculating any capital gain or loss on the subsequent disposal of that share, will be reduced by the Special Dividend amount of $0.15 if that share is in issue as at the Record Date.

Qantas shareholders who are Australian residents will include the Special Dividend in their assessable income. Whether a Qantas shareholder will be required to include the attached franking credits in their assessable income and entitled to claim the benefit of the attached franking credits will depend on various factors, including whether the 45 day holding period requirement (taking into account the related payments rule) has been satisfied such that the Qantas shareholder is a "qualified person" in relation to the Special Dividend for the purposes of the *Income Tax Assessment Act 1936* (Cth). Qantas shareholders should seek their own tax advice on the treatment of the Special Dividend and the attached franking credits.

Qantas shareholders who are non-residents will not be subject to Australian withholding tax on the Special Dividend.

10.6 STAMP DUTY AND GST

Airline Partners Australia will pay the stamp duty (if any) payable in Australia on the transfers of Qantas shares under the Offer. No GST will be payable in Australia on such transfers, except that GST will be payable on any fees or charges that a Controlling Participant (as defined in the ASTC Settlement Rules) (in respect of Qantas shares in a CHESS holding) or a broker, bank, custodian or other nominee (in respect of Qantas shares held for a separate beneficial owner) may charge in connection with acceptance of Airline Partners Australia's Offer.

11. OTHER MATERIAL INFORMATION

11.1 ARRANGEMENTS REGARDING QANTAS' EMPLOYEE INCENTIVE PLANS

Various Qantas Group employees have been allocated interests under Qantas' share-based employee incentive plans. These interests are as follows.

Employee incentive plan	Type of interest issued	No. on issue (as at the date of this Target's Statement)
Qantas Deferred Share Plan	Deferred Shares (see paragraph (a) below)	9,624,536
Qantas Deferred Share Plan	Rights (see paragraph (b) below)	5,021,800
Qantas Long Term Executive Incentive Plan[16]	Entitlements (see paragraph (c) below)	6,292,788

This section 11.1 provides an overview of the arrangements that have been made in relation to the Deferred Shares, Rights and Entitlements. Full details of these arrangements will be provided separately to holders of Deferred Shares, Rights and Entitlements.

(a) Deferred Shares

Deferred Shares are Qantas shares which have been allocated to certain Qantas Group employees (each a ***Participant***) under the Qantas Deferred Share Plan (the ***DSP***). The shares can either be issued or purchased on-market and are held on behalf of the Participant by the Plan Trustee for a specified holding lock period. During the holding lock period, the Participant is not permitted to deal in his or her Deferred Shares.

Currently, certain allocations of the Deferred Shares can, upon request by the relevant Participant, be released from the holding lock before the expiration of the holding lock period.

In respect of the Deferred Shares that cannot be currently released upon request, the Qantas Board has exercised its discretion to cause those shares to be released from the holding lock, provided the following conditions (the ***Relevant Conditions***) are satisfied:

- Airline Partners Australia acquires a relevant interest in at least 50% of the Qantas shares;
- all conditions of the Offer are satisfied or waived; and
- the relevant Participant has complied with certain management standards.

16. Qantas suspended this plan in July 2002.

(b) Rights

Rights have been awarded to certain Qantas Group employees under the DSP. Each Right represents a right to receive one Qantas share at a future point in time, subject to the achievement of specified performance hurdles.

Under the DSP, the Qantas Board has the power to cause all Rights (irrespective of whether the specified performance hurdles have been achieved) to be converted to Qantas shares if there is a takeover bid for Qantas which has resulted in one person becoming legally or beneficially entitled to 50% or more of the Qantas shares. The Qantas Board has exercised that power to cause the conversion of all Rights, whether or not they have vested, into Qantas shares if the Relevant Conditions (see paragraph (a)) are satisfied.

In respect of most of the Rights, the Board can choose whether to satisfy conversion via on-market purchase or the issue of Qantas shares. The Board has decided to satisfy the conversion of all of the Rights (in the event the Relevant Conditions are satisfied) by the issue of Qantas shares. In respect of certain Rights, it is arguable that the Board can only satisfy conversion via on-market purchase rather than by issue of Qantas shares. However, in order to clarify the position, Qantas has sought a waiver from the ASX of Listing Rule 10.14.

(c) Entitlements

Entitlements have been awarded to certain executives under the Qantas Long Term Executive Incentive Plan (the ***QLTEIP***). Each Entitlement represents an entitlement to receive a certain number of Qantas shares or a certain amount of cash (each calculated in accordance with a conversion formula in the QLTEIP Terms and Conditions, as set out below), subject to the expiration of a specified time frame and the achievement of specified performance hurdles.

Under the QLTEIP, the Qantas Board has the discretion to provide holders of Entitlements (irrespective of whether the specified time frame has elapsed or whether the specified performance hurdles have been achieved) a reasonable period within which to convert Entitlements if there is a takeover bid for Qantas which has resulted, or would result, in one person becoming legally or beneficially entitled to 50% or more of the Qantas shares (a ***Change of Control***). The Qantas Board has exercised that power to cause the conversion of all of the vested Entitlements (unless instructed otherwise by a holder

11. OTHER MATERIAL INFORMATION

in respect of that holder's vested Entitlements) if the Relevant Conditions (see paragraph (a) above) are satisfied.

On the conversion of vested Entitlements, Qantas must, at the election of the Qantas Board in its absolute discretion, either issue to the vested Entitlements holder the number of Qantas shares calculated in accordance with the conversion formula in the QLTEIP Terms and Conditions or provide the vested Entitlements holder an equivalent cash payment. The Qantas Board has decided that the vested Entitlements which will be converted upon the Relevant Conditions being satisfied will be converted into newly issued Qantas shares.

Under the conversion formula, each vested Entitlement confers an entitlement to the following number of Qantas shares:

$$\frac{\text{(Market Price on Conversion – Market Price on Award)}}{\text{Market Price on Conversion}}$$

Given this formula, it is not possible for a vested Entitlement to confer an entitlement to more than 1 Qantas share.

The Market Price on Conversion is determined using the Market Value of Qantas shares on the conversion date. Ordinarily, the Market Value is the average closing price of Qantas shares for the 10 business days up to (but not including) the conversion date. However, if there is a Change of Control, the Board in its discretion may determine the Market Value of the shares.

Having regard to the potential Change of Control as a result of Airline Partners Australia's Offer, the Board has determined that, if the Relevant Conditions are satisfied, the Market Value will be $5.60. A change of that nature requires approval of the ASX under Listing Rule 6.23.3, and Qantas has sought such approval.

Vested Entitlements holders have recently had the opportunity to convert vested Entitlements by tendering a notice of conversion to Qantas by 1 February 2007 (in accordance with the current conversion procedure). In light of Airline Partners Australia's Offer, the Qantas Board decided to grant these holders who submitted their Notice of Conversion for the 1 February 2007 conversion between 14 December 2006 and 1 February 2007, a right to revoke their Notice of Conversion by 14 February 2007 and instead have their Vested Entitlements converted, unless they elect not to convert, upon the Relevant Conditions being satisfied.

(d) Compulsory acquisition of Deferred Shares and Entitlements

Airline Partners Australia has stated in section 7.7.2 of its Bidder's Statement that, if it becomes entitled to do so, it intends to:

- compulsorily acquire outstanding Deferred Shares under Part 6A.1 of the Corporations Act; and
- compulsorily acquire outstanding Entitlements under Part 6A.2 of the Corporations Act.

On the basis that Qantas will cause all unvested Rights to be converted into Qantas shares upon the Relevant Conditions being satisfied, no compulsory acquisition process for Rights will be required.

See section 8.12 above and section 7.7 of the Bidder's Statement.

11.2 MATERIAL CONTRACTS

Qantas has identified 10 contracts to which a Qantas Group entity is a party which:

- contain change of control provisions that will be triggered if Airline Partners Australia acquires a relevant interest in more than 50% of the Qantas shares and the Offer is unconditional at such time; and
- Qantas considers to be material to its operations, such that if a counterparty to any such contract exercises its change of control rights this could have a material impact on the financial or operating position of Qantas or the future prospects of Qantas as a stand-alone entity (if Airline Partners Australia obtains a relevant interest in more than 50% of the Qantas shares and elects to waive the 90% minimum acceptance condition). The future prospects of Qantas would be relevant to those Qantas shareholders who remain as minority shareholders in Qantas.

The relevant provisions of these contracts are summarised below.

(a) Restated Brand Alliance Agreement (oneworld alliance)

Under this agreement, American Airlines, British Airways, Cathay Pacific, Qantas and others operate a long-term multilateral globally-branded airline alliance. Qantas' participation under this agreement may be terminated by a super majority vote (ie. a two-thirds majority of the aggregate voting rights on the alliance's governing board or, where American Airlines and British Airways hold 67% of the voting rights, a majority vote of at least one percent higher than the combined voting rights of American Airlines and British Airways on the alliance's governing board) with six months notice if:

- more than 50% of the Qantas shares at any time are owned by a person who previously held less than such percentage; or
- a third party acquires 20% or more of the Qantas shares as a result of which the third party exercises control of Qantas.

(b) Codeshare Agreement with American Airlines

Under this agreement, Qantas and American Airlines are permitted to designate certain flights on each other's services with individual flight codes. The agreement may be terminated if there is a 'material change' in the corporate ownership or effective control of the other party, such that a different person or persons acting as a group may direct or cause the direction of the management and policies of that party.

(c) Contingent Liability Agreement

Under this agreement, the Commonwealth Bank of Australia (***CBA***) provides credit support in relation to the Card Services Agreement (see further paragraph (d) below). If Qantas becomes aware of a change in control or intended change in control in relation to it, it must give notice to CBA. The agreement may be terminated if there is a change in control of Qantas which is not approved by CBA and, following good faith consultation between the parties, CBA determines that no additional security offered by Qantas would be acceptable.

(d) Qantas Card Services Agreement

CBA has agreed to provide services relating to the establishment of a credit card scheme. If Qantas becomes aware of a change in control or intended change in control in relation to it, it must give notice to CBA. The agreement may be terminated if the Contingent Liability Agreement (see paragraph (c) above) is terminated.

(e) Terms and conditions for Worldwide Acceptance of the American Express card by airlines

American Express provides services in relation to the purchase of air transport and other items. If Qantas becomes aware that there may be or has been a change of control in relation to it, it must notify American Express of this. American Express may terminate the agreement if such a change of ownership or control occurs.

(f) Shareholders Agreement regarding Star Track Express Holdings Pty Limited

Qantas holds 50% of the shares in a joint venture company called Star Track Express Holdings Pty Limited, with the other 50% held by Australian Postal Corporation. If there is a change in control of a shareholder, the affected shareholder must notify the other shareholder of that fact. A 'change in control' in respect of a shareholder means the occurrence of either of the following:

- where a person who controls that shareholder as at the date of the agreement ceases to control that shareholder; or
- where a person who did not control that shareholder as at the date of the agreement obtains control in respect of that shareholder.

Upon a shareholder giving notice of a change in control, the other shareholder may acquire the affected shareholder's shares in Star Track Express Holdings Pty Limited free from encumbrances at a price determined by independent valuation.

(g) Loan Note Facility

Qantas currently has a $1.8 billion syndicated loan note facility under which Barclays Bank PLC is the facility agent. Qantas must notify the facility agent after it becomes aware of a change of control or intended change of control in relation to it. A 'change in control' means the occurrence of either of the following:

- if an entity which does not control Qantas as at the signing date (5 October 2004) gains control of or the capacity to control Qantas; or
- if an entity which does control Qantas as at the signing date (5 October 2004) loses control of Qantas.

11. OTHER MATERIAL INFORMATION

The agreement may be terminated if there is a change in control of Qantas which is not approved by all of the financiers under the facility (such approval not to be unreasonably withheld). If the agreement is terminated, a majority of the financiers (ie. financiers whose aggregate commitments at that time exceed two-thirds of the total commitment) vote to cancel the undrawn commitment and require repayment of drawn amounts.

(h) ISDA Swap Agreement - WestLB

Under its International Swaps and Derivatives Association (***ISDA***) swap agreements, Qantas may negotiate swap and derivative transactions with counterparties, including WestLB, in relation to its currency and interest rate exposures. Qantas must notify WestLB if it becomes aware of a change in control. All transactions under the agreement may be terminated if a party or parties gain control of Qantas or if Qantas is delisted from the ASX.

(i) ISDA Swap Agreement - Barclays Bank PLC

Barclays Bank PLC is another counterparty to Qantas' ISDA agreements. Qantas must notify Barclays Bank promptly after it becomes aware of a person, related persons or an entity acquiring beneficial ownership of shares giving the power to elect a majority of the Directors of Qantas or any other ownership interest enabling the exercise of control of Qantas, if the creditworthiness of Qantas immediately following that event is materially weaker than before. In such an event, the other party may elect to terminate all transactions under the agreement.

(j) Australian Operating Aircraft Leases (former Impulse fleet)

Pembroke Aircraft Leasing Australia Pty Limited leases 6 aircraft to a subsidiary of Qantas and each operating lease is guaranteed by Qantas. Qantas must notify Pembroke if a person or group of persons acquires control of the lessee without Pembroke's written consent and the acquisition would have a material adverse effect on the Qantas subsidiary's ability to perform its obligations under the lease. Such an occurrence entitles Pembroke to terminate the lease and require redelivery of aircraft to Pembroke.

11.3 IMPLEMENTATION DEED

On the Announcement Date (14 December 2006), Qantas entered into an implementation deed with Airline Partners Australia and the Investor Group Members (as defined in section 7) (the ***Implementation Deed***). Below is a summary of the key provisions of the Implementation Deed.

(a) Takeover bid

Airline Partners Australia has agreed to make the Offer. The consideration which Airline Partners Australia is required to offer Qantas shareholders is $5.60 cash per Qantas share.[17]

(b) Bid conditions

Qantas has agreed not to do (or omit to do) anything which will, or is likely to, result in any of the Offer conditions being breached. However, this does not prevent Qantas or the Qantas Directors from taking or refusing to take any action, provided that the Qantas Directors have determined, in good faith after having consulted with their external legal and financial advisers, that failing to take, or failing to refuse to take, such action would or would be likely to constitute a breach of the Qantas Directors' fiduciary or statutory obligations.

Airline Partners Australia warrants that there is no act, omission, event or fact of which Airline Partners Australia or any of its officers, employees and advisers is aware (or which any of them ought reasonably to be aware of as a result of the due diligence conducted on Qantas) that would or is likely to result in one or more of the Offer conditions being triggered.

(c) Exclusivity

Qantas has agreed, for a period commencing on the signing date (14 December 2006) until termination of the Implementation Deed (the ***Exclusivity Period***), that:

(i) it must not, and must ensure that none of its officers, employees and advisers do not, directly or indirectly solicit, invite, facilitate or encourage any person, or communicate any intention to do any of these things, with a view to obtaining any offer or proposal from any person in relation to a competing proposal for Qantas;

(ii) it must not, and must ensure that none of its officers, employees and advisers do not, negotiate or enter into, continue or participate in negotiations or discussions with any other person regarding a competing proposal, even if:

17. See footnote 1 above.

– that person's competing proposal was not directly or indirectly solicited, initiated, or encouraged by Qantas or any of its officers, employees or advisers; or

– that person has publicly announced their competing proposal,

(the ***No-Talk Restriction***);

(iii) Qantas must not without Airline Partners Australia's prior written consent:

– solicit, invite, facilitate or encourage any party (other than Airline Partners Australia or its officers, employees and advisers) to undertake due diligence investigations on Qantas or any of its related bodies corporate where to do so would involve a breach of paragraph (i) above; or

– make available to any person (other than to Airline Partners Australia or its officers, employees and advisers) or permit any such person to receive any non-public information relating to Qantas or any of its related bodies corporate,

(the ***No Due Diligence Restriction***).

The obligations in paragraphs (ii) and (iii) do not apply to the extent that they restrict Qantas or the Qantas Board from taking any action in respect of a bona fide competing proposal which was not encouraged, solicited, invited, facilitated or initiated by Qantas in contravention of paragraph (i) above provided that the Qantas Board has determined:

- that the competing proposal for Qantas is a 'superior proposal' (see definition below); or
- in good faith and acting reasonably, that failing to respond to that competing proposal would constitute a breach of the Qantas Directors' fiduciary or statutory obligations, after receiving written advice to that effect from Qantas' external lawyers,

(the ***Competing Proposal Exception***).

(d) Notification of other approaches

Qantas has agreed that during the Exclusivity Period, it will immediately inform Airline Partners Australia if it is approached by any person to engage in any activity that would breach the No-Talk Restriction or the No Due Diligence Restriction (or would breach those restrictions if it were not for the Competing Proposal Exception), in which case Qantas must also keep Airline Partners Australia reasonably informed about the nature of any further or ongoing interaction with any such persons, but Qantas will not be obliged to identify the relevant person to Airline Partners Australia, or the details of the competing proposal, unless:

- such competing proposal, or details of the relevant competing proposal, has been made public; or
- the Competing Proposal Exception permits or requires Qantas to respond to the competing proposal (in which case Qantas must identify the relevant person to Airline Partners Australia, and the details of the competing proposal).

(e) Definition of 'superior proposal'

A 'superior proposal' means a bona fide competing proposal which the Qantas Directors have determined, in good faith after consultation with their external legal and financial advisers, is, or is reasonably likely to result in, a proposal by the person making the competing proposal that:

- is reasonably capable of being valued, taking into account all aspects of the competing proposal or the proposal and the person making it;
- is reasonably capable of being completed on a timely basis and is no more conditional than the Offer as at the time of announcement of the Offer; and
- is more favourable to Qantas shareholders (as a whole) than the Offer, taking into account all the terms and conditions of the competing proposal or the proposal.

(f) Undertakings by each Investor Group Member

Each Investor Group Member will in their specified respective proportions (where such proportions total 100%) procure that Airline Partners Australia is immediately provided with sufficient funds for the due and punctual performance of any of Airline Partners Australia's obligations under the Implementation Deed.

(g) Restrictions

Between the date of the Implementation Deed (14 December 2006) and the end of the Offer Period, Qantas must not pay a dividend or undertake any other form of capital return to Qantas shareholders without the consent of Airline Partners Australia. Airline Partners Australia has consented to Qantas paying the Special Dividend.

11. OTHER MATERIAL INFORMATION

11.4 LITIGATION

Various Qantas Group companies are involved in litigation in the ordinary course. A contingent liability of approximately $9.5 million has been noted in relation to litigation in the audited accounts of Qantas and its controlled entities for the year ended 30 June 2006, as set out in the 2006 Annual Report.

(a) Freight cartel

As disclosed in the 2006 Annual Report, in May 2006 Qantas received a subpoena to produce documents from the US Department of Justice (***DOJ***) as part of its investigation into alleged price fixing in the air cargo market. Other regulators, including the Australian Competition and Consumer Commission, New Zealand Commerce Commission and European Commission have been conducting similar investigations. Following receipt of the DOJ subpoena, Qantas immediately undertook a detailed review of its cargo operations to review whether it had, at all times, complied with the law. During this investigation Qantas learned that the practice adopted by Qantas Freight and the cargo industry generally, to fix and impose cargo fuel surcharges is likely to have breached relevant competition laws. Qantas has been co-operating fully with all regulators and will continue to provide information to assist with their investigations.

On 1 February 2007, Qantas was served with representative proceedings filed in the Federal Court of Australia against Qantas and other airlines in relation to alleged price fixing in the air cargo market. No estimate of quantum has been provided in the pleadings.

On 9 February 2007, Qantas was advised that it has been named as a defendant in a class action consolidated amended complaint filed in the US District Court Eastern District of New York.

Qantas expects that it will take at least 12 months before it is possible to quantify any direct or indirect liability associated with these matters.

(b) Travel agent class action

On 18 December 2006, Leonie's Travel Pty Limited (as representative for a class of travel agencies) lodged a statement of claim in the Federal Court of Australia against the International Air Transport Association, Qantas and certain other airlines. The claim alleges that Qantas and each other respondent is in breach of the provisions of the IATA Passenger Sales Agency Agreement to which they are a party. The statement of claim alleges that the respondents (including Qantas) improperly calculated commissions payable to travel agents by excluding the value of the international fuel surcharge from the aggregate "fares applicable". The applicant is seeking damages equal to the difference between the true amount of the commission (calculated upon the aggregate "fares applicable" including the international fuel surcharge) and the lesser amount actually paid, together with interest from the date of breach.

The application also alleges that Qantas and each other respondent has counselled or procured and induced a contravention of section 52 of the *Trade Practices Act 1974* (Cth). The applicant is seeking an injunction restraining the respondents (which include Qantas) from requiring that the international fuel surcharge be designated, charged or otherwise represented as a tax, fee or charge.

Qantas is currently reviewing the class action claim in detail. The intention of Qantas is to defend the claim.

11.5 CONSENTS

Allens Arthur Robinson has given and has not, before the date of this Target's Statement, withdrawn its consent:

- to be named in this Target's Statement in the form and context in which it is named;
- for the inclusion of its reports or statements (if any) noted next to its name and the references to those reports or statements in the form and context in which they are included in this Target's Statement; and
- for the inclusion of other statements in this Target's Statement which are based on or referable to statements made in those reports or statements, or which are based on or referable to other statements made by it in the form and context in which they are included.

Link Market Services Limited has given and has not, before the date of this Target's Statement, withdrawn its consent to be named as Share Registrar to Qantas in this Target's Statement, in the form and context in which it is so named.

Grant Samuel & Associates Pty Limited consents to the inclusion of its Independent Expert's Report as Annexure A to this Target's Statement and to any other statement made by it, or based on statements made by it in this Target's Statement:

- in the form and context in which they are included; and
- to all references to that information in the form and context in which it appears.

Each of UBS AG and Carnegie, Wylie & Company have given, and have not, before the date of this Target's Statement, withdrawn their consent to references to their names in this Target's Statement in the form and context in which they are included.

KPMG has given and has not, before the date of this Target's Statement, withdrawn its consent to:

- being named as Independent Auditor in Annexure B of this Target's Statement in the form and context in which it is so named; and
- the inclusion of its Auditor's Review Report on the interim financial report of Qantas in Annexure B of this Target's Statement, and any references to the Auditor's Review Report in this Target's Statement, in the form and context in which it is so included.

Each of Allens Arthur Robinson, Link Market Services Limited and Grant Samuel & Associates Pty Limited:

- does not make, or purport to make, any statement in this Target's Statement other than those statements (if any) referred to above and as consented to by that person; and
- to the maximum extent permitted by law, expressly disclaims and takes no responsibility for any part of this Target's Statement other than as described in this section with the person's consent.

Each of UBS AG and Carnegie, Wylie & Company, to the maximum extent permitted by law, expressly disclaim and take no responsibility for any statements or omissions from this Target's Statement, other than the reference to their names included in this Target's Statement with their consent.

KPMG has not authorised the issue of this Target's Statement and makes no representation regarding, and takes no responsibility for, any statements or material in, or omissions from, this Target's Statement (other than as described in this section with its consent).

As permitted by ASIC Class Order 01/1543 this Target's Statement contains statements which are made, or based on statements made, in documents lodged by Airline Partners Australia with ASIC or given to the ASX, or announced on the Company Announcements Platform of the ASX, by Airline Partners Australia. Pursuant to the Class Order, the consent of Airline Partners Australia is not required for the inclusion of such statements in this Target's Statement.

In addition, as permitted by ASIC Class Order 03/635, this Target's Statement may include or be accompanied by certain statements:

- fairly representing a statement by an official person; or
- from a public official document or a published book, journal or comparable publication,

without the consent of persons responsible for such statements, where the statement was not made, or the document was not published, in connection with the Offer or Airline Partners Australia or Qantas or any business, property or person the subject of the Bidder's Statement or this Target's Statement.

Any Qantas shareholder who would like to receive a copy of any of the following documents that contain the statements which have been included pursuant to ASIC Class Orders 01/1543 and 03/635 may obtain a copy (free of charge) during the Offer Period by contacting the Qantas Shareholder Information Line on 1300 658 942 (if in Australia), or +61 3 9415 4285 (if outside Australia) Monday to Friday between 9.00am and 5.00pm (Sydney time)[18]:

- the Bidder's Statement;
- Airline Partners Australia's announcement to the ASX on 14 December 2006; and
- Statement from Mark Vaile, Deputy Prime Minister of Australia and Federal Leader of the Nationals (14 December 2006), in relation to the final sentence in section 3.5.

11.6 CONTINUOUS DISCLOSURE

Qantas is a disclosing entity under the Corporations Act and subject to regular reporting and disclosure obligations under the Corporations Act and the ASX Listing Rules. These obligations require Qantas to notify the ASX of information about specified matters and events as they occur for the purpose of making that information available to the market. In particular, Qantas has an obligation (subject to limited exceptions) to notify the ASX immediately on becoming aware of any information which a reasonable person would expect to have a material effect on the price or value of Qantas shares.

18. As required by the Corporations Act, any telephone calls to these numbers will be recorded, indexed and stored.

11. OTHER MATERIAL INFORMATION

Copies of the documents filed with the ASX may be obtained from the ASX website at www.asx.com.au and Qantas' website at www.qantas.com.au/info/about/investors/companyAnnouncements.

In addition, Qantas will make copies of the following documents available for inspection at Qantas Centre, Level 9, Building A, 203 Coward Street, Mascot, New South Wales, Australia (between 9.00am and 5.00pm on business days):

- its 2006 Annual Report;
- Qantas' Constitution; and
- any document lodged in relation to Qantas with the ASX and announced to the market between the release of the 2006 Annual Report to the ASX on 11 September 2006 and the date of this Target's Statement.

A copy of these documents may be requested to be provided free of charge by contacting the Qantas Shareholder Information Line on 1300 658 942 (if in Australia), or +61 3 9415 4285 (if outside Australia) Monday to Friday between 9.00am and 5.00pm (Sydney time).[19]

Copies of documents lodged with ASIC in relation to Qantas may be obtained from, or inspected at, an ASIC office for a fee.

11.7 NO OTHER MATERIAL INFORMATION

This Target's Statement is required to include all the information that Qantas shareholders and their professional advisers would reasonably require to make an informed assessment whether to accept the Offer, but:

- only to the extent to which it is reasonable for investors and their professional advisers to expect to find this information in this Target's Statement; and
- only if the information is known to any Director of Qantas.

The Directors of Qantas are of the opinion that the information that Qantas shareholders and their professional advisers would reasonably require to make an informed assessment whether to accept Airline Partners Australia's Offer is:

- the information contained in the Bidder's Statement (to the extent that the information is not inconsistent with or superseded by information in this Target's Statement);
- the information contained in Qantas' releases to the ASX, and the documents lodged by Qantas with ASIC, before the date of this Target's Statement; and
- the information contained in this Target's Statement (including the information contained in the Independent Expert's Report).

The Directors of Qantas do not take any responsibility for the contents of the Bidder's Statement and are not to be taken as endorsing, in any way, any or all of the statements contained in it.

In deciding what information should be included in this Target's Statement, the Directors of Qantas have had regard to:

- the nature of the Qantas shares;
- the matters that shareholders may reasonably be expected to know;
- the fact that certain matters may reasonably be expected to be known to shareholders' professional advisers; and
- the time available to Qantas to prepare this Target's Statement.

19. See footnote above.

12. GLOSSARY AND INTERPRETATION

12.1 GLOSSARY

In this Target's Statement defined terms have the meanings set out below:

Term	Meaning
Acceptance Form	the form of acceptance and transfer for the Offer which accompanies the Bidder's Statement
Airline Partners Australia	Airline Partners Australia Limited (ACN 123 058 917)
Airline Partners Australia's Offer or **Offer**	the takeover offer by Airline Partners Australia to acquire all of the Qantas shares on the terms and conditions set out in the Bidder's Statement
Announcement Date	the date that the Offer was announced, being 14 December 2006
ASIC	Australian Securities and Investments Commission
ASTC	ASX Settlement and Transfer Corporation Pty Limited (ABN 49 008 504 532)
ASTC Settlement Rules	the operating rules of the settlement facility provided by ASTC
ASX	Australian Securities Exchange (formerly known as Australian Stock Exchange)
Bidder's Statement	the bidder's statement in relation to Airline Partners Australia's Offer, prepared by Airline Partners Australia and dated 2 February 2007, as supplemented by the first supplementary bidder's statement dated 7 February 2007
Board or Qantas Board	the Board of Directors of Qantas
Broker	a person who is a share broker and a participant in CHESS
CGT	Australian capital gains tax
CHESS	Clearing House Electronic Subregister System, which provides for electronic share transfer in Australia
CHESS Holding	a holding of Qantas shares on the CHESS subregister of Qantas
Controlling Participant	the meaning given in the ASTC Settlement Rules
Corporations Act	the *Corporations Act 2001* (Cth)
Deferred Share	the meaning given in section 11.1(a)
DSP	the Qantas Deferred Share Plan
Entitlement	the meaning given in section 11.1(c)
Ex-Dividend Date	13 February 2007, the ex-dividend date of the Special Dividend
Implementation Deed	the meaning given in section 11.3
Independent Directors	the meaning given in section 5.1
Independent Expert	Grant Samuel & Associates Pty Limited (ABN 28 050 036 372)

12. GLOSSARY AND INTERPRETATION

Term	Meaning
Independent Expert's Report	the independent expert's report prepared by the Independent Expert and dated 9 February 2007, incorporated as Annexure A to this Target's Statement
Issuer Sponsored Holding	a holding of Qantas shares on Qantas' issuer sponsored subregister
Management Rollover Offer	a separate offer which Airline Partners Australia may make to certain senior members of Qantas management to acquire their Qantas shares in exchange for shares in Airline Partners Australia, where such offer would be only made if the Offer is successful and would be made after completion of the Offer but prior to commencing compulsory acquisition. See section 7.3.1 of the Bidder's Statement for further details
Offer Period	the period during which Airline Partners Australia's Offer will remain open for acceptance in accordance with the Bidder's Statement
Onex Partners	Onex Partners II LP
Plan Trustee	Pacific Custodians Pty Limited (ACN 009 682 866), which is a wholly owned subsidiary of Link Market Services Limited (ACN 083 214 537)
Pre-Bid Agreement	an agreement referred to in section 5.4 of this Target's Statement, as described in section 7.3.2 of the Bidder's Statement
Qantas	Qantas Airways Limited (ABN 16 009 661 901)
Qantas Group	Qantas and its subsidiaries
Qantas Sale Act	*Qantas Sale Act 1992* (Cth)
Qantas shares or **shares**	fully paid ordinary shares in the capital of Qantas
QLTEIP	the Qantas Long Term Executive Incentive Plan
Record Date	5.00pm (Sydney time) on 19 February 2007, the record date of the Special Dividend
Register	the Qantas register of members
Right	the meaning given in section 11.1(b)
Special Dividend	the fully franked special dividend of $0.15 for each Qantas share as described in section 3.4
Target's Statement	this document (including the annexures), being the statement of Qantas under Part 6.5 Division 3 of the Corporations Act relating to Airline Partners Australia's Offer
TPG	TPG Partners V, L.P. and Newbridge Asia IV, LP
2006 Annual Report	Qantas' Annual Report for the year ended 30 June 2006

12.2 INTERPRETATION

In this Target's Statement:

- other words and phrases have the same meaning (if any) given to them in the Corporations Act;
- a reference to $, dollars and ¢ is to Australian currency;
- words of any gender include all genders;
- words importing the singular include the plural and vice versa;
- an expression importing a person includes any company, partnership, joint venture, association, corporation or other body corporate and vice versa;
- a reference to a section, clause, annexure and schedule is a reference to a section of, clause of and an annexure and schedule to this Target's Statement as relevant;
- a reference to any legislation includes all delegated legislation made under it and amendments, consolidations, replacements or re-enactments of any of them;
- headings and bold type are for convenience only and do not affect the interpretation of this Target's Statement; and
- a reference to time is a reference to Sydney time.

13. AUTHORISATION

This Target's Statement has been approved by a resolution passed by the Directors of Qantas. All Qantas Directors voted in favour of that resolution.

Signed for and on behalf of Qantas Airways Limited:

Date: 12 February 2007

Margaret Jackson, AC

Chairman

ANNEXURE A.
INDEPENDENT EXPERT'S REPORT

GRANT SAMUEL

GRANT SAMUEL & ASSOCIATES

LEVEL 19 GOVERNOR MACQUARIE TOWER
1 FARRER PLACE SYDNEY NSW 2000
GPO BOX 4301 SYDNEY NSW 2001
T: +61 2 9324 4211 / F: +61 2 9324 4301
www.grantsamuel.com.au

9 February 2007

The Directors
Qantas Airways Limited
Level 9, Building A
203 Coward Street
Mascot NSW 2020

Dear Directors

Offer by Airline Partners Australia

1 Introduction

On 14 December 2006, Airline Partners Australia ("APA") announced a cash takeover offer (the "APA Offer") for all of the shares in Qantas Airways Limited ("Qantas"). The APA Offer is $5.60 cash per share. APA has announced that the APA Offer is final in the absence of an alternative proposal from a third party.

On 8 February 2007, Qantas announced a fully franked special dividend of 15 cents per share. As a result, the offer consideration received by shareholders will comprise:

- the fully franked dividend of 15 cents per share; and
- the balance of the $5.60 offer price (i.e. $5.45) by way of a cash payment from APA.

Qantas and APA have executed an Implementation Deed to facilitate the APA Offer. The Implementation Deed sets out the conditions of the APA Offer. In summary, the key conditions are:

- APA obtains a relevant interest in at least 90% of Qantas' issued shares;
- no material adverse change occurs that would have the effect of reducing the consolidated net profit after tax of Qantas by at least $100 million;
- there is no breach of the Implementation Deed by Qantas; and
- none of the specified prescribed occurrences occur during the offer period.

APA is a consortium comprising Allco Equity Partners Limited, Allco Finance Group Limited, Macquarie Bank Limited, TPG Partners V, L.P. and Newbridge Asia IV, LP, Onex Partners II LP, other foreign investors and Qantas senior management. Foreign investors represent less than 40% of the total voting interests in APA and no single foreign investor has a voting interest of more than 15% in APA.

The APA Offer has been unanimously recommended by the Independent Non Executive Directors of Qantas in the absence of a superior proposal and subject to an independent expert providing an opinion that the APA Offer is fair and reasonable.

There is no regulatory requirement for Qantas to commission an independent expert's report in relation to the APA Offer. However, Qantas has engaged Grant Samuel & Associates Pty Limited ("Grant Samuel") to prepare an independent expert's report setting out whether, in its opinion, the APA Offer is fair and reasonable. A copy of this report will accompany the Target's Statement issued by Qantas to be sent to shareholders by Qantas. This letter contains a summary of Grant Samuel's opinion and main conclusions.

GRANT SAMUEL & ASSOCIATES PTY LIMITED
ABN 28 050 036 372 AFS LICENCE NO 240985

2 Summary of Opinion

Qantas is one of the best performing airlines in the world with a number of very attractive attributes including its brand, business mix, powerful domestic market position, growth prospects and potential for cost savings. However:

- **the airline industry is notoriously difficult and complex and, perhaps more than any other, is susceptible to external shocks (although Qantas has demonstrated a significant degree of resilience);**
- **Qantas has a number of structural disadvantages compared to its key international competitors; and**
- **Qantas faces a very substantial capital expenditure program both to maintain its competitive position and to capitalise on the growth opportunities. Qantas' current program calls for aggregate expenditure on aircraft of more than $10 billion over the next six years. Earning an adequate return on capital invested has always been, and continues to be, a challenge in the airline industry.**

In Grant Samuel's opinion, the APA Offer of $5.60 per share (inclusive of the special dividend) is fair and reasonable. Precision in the valuation of Qantas shares is unrealistic given the inherent volatility of the business, the sensitivity of earnings and cash flows to small changes in key variables (such as load factor, yield or fuel price) and the difficulties of long range and even short term forecasting. Nevertheless, Grant Samuel believes that the APA Offer of $5.60 per share (inclusive of the special dividend) represents fair value for a change of control transaction in the current market:

- **it provides a premium of 33% over the price at which Qantas shares were trading prior to the initial press reports of the potential offer. The share price is likely to fall back towards the pre bid price of around $4.20 if the APA Offer is not successful. It may trade higher than $4.20 given the earnings upgrade and the reductions in fuel price but, in the absence of regulatory change, there is no reason to expect a significant re-rating in the short term. The market was already informed about Qantas's key strategies and plans. At one level, it might seem that the pre bid market prices of around $4.20 did not fully take account of the long term growth opportunities. However, the share price is a "risk adjusted" price that inevitably reflects the airline industry's turbulent history. The market will probably always discount airline stocks and the APA Offer represents an opportunity to sell to an investor group with a different outlook;**
- **it falls within Grant Samuel's estimated range of the full underlying value of Qantas of $5.18 to $5.98 per share. Any price above $5.18 would be fair value;**
- **discounted cash flow analysis (which explicitly captures the capital expenditure requirements of the business) demonstrates that a net present value of $5.60 requires scenarios that reflect a reasonably optimistic set of assumptions; and**
- **while the multiples of EBITDAR[1] (the metric most commonly used in valuing airlines) and net profit implied by the offer price are lower than some of its listed peer group airlines such as Singapore Airlines and Cathay Pacific (whose prices generally do not include a premium for control), this reflects differences in their growth prospects and geographic location, the absence of synergies and other factors.**

Qantas' strategic plans and the available growth opportunities could, if realised, ultimately support a value of $5.60 or more but there are significant execution and other risks. It is Grant Samuel's judgement that the balance of potential return and risk suggests that shareholders are likely to be better off accepting $5.60 now rather than waiting for such a price to be achieved over time through other means. In effect, shareholders will capture a reasonable share of the upside potential by accepting the APA Offer.

1 Earnings before net interest, tax, depreciation, amortisation, non-cancellable operating lease payments and significant and non recurring items.

3 Key Conclusions

- **Qantas is one of the most successful airlines in the world with solid long term growth potential.**

  Qantas is one of the best performing airlines in the world with a number of very attractive attributes:

  - a globally recognised brand that enjoys excellent brand equity and outstanding customer loyalty (with over 4.6 million members of its frequent flyer program);
  - a well regarded management team;
  - a unique combination of both domestic and international businesses as well as a full service airline (Qantas) and a successful low cost carrier (Jetstar);
  - a powerful domestic market position (through both Qantas and Jetstar) in what is effectively a relatively stable duopoly market;
  - quality bilateral partners and global alliance membership (**one**world);
  - the prospects for further enhancing international services into the high growth regions of Asia;
  - the scope to grow Jetstar international;
  - a strong position in the premium sector of the market;
  - potential for substantial cost savings through the continued implementation of the Sustainable Future Program; and
  - high returns on invested capital compared to many other airlines.

  It is a very strategic business within the Asia Pacific airline industry and has a virtually irreplaceable set of assets.

  Qantas has also demonstrated its resilience (albeit mostly in the domestic business) through its ability to weather the effects of global terrorism threats and, more recently, increased fuel prices.

  Management's three and five year plans show continued development of the business with growth in revenue (particularly as new aircraft such as the A380 and B787 come on stream) and in earnings. The outlook for the next 2-3 years is particularly positive, reflecting:

  - continuation of high loads and improvements in yield underpinned by:
    - strong economic performance in Australia and globally;
    - moderate capacity increases in the domestic market; and
    - the A380 delay tightening capacity on key international routes; and
  - the potential for further cost savings from implementation of the Sustainable Future Program.

- **However, the airline industry operates in a very challenging environment.**

  While the growth potential for Qantas is clear, it is necessary to recognise that the airline industry is very challenging for operators:

  - it is a complex business to manage as regards both day to day operations and long term capital planning;
  - the business has a high degree of operating leverage with most operating costs being fixed. This exacerbates the effects of changes in key revenue drivers such as passenger volumes and

yields. Similarly, changes in major cost items such as fuel can also have a substantial impact on earnings;

- key variables (yield, fuel price, foreign exchange rates) have themselves shown significant volatility. International airlines are particularly exposed to fluctuations in foreign exchange rates;

- it is subject to substantial levels of government regulation and policy (particularly in relation to international traffic rights and ownership restrictions). Decisions are not always based on economic or rational criteria;

- it is highly capital intensive with a constant demand for fleet replacement, upgrading and capacity increases. In addition, the long lead times for ordering aircraft and the requirement to commit to fleet based decisions coupled with variability in demand mean periods of excess capacity are not uncommon;

- net cash flows are extremely volatile as a result of both variability in operating cash flows and the lumpy nature of capital expenditure;

- it is labour intensive with large, highly unionised workforces;

- competitors include government owned national "flag carriers" for whom airline profitability has been considered less important than the flow on effects for national economic development (e.g. tourism, trade facilitation); and

- perhaps more than any other industry, it is susceptible to external shocks that when combined with the operating and financial leverage, can have devastating consequences for profitability (or even solvency). In recent years, the airline industry has been impacted by potential pandemics (such as SARS[2]) and global terrorism, both of which affected the propensity to travel, as well as the dramatic movements in the fuel price (also, in turn affected by terrorism). While the industry has flexibility to respond, this is difficult to achieve in a timely fashion given the operational complexities and fixed cost base.

In short, sustained and consistent profitability and adequate returns on capital have proved elusive for the airline industry. The industry as a whole (and legacy or full service carriers in particular) has seldom generated sufficient operating cash flows to cover the capital costs of new aircraft. Whether or not this situation is likely to improve going forward is open to considerable debate. There are some positive factors:

- global economic conditions remain relatively benign with low inflation (despite some upward pressure), low interest rates and low unemployment (albeit not uniformly so) and there are expectations of reasonable growth;

- there is potential to relax some of the excess regulation affecting the industry (albeit not in all jurisdictions). As a result of privatisation and other changes, there is increasingly less government involvement in ownership and operation;

- fuel prices have eased from the peaks of 2006;

- there has been some consolidation amongst major airlines (e.g. Air France-KLM and US Airways/America West Airlines) with more initiated recently. Continuation of this trend could assist in achieving increased rationality and stability in pricing as well as generating substantial operating efficiencies;

- the industry has generally begun taking a more aggressive approach to cost control, with existing operators having to respond to the competitive threat from low cost carriers; and

- new generation aircraft will bring operating efficiencies.

2 Severe Acute Respiratory Syndrome.

On the other hand:

- the demand growth will require very substantial capital investment by airlines;
- economic cycles have not been eliminated and the long upswing of the past 15 years raises the probability of a downturn;
- deregulation such as "open skies" may drive down yields. In any event, new airlines keen to gain market share (under existing rules) continue to emerge and some major existing operators plan substantial capacity increases ahead of demand growth;
- regulatory changes allowing consolidation are likely to take a considerable period of time;
- fuel prices will remain volatile with arguably more risk of increases rather than decreases;
- more efficient aircraft tend to drive down yields;
- there are risks of carbon emission regulations that will increase operating costs; and
- if anything, the potential for inherently unpredictable external shocks continues to grow.

▪ **Qantas faces a number of specific structural disadvantages in its international business.**

While Qantas enjoys a powerful market position in its domestic business, key international routes such as Australia/Asia and Australia/Europe are subject to intense competition and its international business has a number of specific disadvantages compared to key competitors:

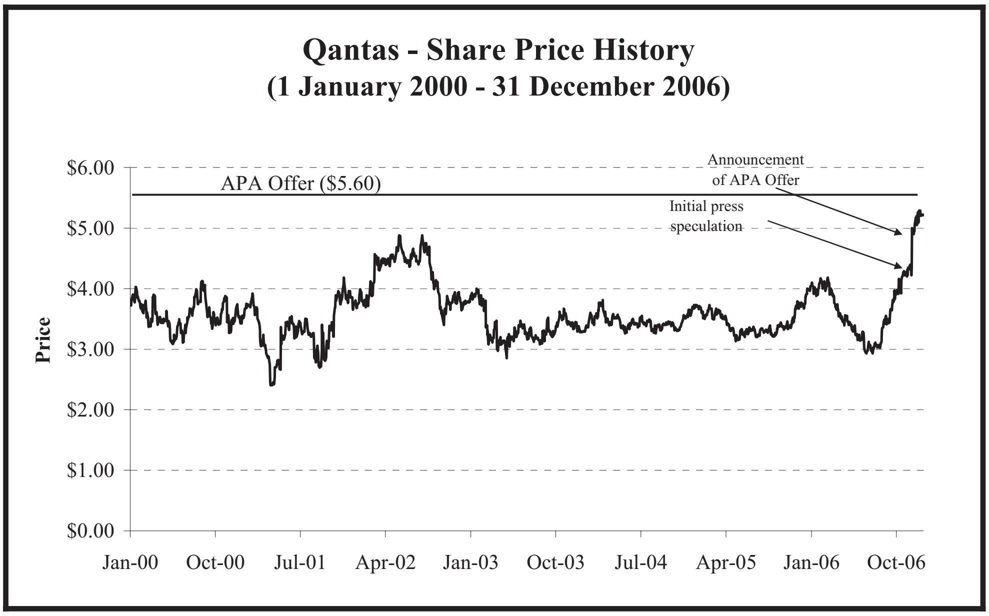
- Qantas is an "end of line" carrier while competitors such as Singapore Airlines, Cathay Pacific and Emirates operate out of "regional hubs". A hub location enables an airline to capture traffic to other destinations from a wide variety of third countries (with a single carrier service). This includes traffic to or from surrounding cities within the region (e.g. for Cathay Pacific or Singapore Airlines into numerous other cities in China and South East Asia) as well as long haul pass through traffic (e.g. Australia to Europe). In contrast, Qantas is largely (albeit not entirely) limited to traffic into or out of Australia;
- competitors such as Singapore Airlines, Cathay Pacific and Emirates enjoy low corporate tax rates (on worldwide income) and accelerated depreciation on aircraft as well as benefiting from the payroll cost advantages of low personal tax rates in their home bases;
- Qantas faces higher labour rates and a less flexible industrial relations regime; and
- competitors such as UAL Corporation[3] ("United Airlines") have been under the protection of Chapter 11 of the United States Bankruptcy Code for a number of years. United Airline's financial position has impacted on its ability to compete on product and service quality but it has not faced the same demands to achieve adequate returns for shareholders.

Qantas is generally regarded as a very well managed airline but its circumstances require it to be.

[3] UAL Corporation (the parent company of United Airlines) emerged from Chapter 11 bankruptcy in February 2006.

- **The APA Offer provides a significant premium over the pre bid share price.**

  The APA Offer of $5.60 provides shareholders with a significant premium over the pre bid share price:



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The offer price represents a premium of 33% over the closing price on 6 November 2006 of $4.20, the day prior to speculation about the offer first appearing in the media, and a premium of 36% over the volume weighted average price for the month prior to 6 November 2006.

Prior to the announcement of the APA Offer, Qantas shares had not traded at prices above $5.00 since 1999 (when they briefly touched $5.34[4]) and were as low as $2.91 as recently as July 2006.

Qantas is a well traded stock and the market appears to have a good understanding of its strategies and plans. The share price should therefore represent a reasonably well informed market judgement about value.

- **While the business has upside potential, the balance of risks suggest shareholders are likely to be better off accepting $5.60 than waiting for the market price to improve.**

  The fundamental question for shareholders is whether there is a reasonable prospect of obtaining a price higher than $5.60 within the foreseeable future, either in the sharemarket or through an alternative acquirer. APA has declared its offer to be final. In the absence of regulatory change, there is little prospect of an alternative offer. The question therefore turns on where the shares might be expected to trade if the APA Offer is not successful.

  Qantas shares have largely been locked in a trading range of $3.00-4.00 for much of the past six years and are likely, at least initially, to fall back towards the pre bid levels of around $4.20. The share price may not fall all the way back to $4.20. There appears to have been some changes in market sentiment towards Qantas (and airlines generally) resulting from:

  - the continuation of strong load factors and overall yield improvement through the period to 31 December 2006;

4 Price adjusted for the dilutionary impact of a subsequent rights offering under a share purchase plan.

- the positive earnings guidance announced by Qantas since the initial announcement on 22 November 2006;
- the fall in the fuel price from US$85-90 per barrel (Singapore Jet Fuel Price) during much of 2006 to around US$75-80 per barrel; and
- increasing awareness of the benefits of the A380 delay in tightening capacity over the next 2-3 years.

In addition, the overall sharemarket has risen as have the prices of Qantas' peer group airlines. On the other hand, despite the shift in sentiment, the price is unlikely to trade at anywhere near $5.60 in the short term in the absence of the APA Offer. Realistically, fundamental long term value is unlikely to have changed materially since late 2006:

- the load and yield growth seen over the last couple of years are the result of particularly favourable circumstances (a combination of economic strength and limited capacity increases in both domestic and international markets). These conditions will not always prevail and the general trend in yields over the longer term has been down;
- Qantas has hedged a majority of its fuel price exposure until 30 June 2007[5] and for a proportion of the following year (and therefore does not capture the full short term benefit from the current fall) and the forward curve still shows an upward trend in fuel prices;
- the A380 benefits are temporary; and
- none of the other issues affecting the industry (e.g. volatility, capital demands, capacity increases, regulation) have changed.

Nevertheless, there is a possibility that the shares could trade at levels approaching the offer price of $5.60 at some future date but it may take some time and would require a confluence of favourable outcomes including most, if not all, of the following:

- continuation of strong economic conditions both in Australia and globally that enable growth in demand and enhancement of yields;
- capacity increases on key domestic and international routes by competitors generally in line with demand growth and no irrational behaviour from competitors;
- no adverse changes in the regulatory framework or government policies (e.g. in relation to access to the Pacific route);
- successful execution of the strategic plan including:
  - further development of the Jetstar international business (recognising that there are constraints in terms of fleet and generation of adequate demand on new routes); and
  - further significant reduction in operating costs, primarily staff;
- no material rise in fuel prices; and
- no other external shocks (such as significant terrorism events or pandemics).

In addition, shareholders need to recognise that despite the generally positive outlook for Qantas and the quality of its business, the market price will inevitably reflect the somewhat jaundiced view investors have about the airline industry. The share price will be "risk adjusted" to reflect the industry's turbulent history. This experience tempers any market exuberance and will serve as a constraint on the re-rating potential of the shares.

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[5] The balance of Qantas' fuel requirements for the 2006/07 year are largely covered by options which give it some exposure to lower fuel costs but at the cost of option premiums paid.

The share price could also strengthen if there are any significant changes in industry structure or regulation (e.g. relaxation of ownership restrictions which allow operational consolidation with other international airlines). However, there is no basis for being confident this will occur within the next 2-3 years.

It is Grant Samuel's judgement that there is potential for the share price to reach or exceed $5.60 in due course. However, having regard to the time value of money and, more importantly, the execution risks of the strategic plan and other risks inherent in the business, shareholders are likely to be better off accepting $5.60 now rather than waiting for the market price to possibly rise to these levels over time.

APA may generate high returns on its investment (at $5.60) but this:

- will require a "following wind" in a volatile and difficult industry;
- will reflect the much higher financial leverage, with its attendant increase in financial risk, to levels unlikely to be acceptable to public company investors;
- may result from future actions that could be difficult to achieve in a publicly listed environment; and
- may arise from consolidation or other opportunities flowing from future regulatory change.

■ **Grant Samuel has estimated the underlying value of Qantas to be in the range of $5.18 to $5.98 per share.**

Grant Samuel's valuation of Qantas (on a pre dividend basis[6]) is summarised below:

Qantas – Valuation Summary ($ millions)

	Valuation Range	
	Low	High
Airline operations and related businesses	14,500.0	16,000.0
Interests in jointly controlled entities, associates and investments	689.2	769.4
Cost savings (listed company costs)	67.0	80.4
Other assets and liabilities	(318.3)	(315.8)
Enterprise Value	**14,937.9**	**16,534.0**
Net borrowings at 31 December 2006	(2,073.6)	(2,073.6)
Present value of future operating lease payments at 31 December 2006	(2,548.9)	(2,548.9)
Value of Equity	**10,315.4**	**11,911.5**
Fully diluted shares on issue (millions)	1,990.6	1,990.6
Value per share	**$5.18**	**$5.98**

In considering this value range, shareholders should take note of the following:

- the bottom of the range ($5.18) represents the threshold price. A price above that level is fair from a financial point of view while prices below would not be fair value in a change of control transaction;
- the value range is relatively wide. Precision in the valuation of Qantas is unrealistic and potentially misleading given the inherent volatility of the business;
- the value includes a premium for control. Synergies available to acquirers are normally a significant factor in justifying their ability to pay a meaningful premium over market prices. However in this case, there are few synergies available as:

6 Before the 15 cents per share special dividend declared by Qantas. The value range is equivalent to $5.03 to $5.83 on an ex dividend basis.

- buyers who could achieve substantial synergies such as other international airlines are not able to acquire Qantas because of the ownership restrictions under the Qantas Sale Act; and
- there are no local trade buyers. Inevitably, the acquirers would be consortia such as APA where there would be no opportunities to merge operations.

Accordingly, the level of any premium for control can be expected to be less than in other takeover situations;

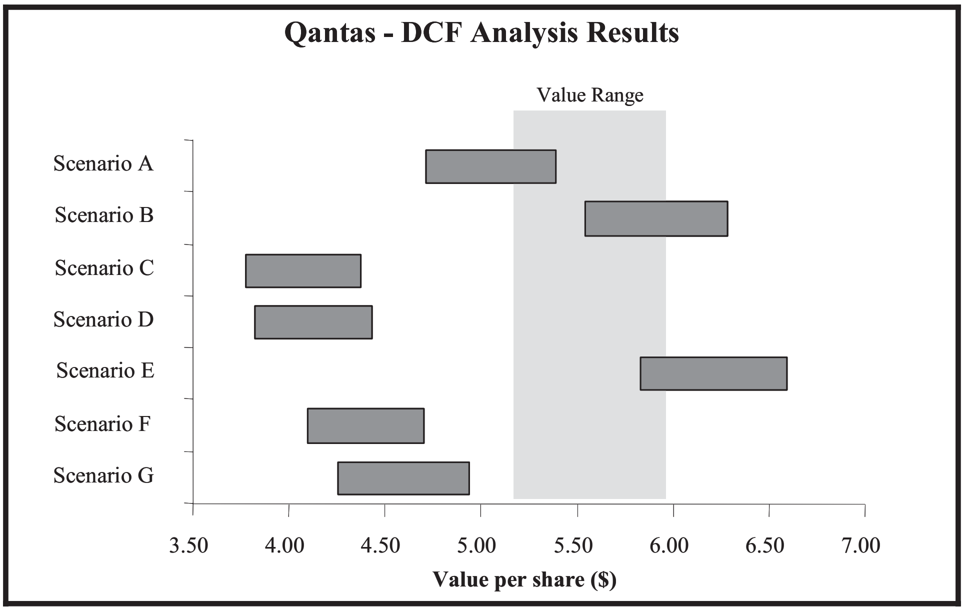
- Qantas has a number of operating divisions but the reality is that it is largely operated as a single integrated business. For example, while Jetstar is run as a separate organisation it is not stand alone. Its routes are co-ordinated with Qantas to avoid cannibalisation of the existing business. Accordingly, Grant Samuel's approach was to value the business in one line except for investments and partly owned associates. The analysis indicates that while some business units or other assets could be sold there is not any material "hidden value" that can be reliably assessed at this point in time; and
- the value range for the operating business was determined having regard to both:
  - discounted cash flow analysis; and
  - multiples of earnings.

  However, there are issues attached to both of these methodologies which mean that considerable caution should be exercised in relying on any single approach.

- **A value of $5.60 requires generally optimistic assumptions in a discounted cash flow analysis.**

Grant Samuel has prepared a high level discounted cash flow analysis of Qantas based on a ten year forecast model. As discussed above, the nature of the airline industry means that considerable caution should be applied to any analysis based on long term cash flow projections. Equally plausible sets of assumptions give rise to very substantial differences in net present value. Nevertheless, discounted cash flow analysis can give some insights into value.

The following table sets out the net present value outcomes under a variety of scenarios (described in detail in Section 6.4.2 of the full Report). The per share values are based on the net present value of the business operations (from the discounted cash flow analysis) together with the value of investments, other assets and liabilities and borrowings as set out in the table above:



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The value range reflects a value for the airline operations and related businesses of $14.5-16.0 billion. This range was selected having regard to these outcomes and based on Grant Samuel's judgement about the relative likelihood of the various scenarios and sensitivities. The value range lies towards the top of Scenario A (the closest to a "base case") but this is considered appropriate for a change of control transaction.

The analysis also shows that:

- a set of reasonably optimistic assumptions is required to generate a value of $5.60; and
- sets of assumptions that do not appear to be excessively conservative give rise to values well below $5.60.

- **The implied earnings multiples are reasonable having regard to the qualitative differences between Qantas and its peers.**

The two valuation parameters that airline industry analysts tend to focus on are multiples of EBITDAR and multiples of net profit after tax (i.e. PE multiples). EBITDAR is a measure of operating profit that eliminates the effect of different financing structures used by airlines (e.g. debt, finance leases, operating leases).

There have been no acquisitions that can be compared directly to Qantas. The most comparable transaction, the Air France/KLM merger, involved underperforming businesses and expectations of very substantial operating and other synergies which had a significant impact on the implied multiples. The transactions generally indicate EBITDAR multiples of less than 5 times allowing for anticipated synergy benefits.

Accordingly, empirical evidence can really only be discovered from the trading prices of other listed airlines. However, consideration of this analysis needs to take account of:

- the absence of a control premium in the ratings of listed comparables;
- the nature of the airlines' operations. In this context, low cost carriers (such as Ryanair, easyJet, Southwest Airlines) currently trade at higher multiples than full service airlines. In any event, no listed company is directly comparable to Qantas with its dual brand and domestic/international mix; and
- financial performance. Airlines with depressed profitability or in a turnaround (of which there are many) will trade at higher multiples of current or short term earnings.

The multiples for the year ending 30 June 2007 for Qantas implied by the APA Offer and by Grant Samuel's valuation range are shown below:

Implied Earnings Multiples			
	Grant Samuel Low Value	APA Offer	Grant Samuel High Value
EBITDAR[7]			
Year ended 30 June 2006	5.9	6.2	6.5
Year ending 30 June 2007 (broker consensus)[8]	5.0	5.3	5.5
Net Profit after Tax[7]			
Year ended 30 June 2006	17.4	18.8	20.1
Year ending 30 June 2007 (broker consensus)[8]	13.1	14.2	15.1

7 Normalised to exclude significant and non recurring items.

8 Multiples are based on broker consensus forecasts for the year ending 30 June 2007 (see Appendix 5). These consensus numbers are close enough to Qantas' internal forecast as to be useful for analytical purposes.

The multiples for Qantas are above the trading multiples of some of its peer group but are below some of its key competitors. Qantas does have a positive growth outlook, both in the short term and in the longer term. However:

- the high ratings of some of the listed peers reflect turnarounds and other temporary factors. Their stabilised multiples would be materially lower. Full service airlines have traditionally traded at around 4-6 times EBITDAR. Qantas has traded at forward EBITDAR multiples below 5 times over the past few years and well below the level implied by the APA Offer;

- peers such as Cathay Pacific or Singapore Airlines, which are rated somewhat higher, have stronger long term growth prospects than Qantas (Cathay Pacific should also see significant earnings growth from its recent Dragonair acquisition). These two airlines in particular are better positioned to capture the opportunities in China and elsewhere in Asia through their regional hub locations. They also enjoy other structural advantages (e.g. taxation and accelerated depreciation) and Singapore Airlines has the advantage of a much younger fleet. Both have limited free floats which may also contribute to their higher ratings;

- most international airlines will also benefit from the fuel price reductions and A380 delays and this is already reflected in their ratings;

- a significant contributor to the profitability of Qantas international is the Pacific route and in the medium term this could come under threat from increased competition;

- there are no significant synergy benefits available to APA and there are structural impediments for those buyers that could capture synergies;

- Qantas faces a very substantial capital expenditure program over the next decade relative to its operating cash flows; and

- Qantas has less scope than airlines in some other markets to participate in consolidation opportunities.

▪ **In the absence of regulatory change, there is little likelihood of an alternative offer.**

Under the Qantas Sale Act, shareholdings by individual foreign investors are limited to 25% of Qantas' voting capital and to 49% in aggregate. In addition, individual foreigners are limited to less than 15% of Qantas shares under the Foreign Acquisitions and Takeovers Act without approval from the Federal Treasurer. In view of the national interest issues involved, it is likely that any such investment would be carefully scrutinised.

Accordingly, there is unlikely to be an alternative offer for Qantas unless the Australian Government was to change the Qantas Sale Act:

- there are no domestic trade buyers of sufficient size;

- it would be difficult to find sufficient alternative domestic financial investors to provide 51% (or more) of the local equity content; and

- foreign trade buyers are likely to want substantially more than 15%.

Grant Samuel has no reason to believe that the Australian Government is likely to change the key terms of the Qantas Sale Act in the foreseeable future.

4 Other Matters

This report is general financial product advice only and has been prepared without taking into account the objectives, financial situation or needs of individual Qantas shareholders. Because of that, before acting in relation to their investment, shareholders should consider the appropriateness of the advice having regard to their own objectives, financial situation or needs. Shareholders should read the Bidder's Statement issued by APA and the Target's Statement issued by Qantas in relation to the APA Offer.

Acceptance or rejection of the APA Offer is a matter for individual shareholders, based on their own views as to value and expectations about future market conditions and their particular circumstances including risk profile, liquidity preference, investment strategy, portfolio structure and tax position. Shareholders who are in doubt as to the action they should take in relation to the APA Offer should consult their own professional adviser.

Grant Samuel has prepared a Financial Services Guide as required by the Corporations Act, 2001. The Financial Services Guide is included at the beginning of the full report.

This letter is a summary of Grant Samuel's opinion. The full report from which this summary has been extracted is attached and should be read in conjunction with this summary.

The opinion is made as at the date of this letter and reflects circumstances and conditions as at that date.

Yours faithfully
GRANT SAMUEL & ASSOCIATES PTY LIMITED

Grant Samuel & Associates

Financial Services Guide
and
Independent Expert's Report
in relation to the Takeover Offer by
Airline Partners Australia

Grant Samuel & Associates Pty Limited
(ABN 28 050 036 372)

9 February 2007

GRANT SAMUEL

GRANT SAMUEL & ASSOCIATES

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Financial Services Guide

Grant Samuel & Associates Pty Limited ("Grant Samuel") holds Australian Financial Services Licence No. 240985 authorising it to provide financial product advice on securities and interests in managed investments schemes to wholesale and retail clients.

The Corporations Act, 2001 requires Grant Samuel to provide this Financial Services Guide ("FSG") in connection with its provision of an independent expert's report ("Report") which is included in a document ("Disclosure Document") provided to members by the company or other entity ("Entity") for which Grant Samuel prepares the Report.

Grant Samuel does not accept instructions from retail clients. Grant Samuel provides no financial services directly to retail clients and receives no remuneration from retail clients for financial services. Grant Samuel does not provide any personal retail financial product advice to retail investors nor does it provide market-related advice to retail investors.

When providing Reports, Grant Samuel's client is the Entity to which it provides the Report. Grant Samuel receives its remuneration from the Entity. In respect of the Report for Qantas Airways Limited ("Qantas") in relation to the takeover offer from Airline Partners Australia ("APA") ("the Qantas Report"), Grant Samuel will receive a fixed fee plus reimbursement of out-of-pocket expenses for the preparation of the Qantas Report (as stated in Section 8.3 of the Qantas Report).

No related body corporate of Grant Samuel, or any of the directors or employees of Grant Samuel or of any of those related bodies or any associate receives any remuneration or other benefit attributable to the preparation and provision of the Report.

Grant Samuel is required to be independent of the Entity in order to provide a Report. The guidelines for independence in the preparation of Reports are set out in Practice Note 42 issued by the Australian Securities Commission (the predecessor to the Australian Securities & Investments Commission) on 8 December 1993. The following information in relation to the independence of Grant Samuel is stated in Section 8.3 of the Qantas Report:

> *"Grant Samuel and its related entities do not have at the date of this report, and have not had within the previous two years, any shareholding in or other relationship with Qantas or APA that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the APA Offer. Grant Samuel advises that:*
>
> - *Grant Samuel Property Pty Limited ("Grant Samuel Property"), a related company of Grant Samuel, has been retained by Qantas to provide corporate real estate services;*
> - *Grant Samuel Property has been retained to provide corporate real estate services to Macquarie Bank and certain of its subsidiaries;*
> - *Grant Samuel prepared an independent expert's report dated 15 March 2005 for the shareholders of Record Investments Limited ("Record") in relation to a share placement to a member of the Allco group of companies ("Allco"), changes to the Record board of directors and amendments to the terms of the Record Management Agreement;*
> - *Grant Samuel prepared an independent expert's report dated 1 May 2006 for the shareholders of Record in relation to the merger of Record and Allco to form Allco Finance Group Limited; and*
> - *Grant Samuel Corporate Finance Pty Limited, a related company of Grant Samuel, was retained by Allco in March 2005 to review the business model of a telecommunications company and in May 2005 to review five competitive global sales for broadband wireless access spectrum.*
>
> *The Grant Samuel group of companies has a corporate scheme for Qantas Club membership and individual executives are members of the Qantas Frequent Flyer program. In addition, three Grant Samuel group executives hold a total of less than 155,000 Qantas shares.*
>
> *Grant Samuel had no part in the formulation of the APA Offer. Its only role has been the preparation of this report.*
>
> *Grant Samuel will receive a fixed fee for the preparation of this report. This fee is not contingent on the outcome of the APA Offer. Grant Samuel's out of pocket expenses in relation to the preparation of the report will be reimbursed. Grant Samuel will receive no other benefit for the preparation of this report.*
>
> *Grant Samuel considers itself to be independent in terms of Practice Note 42 issued by the ASIC (previously known as Australian Securities Commission) on 8 December 1993."*

Grant Samuel has internal complaints-handling mechanisms and is a member of the Financial Industry Complaints Services' Complaints Handling Tribunal, No. F 4197.

Grant Samuel is only responsible for the Report and this FSG. Complaints or questions about the Disclosure Document should not be directed to Grant Samuel which is not responsible for that document. Grant Samuel will not respond in any way that might involve any provision of financial product advice to any retail investor.

GRANT SAMUEL & ASSOCIATES PTY LIMITED
ABN 28 050 036 372 AFS LICENCE NO 240985

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1 Details of the APA Offer

On 14 December 2006, Airline Partners Australia ("APA") announced a cash takeover offer (the "APA Offer") for all of the shares in Qantas Airways Limited ("Qantas"). The APA Offer is $5.60 cash per share. APA has announced that the APA Offer is final in the absence of an alternative proposal from a third party.

The APA Offer followed Qantas' announcement on 22 November 2006 that it had received an approach from Macquarie Bank Limited ("Macquarie Bank") and TPG Partners V, L.P. and Newbridge Asia IV, LP ("TPG") on behalf of a consortium that they represented and its announcement on 13 December 2006 that it had received a non-binding conditional proposal from APA to acquire all of the issued shares in Qantas at a price of $5.50 per share, the terms of which were not acceptable to the Independent Non Executive Directors of Qantas.

On 8 February 2007, Qantas announced a fully franked special dividend of 15 cents per share. As a result, the offer consideration received by shareholders will comprise:

- the fully franked dividend of 15 cents per share; and
- the balance of the $5.60 offer price (i.e. $5.45) by way of a cash payment from APA.

Qantas and APA have executed an Implementation Deed to facilitate the APA Offer. The Implementation Deed sets out the conditions of the APA Offer, which are:

- APA obtains a relevant interest in at least 90% of Qantas' issued shares;
- no order is made that restrains or prohibits the making or implementation of the APA Offer or the transfer of Qantas shares under the APA Offer;
- no material adverse change occurs that would have the effect of reducing the consolidated net profit after tax of Qantas by at least $100 million;
- no breach of the Implementation Deed by Qantas; and
- none of the specified prescribed occurrences occur during the offer period.

The Implementation Deed also provides for an exclusivity period for APA until termination of the Implementation Deed during which Qantas has agreed:

- not to solicit a competing proposal for Qantas; and
- not to allow any party to undertake due diligence investigations on Qantas or provide any non public information relating to Qantas without APA's prior written consent.

These restrictions will not apply to the extent that they restrict Qantas from acting in relation to any bona fide proposal that was not solicited by Qantas provided that the Qantas Board determines that:

- the competing proposal is a superior proposal; and
- failing to respond to the competing proposal would amount to a breach of the Qantas Directors' fiduciary or statutory obligations.

APA is a consortium comprising Australian and foreign investors. The ownership structure of APA is set out in the following table:

APA – Ownership Structure		
Consortium Member	**Voting Interest**	**Economic Interest**
Allco Equity Partners Limited	34.9%	26.9%
Allco Finance Group Limited	10.9%	8.4%
Macquarie Bank	14.5%	14.7%
Qantas senior management	1.4%	1.0%
Total Australian interest	**61.7%**	**51.0%**
TPG	14.7%	25.0%
Onex Partners II LP	8.9%	12.5%
Take-up investors[1]	14.7%	11.5%
Total foreign interest	**38.3%**	**49.0%**
Total	**100.0%**	**100.0%**

Source: Bidder's Statement

The ownership structure set out above assumes that APA makes a separate offer to acquire the Qantas shares held by 20-30 of Qantas' senior management. APA has not yet finally decided whether this offer will be made or, if it is made, which members of Qantas' management will participate, although the offer will only be made if the APA Offer is successful.

Voting interests refer to the equity securities held by investors in APA. Economic interests take into account equity securities and special warrants held by investors. APA is majority Australian owned. Foreign investors represent less than 40% of the total voting interests in APA and no single foreign investor has a voting interest of more than 15% in APA.

The APA Offer has been unanimously recommended by the Independent Non Executive Directors of Qantas in the absence of a superior proposal and subject to an independent expert providing an opinion that the APA Offer is fair and reasonable.

1 Take-up investors are foreign third party investors that TPG has agreed to procure.

2 Scope of the Report

2.1 Purpose of the Report

The Independent Non Executive Directors of Qantas have engaged Grant Samuel & Associates Pty Limited ("Grant Samuel") to prepare an independent expert's report in relation to the APA Offer. This report is to set out whether, in Grant Samuel's opinion, the APA Offer is fair and reasonable and to state reasons for that opinion.

The sole purpose of this report is an expression of Grant Samuel's opinion as to whether the APA Offer is fair and reasonable. A copy of this report is to accompany the Target's Statement to be despatched to shareholders by Qantas.

This report is general financial product advice only and has been prepared without taking into account the objectives, financial situation or needs of individual Qantas shareholders. Because of that, before acting in relation to their investment, shareholders should consider the appropriateness of the advice having regard to their own objectives, financial situation or needs. Shareholders should read the Bidder's Statement issued by APA and the Target's Statement issued by Qantas in relation to the APA Offer.

Whether or not to accept the APA Offer is a matter for individual shareholders based on their own views as to value, their expectations about future market conditions and their particular circumstances including risk profile, liquidity preference, investment strategy, portfolio structure and tax position. Shareholders who are in doubt as to the action they should take in relation to the APA Offer should consult their own professional adviser.

2.2 Basis of Evaluation

The term "fair and reasonable" has no legal definition although over time a commonly accepted interpretation has evolved. In the context of a takeover, an offer is considered fair and reasonable if the price fully reflects the value of a company's underlying businesses and assets.

Policy Statement 75 issued by the Australian Securities Commission, the predecessor to the Australian Securities & Investment Commission ("ASIC"), attempts to provide a precise definition of fair and reasonable. The Policy Statement continues earlier regulatory guidelines that create a distinction between "fair" and "reasonable". Fairness is said to involve a comparison of the offer price with the value that may be attributed to the securities that are the subject of the offer based on the value of the underlying businesses and assets. In determining fairness any existing entitlement to shares by the offerer is to be ignored. Reasonableness is said to involve an analysis of other factors that shareholders might consider prior to accepting a takeover offer such as:

- the offeror's existing shareholding;
- other significant shareholdings;
- the probability of an alternative offer; and
- the liquidity of the market for the target company's shares.

A takeover offer could be considered "reasonable" if there were valid reasons to accept the offer notwithstanding that it was not "fair".

For the purpose of this report, Grant Samuel has treated "fair" and "reasonable" as separate concepts in accordance with Policy Statement 75. Fairness is a more demanding criteria. A "fair" offer will always be "reasonable" but a "reasonable" offer will not necessarily be "fair".

A fair offer is one that reflects the full market value of a company's businesses and assets. A takeover offer that is in excess of the pre-bid market prices but less than full value will not be fair but may be reasonable if shareholders are otherwise unlikely in the foreseeable future to realise an amount for their shares in excess of the bid price. This is commonly the case in takeover offers where the bidder already controls the target company. In that situation the minority shareholders have little prospect of receiving full value from a third party offeror unless the controlling shareholder is prepared to sell its controlling shareholding.

Grant Samuel has determined whether the APA Offer is fair by comparing the estimated underlying value range of Qantas with the offer price. The APA Offer will be fair if it falls within the estimated underlying value range. In considering whether the APA Offer is reasonable, the factors that have been considered include:

- the estimated value of Qantas compared to the offer price;
- the existing shareholding structure of Qantas;
- the likelihood of an alternative offer and alternative transactions that could realise fair value;
- the likely market price and liquidity of Qantas shares in the absence of the APA Offer; and
- other advantages and disadvantages for Qantas shareholders of accepting the APA Offer.

2.3 Sources of the Information

The following information was utilised and relied upon, without independent verification, in preparing this report:

Publicly Available Information

- the Bidder's Statement;
- the Target's Statement (including earlier drafts);
- annual reports of Qantas for the five years ended 30 June 2006;
- half year announcement of Qantas for the six months ended 31 December 2006;
- press releases, public announcements, media and analyst presentation material and other public filings by Qantas including information available on its website;
- brokers' reports and recent press articles on Qantas and the airline industry; and
- sharemarket data and related information on Australian and international listed companies engaged in the airline industry and on acquisitions of companies and businesses in this industry.

Non Public Information provided by Qantas

- Board Business Reports (including management accounts) for Qantas for the four months ended 31 October 2006 and the six months ended 31 December 2006, the latter of which includes the latest forecast for the year ending 30 June 2007 prepared by Qantas management (the "2007 Forecast");
- the three year plan ending 30 June 2009 and the five year outlook ending 30 June 2011 prepared by Qantas management in May 2006 and July 2006 respectively (the "Projections"); and
- other confidential documents, board papers, presentations and working papers.

In preparing this report, Grant Samuel has held discussions with, and obtained information from, senior management of Qantas and its advisers.

2.4 Limitations and Reliance on Information

Grant Samuel believes that its opinion must be considered as a whole and that selecting portions of the analysis or factors considered by it, without considering all factors and analyses together, could create a misleading view of the process underlying the opinion. The preparation of an opinion is a complex process and is not necessarily susceptible to partial analysis or summary.

Grant Samuel's opinion is based on economic, sharemarket, business trading, financial and other conditions and expectations prevailing at the date of this report. These conditions can change significantly over relatively short periods of time. If they did change materially, subsequent to the date of this report, the opinion could be different in these changed circumstances. However, Grant Samuel has no obligation or undertaking to advise any person of any change in circumstances which has come to its attention after the date of this report or to review, revise or update its report or opinion.

This report is also based upon financial and other information provided by Qantas and its advisers. Grant Samuel has considered and relied upon this information. Qantas has represented in writing to Grant Samuel that to its knowledge the information provided by it was complete and not incorrect or misleading in any material aspect. Grant Samuel has no reason to believe that any material facts have been withheld.

The information provided to Grant Samuel has been evaluated through analysis, inquiry and review to the extent that it considers necessary or appropriate for the purposes of forming an opinion as to whether the APA Offer is fair and reasonable to Qantas shareholders. However, Grant Samuel does not warrant that its inquiries have identified or verified all of the matters that an audit, extensive examination or "due diligence" investigation might disclose. While Grant Samuel has made what it considers to be appropriate inquiries for the purposes of forming its opinion, "due diligence" of the type undertaken by companies and their advisers in relation to, for example, prospectuses or profit forecasts, is beyond the scope of an independent expert.

Accordingly, this report and the opinions expressed in it should be considered more in the nature of an overall review of the anticipated commercial and financial implications rather than a comprehensive audit or investigation of detailed matters.

An important part of the information used in forming an opinion of the kind expressed in this report is comprised of the opinions and judgement of management. This type of information was also evaluated through analysis, inquiry and review to the extent practical. However, such information is often not capable of external verification or validation.

Preparation of this report does not imply that Grant Samuel has audited in any way the management accounts or other records of Qantas. It is understood that the accounting information that was provided was prepared in accordance with appropriate accounting principles and in a manner consistent with the method of accounting in previous years (except where noted).

Qantas is responsible for the 2007 Forecast and the Projections provided to Grant Samuel. Grant Samuel has used and relied on this financial information for the purposes of its analysis. The major assumptions underlying the 2007 Forecast and the Projections were reviewed by Grant Samuel in the context of current economic, financial and other conditions.

In addition, the airline industry is a volatile industry where relatively small changes in key variables can have a significant impact on earnings and cash flows. Some of these variables are subject to external forces (e.g. fuel prices or foreign exchange rates) and difficult to predict with any reliability. Accordingly, it is extremely difficult to make reliable forecasts of future profitability.

Subject to these limitations, Grant Samuel considers that, based on the inquiries it has undertaken and only for the purposes of its analysis for this report (which do not constitute, and are not as extensive as, an audit or accountant's examination), there are reasonable grounds to believe that the 2007 Forecast and the Projections have been prepared on a reasonable basis. In forming this view, Grant Samuel has taken the following factors, inter alia, into account:

- the 2007 Forecast and the Projections have been prepared through a detailed budgeting process involving preparation of "ground up" budgets by the management of individual operations and review by management of Qantas;
- the Target Statement Due Diligence Committee commissioned reports from accounting advisers in relation to the forecast financial information provided to Grant Samuel, including identifying the key drivers of performance (and their underlying assumptions), identifying the sources of information and the supporting evidence on which the assumptions were based and assessing the mathematical integrity of the forecast financial information. Extracts from these reports were made available to Grant Samuel; and
- the 2007 Forecast was approved and the three year plan was endorsed by the Directors of Qantas.

While Qantas has made guidance statements about profit before tax for the year ending 30 June 2007, the Independent, Non Executive Directors of Qantas have decided not to include the 2007 Forecast or the Projections in the Target's Statement and therefore this information has not been disclosed in this report.

Grant Samuel has no reason to believe that the 2007 Forecast or the Projections reflect any material bias, either positive or negative. However, the achievability of the 2007 Forecast and the Projections is not warranted or guaranteed by Grant Samuel. Future profits and cash flows are inherently uncertain. They are predictions by management of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of the company or its management. Actual results may be significantly more or less favourable.

As part of its analysis, Grant Samuel has reviewed the sensitivity of net present values to changes in key variables. The sensitivity analysis isolates a limited number of assumptions and shows the impact of expressed variations to those assumptions. No opinion is expressed as to the probability or otherwise of those expressed variations occurring. Actual variations may be greater or less than those modelled. In addition to not representing best and worst outcomes, the sensitivity analysis does not, and does not purport to, show the impact of all possible variations to the business model. The actual performance of the business may be negatively or positively impacted by a range of factors including, but not limited to:

- changes to the assumptions other than those considered in the sensitivity analysis;
- greater or lesser variations to the assumptions considered in the sensitivity analysis than those modelled; and
- combinations of different variations to a number of different assumptions that may produce outcomes different to the combinations modelled.

In forming its opinion, Grant Samuel has also assumed that:

- matters such as title, compliance with laws and regulations and contracts in place are in good standing and will remain so and that there are no material legal proceedings, other than as publicly disclosed;
- the information set out in the Target's Statement sent by Qantas to its shareholders is complete, accurate and fairly presented in all material respects; and
- the publicly available information relied on by Grant Samuel in its analysis was accurate and not misleading.

To the extent that there are legal issues relating to assets, properties, or business interests or issues relating to compliance with applicable laws, regulations, and policies, Grant Samuel assumes no responsibility and offers no legal opinion or interpretation on any issue.

3 Information on Qantas

3.1 Background

Qantas was founded in 1920 as Queensland and Northern Territory Aerial Services Limited, a private venture which offered air travel across Queensland and the Northern Territory. In November 1922, Qantas began its first regular scheduled service, carrying airmail (and subsequently passengers) between Charleville and Cloncurry in Queensland. In 1934, it commenced its first international service, an Australia-United Kingdom mail service through Qantas Empire Airways Limited, a joint venture with Imperial Airways Limited ("Imperial Airways") (the predecessor to British Airways Plc ("British Airways")), with Qantas operating the Australia-Singapore leg of the service. Passenger services on the route commenced in 1935.

During World War II, Qantas provided air links and supply drops for the Allied Forces in the Asia Pacific region. However in 1947, the Australian Government acquired 100% of the airline, including the interest held by Imperial Airways. Under government ownership, Qantas expanded its international operations over the next four decades, commencing regular weekly flights between Sydney and London (the "Kangaroo route") and services to Japan, South Africa and the United States. Qantas' domestic operations were taken over by Trans Australia Airlines ("TAA") (also owned by the Australian Government) in 1949. The first jet airline service commenced in 1959.

In 1990, the Australian Government announced its intention to sell a 49% interest in Qantas and 100% of Australian Airlines (previously TAA). Following substantial deregulation of the Australian airline industry, Qantas acquired Australian Airlines for $400 million in 1992. In March 1993, the Australian Government completed the sale of a 25% interest in Qantas to British Airways for $665 million and in June 1995, the two airlines entered into a Joint Services Agreement under which Qantas and British Airways would agree on fares. The agreement was initially for a five year period. In July 1995, the Australian Government sold its 75% shareholding in Qantas through an initial public offering raising $1.5 billion.

Co-operation with British Airways was expanded in April 2000 to include co-ordination of freight, scheduling, marketing, sales, pricing and customer service activities on services between Australia and Europe. This agreement was approved by the Australian Competition and Consumer Commission ("ACCC") until July 2003 and was subsequently granted interim authorisation until it was renewed in February 2005 for a further five year term. British Airways sold its interest in Qantas (which had been diluted to 18.25%) to Australian and international investors in September 2004.

Following the collapse of Ansett Australia Pty Ltd ("Ansett"), Qantas' major domestic competitor, in September 2001, Qantas leased additional aircraft and added flights, providing free or discounted air travel to Ansett customers thereby acquiring a proportion of Ansett's market share. In November 2001, Qantas acquired Impulse Airlines Limited ("Impulse Airlines"), a small domestic airline, having previously entered into a long term commercial relationship that involved Impulse Airlines withdrawing from operating scheduled air services in Australia under its own brand.

In November 2002, Qantas and Air New Zealand Limited ("Air New Zealand") announced a proposal for a strategic alliance which included Qantas taking an equity investment of up to 22.5% in Air New Zealand and co-operation on pricing and scheduling on all Air New Zealand flights and those Qantas flights to, from and within New Zealand. In September and October 2003, the ACCC and the New Zealand Commerce Commission respectively issued final decisions denying approval of the alliance on the basis it was anti-competitive and not in the public interest. Qantas and Air New Zealand appealed these determinations and while the Australian Competition Tribunal authorised the alliance in October 2004, the appeal was denied by the New Zealand High Court based on several issues, with the conclusion that the likely public benefits of the proposed alliance would not outweigh the likely detriments. In November 2006, the ACCC issued a draft decision proposing to deny authorisation of a subsequent application for a co-operative arrangement by Qantas and Air New Zealand on Trans Tasman services.

In October 2002, in response to the rise in low cost carriers, Qantas launched a leisure focused international airline under the *Australian Airlines* brand, providing air travel from Australia to and between major Asian destinations and in October 2003, unveiled plans to launch a new low cost domestic carrier under the *Jetstar* brand. Jetstar commenced operations in May 2004 with domestic flights between 14 east coast cities. By December 2006, Jetstar operated flights to 20 domestic destinations. In July 2006, the *Australian Airlines* brand was discontinued, with Jetstar now flying low cost international services.

In November 2000, Qantas announced that as part of its long term fleet plan, it would acquire 12 Airbus A380 aircraft for delivery between 2006 and 2011, with options for a further 12 aircraft, to meet passenger growth on key long haul routes between Australia and the United Kingdom and the United States. The delivery of A380 aircraft has been delayed by two years, with Qantas now expecting to have four A380 aircraft by the end of 2008 and seven by mid-2009. All airlines with A380 orders are in the same position as Qantas. Despite the delay in delivery, Qantas has placed firm orders for a further eight A380 aircraft. In addition, in December 2005, Qantas announced that it would acquire up to 115 Boeing B787 aircraft, 65 for Qantas domestic full service, Qantas international and Jetstar international for delivery from 2008 and rights for an additional 50 for growth. The B787 and the A380 aircraft both have significantly lower operating costs than existing aircraft and will form the basis of the Qantas and Jetstar fleets out to 2015 and beyond.

3.2 Business Operations

Qantas is the world's second oldest airline and the eleventh largest airline globally in terms of Revenue Passenger Kilometres ("RPKs")[2]. In the year ended 30 June 2006, it carried approximately 34 million passengers, providing air services to 85 international destinations in 39 countries (including codeshare flights operated by other airlines) and regular services to 57 destinations throughout Australia.

The group's airline businesses include Qantas (full service domestic and international), JetConnect (domestic New Zealand and Trans Tasman), QantasLink (regional Australia) and Jetstar (low cost domestic and international). In addition to its airline operations, the company operates a portfolio of airline related businesses including airport operations, freight, engineering, catering and travel and accommodation booking. It employs approximately 37,000 people worldwide. Qantas is regarded as one of the world's leading international airlines, with an industry leading safety record and has been the recipient of numerous industry "best airline" awards.

Brief overviews of each of Qantas' major business operations are set out below. More detailed information and analysis on each of the major business operations is set out in Sections 5.1 to 5.6 of this report.

- ***Qantas Full Service Domestic and Qantas International ("Qantas Airways")***

  Qantas Airways is a full-service domestic and international airline. It is consistently ranked amongst the world's top airlines in terms of service and product quality. Qantas full service domestic comprises domestic main trunk air services provided under the *Qantas* brand and regional services provided by QantasLink. Qantas international services a wide range of routes including New Zealand, South East Asia, Japan, South Africa, the United States and the United Kingdom. Qantas also provides domestic main trunk air services in New Zealand under the *Qantas* brand.

- ***Jetstar***

  Jetstar is a low cost carrier which was launched by Qantas in May 2004 to provide a low fare service focussed on the domestic leisure travel market. The carrier's domestic network operates across 20 city and regional tourist destinations primarily along Australia's east coast. Jetstar introduced a Trans Tasman service in December 2005 and in November 2006

[2] Revenue Passenger Kilometres ("RPKs") is the number of paying passengers carried multiplied by the number of kilometres flown.

commenced the progressive introduction of international services to destinations in South East Asia, Japan and the Pacific during 2006 and 2007.

- ***Freight***

  Qantas Freight carries general and express cargo and mail using the belly space of the Qantas and Jetstar international fleets and the capacity on leased freighter aircraft, all of which operate scheduled international routes. The division provides freight handling services at four international freight terminals in Australia and one in the United States. Domestic airfreight and express road freight services are provided by separate joint venture entities owned in conjunction with Australia Post. A wholly owned subsidiary of Qantas, Express Freighters Australia Pty Limited ("Express Freighters Australia"), also leases freighter aircraft to Australian air Express.

- ***Airports***

  Qantas Airports provides a range of airport services to the Qantas domestic and international businesses and to other international airlines. Services principally include check-in, lounge facilities, baggage handling and aircraft ground handling services. Revenue is also earned from retail activities conducted within terminals owned or leased by Qantas and the leasing of advertising space.

- ***Engineering***

  Qantas operates one of the largest engineering organisations in the Asia Pacific region. Qantas Engineering provides heavy and routine aircraft, engine and component maintenance, inspections, upgrades, refits, inventory supply chain management and engineering training for the Qantas group, other international airlines and the Australian Defence Forces.

- ***Catering***

  Qantas Catering prepares fresh and frozen meals for Qantas group airlines and external customers (primarily other airlines). The catering businesses operate from eight catering facilities throughout Australia.

- ***Holidays***

  Qantas Holidays packages and sells domestic and international flights, accommodation and holiday products in conjunction with Qantas and other airlines. Products are sold through a network of over 1,000 agents throughout Australia, Asia and the United Kingdom.

- ***Investments and Associates***

  Qantas has interests in a number of other businesses, including other Asia Pacific airlines, holiday, passenger handling services and reservation systems businesses.

Qantas' business strategy has been built around the following key elements:

- grow and defend the domestic airline business through a two brand strategy of *Qantas* and *Jetstar*;
- expand the two brand strategy internationally;
- invest in new generation aircraft and associated products;
- seek ongoing portfolio business improvements and opportunities (e.g. freight);
- improve other service businesses (catering, airport services, engineering); and
- achieve cost reductions and efficiencies through the Sustainable Future Program.

3.3 Financial Performance

The financial performance of Qantas for the five years ended 30 June 2006 and the six months ended 31 December 2006 is summarised below:

Qantas - Financial Performance[3] ($ millions)

	Year ended 30 June					Six months ended 31 December
	2002 actual AGAAP	**2003 actual AGAAP**	**2004 actual AGAAP**	**2005 actual AIFRS**	**2006 actual AIFRS**	**2006 actual AIFRS**
Operating Revenue	10,968.8	11,374.9	11,353.7	12,563.9	13,542.3[4]	7,629.4[4]
EBITDAR[5]	**1,602.7**	**1,848.1**	**2,360.2**	**2,473.4**	**2,455.5**	**1,579.1**
Non-cancellable operating lease payments	(255.7)	(283.9)	(263.5)	(266.8)	(355.7)	(209.9)
EBITDA[6]	**1,347.0**	**1,564.2**	**2,096.7**	**2,206.6**	**2,099.8**	**1,369.2**
Depreciation and amortisation	(681.8)	(878.7)	(991.2)	(1,241.3)	(1,249.8)	(707.2)
EBIT[7]	**665.2**	**685.5**	**1,105.5**	**965.3**	**850.0**	**662.0**
Share of profit/(loss) of associates	36.1	9.6	19.7	15.7	38.9	13.5
Net interest expense	(48.3)	(64.7)	(133.6)	(99.7)	(54.6)	(24.1)
Amortisation of goodwill	(11.7)	(12.7)	(14.4)	-	-	-
Significant and non recurring items[8]	(10.3)	(115.4)	(12.6)	33.0	(163.1)	(128.0)
Operating profit before tax	**631.0**	**502.3**	**964.6**	**914.3**	**671.2**	**523.4**
Income tax expense	(201.7)	(155.7)	(315.8)	(225.0)	(191.2)	(164.9)
Operating profit after tax	**429.3**	**346.6**	**648.8**	**689.3**	**480.0**	**358.5**
Outside equity interests	(1.3)	(3.1)	(0.4)	(0.8)	(0.5)	0.2
Profit after tax attributable to Qantas shareholders	**428.0**	**343.5**	**648.4**	**688.5**	**479.5**	**358.7**
Statistics						
Basic earnings per share (cents)	*29.1*	*20.0*	*35.7*	*36.8*	*24.9*	*18.2*
Dividends per share (cents)	*17.0*	*17.0*	*17.0*	*20.0*	*22.0*	*15.0*
Dividend payout ratio	*58.4%*	*85.0%*	*47.6%*	*54.3%*	*88.4%*	*82.4%*
Amount of dividend franked	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Revenue growth	*7.7%*	*3.7%*	*-0.2%*	*nc*[9]	*7.8%*	*nc*
EBITDAR growth	*10.0%*	*15.3%*	*27.7%*	*nc*	*-0.7%*	*nc*
EBIT growth	*16.4%*	*3.1%*	*61.3%*	*nc*	*-11.9%*	*nc*
EBITDAR margin	*14.6%*	*16.2%*	*20.8%*	*19.7%*	*18.1%*	*20.7%*
EBIT margin	*6.1%*	*6.0%*	*9.7%*	*7.7%*	*6.3%*	*8.7%*
Interest cover[10]	*2.7x*	*2.6x*	*3.5x*	*3.2x*	*2.6x*	*3.9x*

Source: Qantas annual reports, results media releases, preliminary final reports and half year announcement, Grant Samuel analysis

3 Financial statements for years prior to 30 June 2005 were prepared in accordance with Australian Generally Accepted Accounting Principles ("AGAAP"). Qantas adopted the Australian equivalents to International Financial Reporting Standards ("AIFRS") from 1 July 2005. The financial performance for the year ended 30 June 2005 has been taken from the 2006 Annual Report and was also prepared on the basis of AIFRS.

4 Operating revenue excludes amounts receivable in relation to the A380 delay.

5 EBITDAR is earnings before net interest, tax, depreciation, amortisation, significant and non-recurring items and non-cancellable operating lease payments.

6 EBITDA is earnings before net interest, tax, depreciation, amortisation and significant and non recurring items.

7 EBIT is earnings before net interest, tax and significant and non recurring items.

8 Significant and non recurring items are items of income or expense which are considered to be outside the ordinary course of business and are, either individually or in aggregate, material to Qantas or the relevant business segment.

9 nc = not calculated as not meaningful.

10 Interest cover is EBIT divided by adjusted net interest. Adjusted net interest includes capitalised interest and interest on non-cancellable operating leases.

In recent years, the aviation industry has operated in an environment of rising fuel prices, increasing competition, security concerns and industrial relations issues. Nevertheless, Qantas reported considerable growth in earnings over the four years ended 30 June 2005, which represented a period of improving industry conditions following the impact of the terrorist attacks in the United States on 11 September 2001, the beginning of the war in Iraq and the outbreak of Severe Acute Respiratory Syndrome ("SARS") which affected earnings in the second half of the year ended 30 June 2003.

Earnings declined in the year ended 30 June 2006, despite an 8% increase in operating revenue, largely as a result of record high fuel costs ($3.1 billion before hedging benefits compared to $2.3 billion in the year ended 30 June 2005). Hedging of fuel costs and fuel surcharges recover approximately 75-90% of these additional costs.

Growth in revenue and earnings has been achieved through:

- the Sustainable Future Program, which was launched in February 2003 with the aim of reducing operating costs by $1 billion over two years. The target was subsequently increased to $1.5 billion over three years to the year ended 30 June 2006 (which was achieved) and an additional $1.5 billion reduction in operating costs has been targeted for the next two years. The cost savings achieved over the three and a half years ended 31 December 2006 are summarised below:

Qantas – Sustainable Future Program Cost Savings ($ millions)

Cost category	Year ended 30 June			Six months ended 31 December 2006	Cumulative total
	2004	2005	2006		
Labour	156	150	138	111	555
Fleet, product and overheads	211	280	237	147	875
Distribution	145	115	126	61	447
Total	**512**	**545**	**501**	**319**	**1,877**

Source: Qantas results media releases and preliminary final reports

- the launch of Jetstar domestic in May 2004 and Jetstar international in December 2005.

The transition to AIFRS from 1 July 2004 has resulted in lower reported profit after tax compared to profit after tax under AGAAP. The largest difference is the change in accounting for Frequent Flyer points revenue. Under AGAAP, this revenue was recognised when received whereas under AIFRS, this revenue is determined and recognised when the points are redeemed. Applying AIFRS to the Frequent Flyer program for the year ended 30 June 2005 resulted in a decrease in profit before tax of $142.2 million. In addition, under AIFRS, where hedging transactions do not meet certain effectiveness criteria, changes in the fair value of those transactions are recognised in profits as they occur, potentially causing volatility.

Qantas' operating performance has also been affected by the impact of transactions in foreign currencies and the translation of foreign operations. This impact was most noticeable with the significant strengthening of the A$ in the years ended 30 June 2003 and 2004, which had a positive impact on Qantas' A$ reported results.

Significant and non recurring items over the period have primarily been costs associated with the implementation of the Sustainable Future Program and the launch of the Jetstar domestic and international operations. Details of significant and non recurring items are summarised below:

Qantas – Significant and Non Recurring Items ($ millions)						
	Year ended 30 June					Six months ended 31 December
	2002 actual AGAAP	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2006 actual AIFRS
Redundancy and restructuring costs	(41.5)	(115.4)	(7.1)	(19.1)	(181.5)	(100.1)
Qantas Catering provision release	-	-	18.3	-	-	-
Reversal of surplus revenue provision	-	-	-	52.1	-	-
Profit on sale of investment in EQUANT NV	31.2	-	-	-	-	-
Receivables due from aircraft manufacturers	-	-	-	-	104.4	97.5
Jetstar domestic start up costs	-	-	(23.8)	-	-	-
Jetstar international start up costs	-	-	-	-	(14.2)	(26.0)
Writedown of jointly controlled entities	-	-	-	-	(22.4)	-
Ineffective hedges – open derivative positions	-	-	-	-	(49.4)	(99.4)
Total significant and non recurring items	**(10.3)**	**(115.4)**	**(12.6)**	**33.0**	**(163.1)**	**(128.0)**

Source: Qantas annual reports, results media releases, preliminary final reports and half year announcement, Grant Samuel analysis

In the year ended 30 June 2006 and the six months ended 31 December 2006, significant and non recurring items also includes the present value of amounts receivable from the aircraft manufacturer in relation to revised aircraft delivery dates.

In February 2007, Qantas announced that it expected reported profit before tax for the year ending 30 June 2007 to be 30-40% above the result for the year ended 30 June 2006 (i.e. in the range $873-940 million). The guidance on earnings reflected projected full year results based on fuel costs not increasing significantly, demand continuing to grow and cost reductions not achieved in the first half being realised in the second half. The guidance also reflects the estimated results for the six months ended 31 December 2006 of $523.4 million, which represents approximately 60% of the mid point of the guidance provided to the market. Over the five years ended 30 June 2002 to 30 June 2006, the first half result to 31 December has averaged 61% of the ultimate full year result.

Qantas is the head entity in the tax consolidated group comprising Qantas and all of its Australian wholly owned entities and partnerships. According to the provisions of Australia's tax law and international tax treaties, Qantas pays income tax on virtually all of its worldwide earnings at the Australian corporate tax rate of 30% (and not at the applicable corporate tax rate in the country in which the income may have been generated).

Dividends per share have increased from 17 cents in the years ending 30 June 2002 to 2004 to 20 cents in the year ended 30 June 2005 and 22 cents in the year ended 30 June 2006. The increase in dividends in the year ended 30 June 2005 reflected the strong growth in earnings, as the payout ratio remained relatively steady compared to the prior year (at around 50%). Dividends per share were increased in the year ended 30 June 2006 following strong operating cash flows, even though profit after tax declined (reflected in the increase in the dividend payout ratio to almost 90%). Dividends have consistently been franked to 100%. Before allowing for the payment of the 15 cents per share special dividend, Qantas had $263.7 million in available franking credits.

3.4 Financial Position

The financial position of Qantas as at 30 June 2006 and 31 December 2006 is summarised below:

Qantas - Financial Position ($ millions)	As at 30 June 2006 actual AIFRS	As at 31 December 2006 actual AIFRS
Debtors and prepayments	1,159.2	1,032.5
Inventories	334.8	188.3
Creditors and accruals	(1,988.0)	(1,893.3)
Revenue received in advance	(2,991.3)	(2,914.1)
Net working capital	**(3,485.3)**	**(3,586.6)**
Aircraft related assets	11,030.9	11,035.4
Other property, plant and equipment	1,344.1	1,362.9
Other financial assets (net)	752.1	213.8
Intangible assets	311.7	329.2
Investments accounted for using the equity method	372.9	360.4
Other investments	53.7	78.2
Loans receivable	142.1	142.2
Deferred tax liabilities (net)	(698.3)	(674.1)
Current tax liabilities	(72.4)	(63.6)
Provisions	(946.0)	(931.1)
Deferred lease benefits	(136.3)	(116.8)
Assets classified as held for resale	24.2	9.6
Other (net)	131.7	255.9
Total funds employed	**8,825.1**	**8,415.4**
Cash and cash equivalents	3,031.6	3,180.1
Bank and other loans, lease liabilities	(5,775.6)	(5,517.0)
Net borrowings	**(2,744.0)**	**(2,336.9)**
Net assets	**6,081.1**	**6,078.5**
Outside equity interests	(4.9)	(4.7)
Equity attributable to Qantas shareholders	**6,076.2**	**6,073.8**
Statistics		
Net assets per share ($)	*3.11*	*3.06*
NTA[11] per share ($)	*2.95*	*2.90*
Gearing[12]	*47.1%*	*44.6%*

Source: Qantas annual reports and half year announcement, Grant Samuel analysis

Qantas' total funds employed of $8.4 billion at 31 December 2006 included $11.0 billion of aircraft related assets. Aircraft related assets at 31 December 2006 included $1.2 billion in deposits and progress payments for new aircraft.

Gearing at 31 December 2006 is moderate at 44.6% (based on the book value of equity) and interest cover at 3.9 times EBIT. Net borrowings includes aircraft lease liabilities of $1.1 billion and is net of aircraft security deposits of $126.8 million. At 31 December 2006 Qantas had total committed financing facilities of $1.2 billion, all of which was undrawn and a $1.0 billion commercial paper and medium term note facility, of which $0.1 billion was on issue.

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11 NTA is net tangible assets, which is calculated as net assets less intangible assets.

12 Gearing is net borrowings divided by net assets plus adjusted net borrowings. Adjusted net borrowings includes the present value of non-cancellable operating leases.

For the purposes of calculating gearing, net borrowings includes the net present value of future non-cancellable operating lease payments which, at 31 December 2006, amounted to $2.5 billion.

Qantas is subject to interest rate, foreign currency and fuel price risks. Qantas manages these risks using various financial instruments, including swaps, forward contracts and options. Foreign currency hedges are used to cover the exposure of borrowings, net income and capital expenditure denominated in foreign currencies. At 31 December 2006, the mark to market value of these instruments was a net asset of $213.8 million comprising $377.8 million for interest rate hedges, $2.6 million for fuel hedges and $(166.6) million for foreign currency hedges. Up to 100% of estimated fuel costs out to 12 months may be hedged, up to 50% in the subsequent 12 months and up to 20% in the final year out to 36 months, with any hedging outside these parameters requiring approval of the Board.

Intangible assets at 31 December 2006 predominantly relate to software development expenditure (54%) and goodwill (35%), with the balance representing airport landing slots. Under AIFRS, goodwill and airport landing slots are no longer amortised (but are tested annually for impairment). Software development expenditure is amortised on a straight line basis over three to five years.

Equity accounted investments at 31 December 2006 of $360.4 million primarily represent Qantas' 50% interest in Star Track Express Holdings Pty Limited ("Star Track Express"). It also includes:

- a 46.3% interest in Air Pacific Limited ("Air Pacific"), an airline in Fiji;
- a 50% interest in Australian air Express Pty Limited ("Australian air Express"), a domestic cargo business jointly controlled with Australia Post; and
- a number of other relatively small investments in businesses involved in air transport, passenger handling services, tours and travel, freight services and reservation systems.

Other investments at 31 December 2006 primarily represents Qantas' investment in Air New Zealand (220.8 million convertible notes) which is carried at $73.7 million.

At 31 December 2006, Qantas had net deferred tax liabilities of $674.1 million. This net liability does not include any value for $13.7 million of tax losses (calculated as at 30 June 2006) that exist in relation to Qantas' New Zealand operations on the basis that it is not probable that taxable profit will be generated in the future against which Qantas could utilise these tax losses.

Qantas' financial position at 31 December 2006 includes provisions for:

- insurance and other of $128.9 million. This included a provision for workers' compensation insurance. Qantas self-insures for risks associated with workers' compensation in New South Wales, Victoria and Queensland and the provision is calculated based on an independent actuarial assessment of notified and estimated incurred but not reported claims;
- earned but not redeemed Frequent Flyer points of $68.7 million, calculated based on the present value of the incremental marginal cost of providing the travel rewards; and
- onerous contracts of $21.6 million, in relation to a lease of empty premises and leases of grounded aircraft that cannot be cancelled or sublet.

Loans receivable of $142.2 million includes a $128.2 million loan to Star Track Express.

Outside equity interests at 31 December 2006 of $4.7 million represents minority interests in a number of Asian subsidiaries of QH Tours Ltd ("QH Tours"), a Qantas' travel wholesaler.

3.5 Cash Flow

Qantas' cash flows for the five years ended 30 June 2006 and the six months ended 31 December 2006 are summarised below:

Qantas - Cash Flow ($ millions)						
	Year ended 30 June					Six months ended 31 December
	2002 actual AGAAP	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2006 actual AIFRS
EBITDA	**1,347.0**	**1,564.2**	**2,096.7**	**2,206.6**	**2,099.8**	**1,369.2**
Changes in working capital and other adjustments	4.2	279.3	92.7	660.4	419.7	(31.7)
Capital expenditure (net)	(2,450.7)	(3,100.5)	(1,956.9)	(1,734.9)	(1,479.7)	(652.7)
Operating cash flow	**(1,099.5)**	**(1,257.0)**	**232.5**	**1,132.1**	**1,039.8**	**684.8**
Tax paid	(165.9)	(169.2)	(33.3)	(102.9)	(162.7)	(82.6)
Net interest paid	(100.1)	(153.7)	(179.6)	(174.9)	(157.6)	(81.3)
Proceeds from financing of non-current assets	-	-	171.7	257.9	627.8	-
Payments for investments and intangibles (net of cash)	(19.3)	(92.9)	(319.2)	(44.6)	(37.3)	(11.6)
Proceeds from sale of investments	39.3	-	-	-	-	3.4
Dividends paid	(124.1)	(172.3)	(161.4)	(175.0)	(212.1)	(116.1)
Proceeds from share issues	652.7	701.0	90.6	-	-	-
Other	137.7	204.7	(52.7)	31.3	41.6	10.5
Net cash generated (used)	**(679.2)**	**(939.4)**	**(251.4)**	**923.9**	**1,139.5**	**407.1**
Net cash (borrowings) – opening	*(2,533.5)*	*(3,212.7)*	*(4,152.1)*	*(4,807.4)*	*(3,883.5)*	*(2,744.0)*
Net cash (borrowings) – closing	*(3,212.7)*	*(4,152.1)*	*(4,403.5)*	*(3,883.5)*	*(2,744.0)*	*(2,336.9)*

Source: Qantas annual reports, Grant Samuel analysis

The cash generated by Qantas' business operations has varied considerably over the last five years, despite growth in EBITDA up until the year ended 30 June 2005. This largely reflects the uneven nature of capital expenditure over this period, which peaked at $3.1 billion in the year ended 30 June 2003 and has fallen in subsequent years to $1.5 billion in the year ended 30 June 2006 (partly as a result of more aircraft being financed through operating leases). In addition, since the year ended 30 June 2004, Qantas has generated cash from the sale and subsequent lease back of aircraft.

The cash generated by Qantas' business operations has been used primarily to pay interest on net borrowings, tax and dividends. While a number of acquisitions have been made over this period, they have, with the exception of the $375 million (including a loan of $128.2 million) acquisition of a 50% interest in Star Track Express in the year ended 30 June 2004 and the $89.7 million investment in Air New Zealand in the year ended 30 June 2003, been relatively small.

The decline in tax paid in the year ended 30 June 2004 was due to the impact of accelerated tax depreciation on new aircraft and a refund received from the Australian Taxation Office relating to prior year foreign exchange losses on the hedging of aircraft acquisitions.

3.6 Capital Structure

As at 2 February 2007, Qantas had the following securities on issue:

- 1,984,027,311[13] ordinary shares;
- 5,021,800 rights to Qantas shares awarded to eligible executives under the Performance Rights Plan; and
- 6,329,620 entitlements awarded to certain executives under the Qantas Long Term Executive Incentive Plan.

Selected Qantas executives may be granted rights to Qantas shares under the Performance Rights Plan[14]. Rights granted under this plan are subject to a performance hurdle based on total shareholder return compared to a basket of listed global airlines and the S&P/ASX 100 Index. The performance hurdle is tested three years after the rights are granted and re-tested, if necessary, at quarterly intervals over the subsequent two year period. Subject to achieving the performance hurdle, rights may be converted on a one-for-one basis to Qantas shares. All rights are granted with a nil exercise price. They do not allow the holder to participate in share issues and have no entitlement to dividends. Unvested rights generally lapse on termination of employment.

Qantas also has on issue entitlements to Qantas shares issued under the Qantas Long Term Executive Incentive Plan which were granted in the years ended 30 June 2000, 2001 and 2002. The plan was suspended in July 2002. These entitlements may vest between three and five years following the award date subject to achieving a performance hurdle (based on Qantas' relative total shareholder return compared to the ASX 200 Industrials Index and a basket of global airlines). To the extent that the entitlements vest, they may be converted into Qantas shares within eight years of the award date, in proportion to the gain in the Qantas share price (i.e. not on a one-for-one basis). The entitlements lapse on the eighth anniversary of the date they were awarded. Entitlements do not allow the holder to participate in share issues and have no entitlement to dividends. All of the entitlements had vested or lapsed at 31 December 2006. Based on a Qantas share price of $5.60, these entitlements would convert into 1,558,449 Qantas shares.

In addition, Qantas has awarded deferred shares to selected executives as follows:

- 6,287,536 deferred shares held by the Plan Trustee under the Performance Share Plan[14], where shares are purchased on market or issued and are held subject to a holding lock of 10 years. Executives can "call for" the deferred shares prior to the expiration of the holding lock, but not before the end of the financial year in relation to up to 50% of the deferred shares and the end of the following financial year in relation to the remaining deferred shares. Dividends paid are distributed to the relevant executive;
- 3,000,000 deferred shares held by the Plan Trustee under the Qantas Retention Plan, which provides for deferred share awards, subject to satisfactory service, typically for a period of three years;
- 307,000 deferred shares awarded to Mr Geoff Dixon in lieu of cash under the Performance Cash Plan; and
- 30,000 deferred shares held by the Plan Trustee under the Senior Manager Long Term Executive Incentive Plan. This was an interim plan following the suspension of the Qantas Long Term Executive Incentive Plan under which certain executives were awarded deferred shares subject to a four year holding lock (provided that the employee remains employed by Qantas). These shares are held in trust on behalf of each executive until expiry of the holding lock period. Dividends paid are distributed to the relevant executive. No awards have been made since April 2003.

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13 Including a total of 9,663,529 shares held in trust under the various deferred share plans (38,993 of which are not currently allocated).

14 The Performance Rights Plan and the Performance Share Plan are governed by the terms and conditions of the Qantas Deferred Share Plan. The Qantas Deferred Share Plan governs the provision of equity benefits to eligible employees.

3.7 Ownership

3.7.1 Qantas Sale Act

Ownership of Qantas is governed by the Qantas Sale Act 1992 (Cth) ("Qantas Sale Act"). Under the Qantas Sale Act, Qantas' Constitution must contain:

- restrictions on the issue and ownership (including joint ownership) of shares in Qantas to prevent:
  - "foreign persons", in aggregate, having relevant interests in more than 49% of Qantas' issued shares;
  - any one foreign person having relevant interests in more than 25% of Qantas' issued shares; and
  - "foreign airlines", in aggregate, having relevant interests in more than 35% of Qantas' issued shares.

  In addition to these restrictions, under the Foreign Acquisitions and Takeovers Act 1975 (Cth), any proposal that involves an individual foreign interest of 15% or more or aggregate foreign interests of 40% or more requires the approval of the Foreign Investment Review Board, which has the power to block the proposal on the basis of national interest;
- restrictions on "substantial foreign shareholders" voting to appoint, replace or remove more than one-third of the directors of Qantas;
- prohibitions on Qantas Airways Limited (the parent company):
  - changing its name to a name that does not include the expression "Qantas";
  - providing scheduled international air transport passenger services under a name other than its company name or a registered business name that includes the expression "Qantas"; and
  - taking any action to become incorporated outside Australia; and
- requirements that:
  - the head office of Qantas and its principal operational centre remain in Australia; and
  - at least two-thirds of the Directors and the chairperson of Qantas are Australian citizens.

To enforce these restrictions, the Directors of Qantas have the power to remove voting rights and require the disposal of Qantas shares and have the ability to transfer Qantas shares. The directors of Qantas can also remove a fellow director of Qantas. In addition, the Federal Minister for Transport may apply to the Federal Court for an injunction to prevent a breach or threatened breach of these restrictions.

Under its Constitution, Qantas has expanded the definition of a "foreign airline" to include:

- an entity which substantially owns and effectively controls a foreign airline, including any entity that has a relevant interest in 35% or more of the voting rights or voting shares in the foreign airline; and
- an entity which is substantially owned and effectively controlled by a foreign airline, including where the foreign airline has a relevant interest in 35% or more of the voting rights or voting shares in the entity.

The Qantas Sale Act requires Qantas to maintain a register of foreign ownership of Qantas shares. Qantas' Constitution requires a foreign person or foreign airline to notify Qantas within 10 days of obtaining a relevant interest in Qantas shares.

3.7.2 Current Ownership

The largest shareholders in Qantas are principally institutional nominee companies (i.e. many of the beneficial owners of the Qantas shares are not necessarily registered). Qantas has received substantial shareholder notices from three shareholders:

Qantas – Substantial Shareholders as at 31 January 2007		
	Number of Shares	Percentage
UBS Nominees Pty Ltd	177,429,406	8.9%
Capital Group Companies, Inc.	134,974,699	6.8%
Barclays Global Investors Australia Limited	102,796,232	5.2%

Source: IRESS

Each of these substantial shareholders hold Qantas shares in their capacity as investment or fund managers or as market participants.

Pursuant to the ASX listing Rules, the last announcement on 8 November 2006 advised that the potential level of foreign ownership of Qantas was 46.1%.

3.8 Share Price Performance

3.8.1 Qantas Share Price History

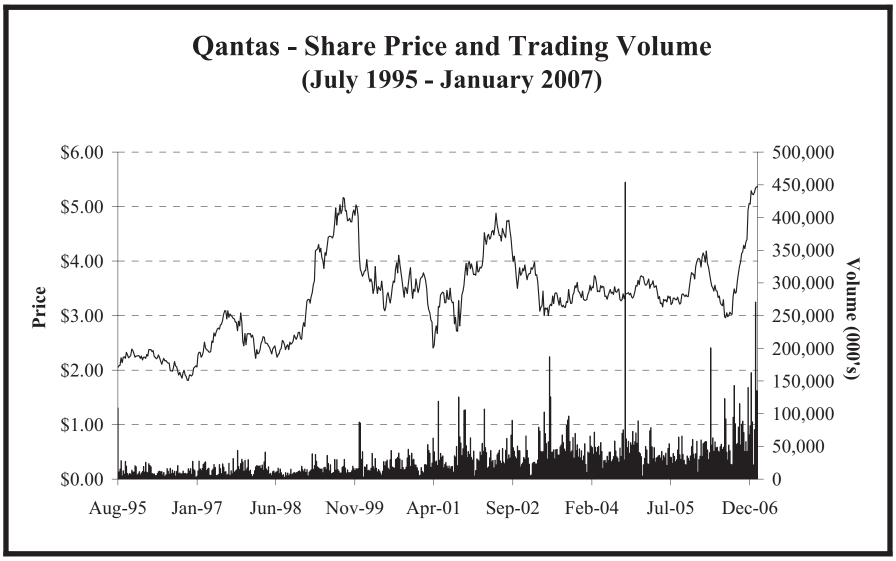
A summary of the price and trading history of Qantas shares since listing is set out below:

Qantas - Share Price History					
	Share Price ($)			Average Weekly Volume (000's)	Average Weekly Transactions
	High	Low	Close		
Year ended 31 December					
1995 (from 31 July)	2.45	2.03	2.24	16,694	709
1996	2.47	1.79	2.10	11,371	525
1997	3.21	2.05	2.72	13,720	657
1998	3.40	2.13	3.33	12,455	861
1999	5.40	3.25	3.80	19,977	2,139
2000	4.25	3.07	3.55	21,669	2,941
2001	4.92	2.34	3.68	37,023	3,869
2002	4.92	3.37	3.83	37,055	3,439
2003	4.03	2.84	3.29	51,320	4,230
2004	3.81	3.13	3.71	52,762	3,235
2005	4.04	3.10	4.04	37,648	3,170
Quarter ended					
31 March 2006	4.29	3.53	3.54	57,730	4,020
30 June 2006	3.65	2.91	2.96	58,093	4,423
30 September 2006	3.98	2.91	3.91	64,124	4,527
Month ended					
31 October 2006	4.31	3.88	4.24	71,282	6,247
30 November 2006	5.25	4.16	4.95	70,507	7,180
31 December 2006	5.37	4.93	5.22	97,907	6,880
31 January 2007	5.40	5.20	5.39	155,353	3,742

Source: IRESS

Qantas shares commenced trading on 31 July 1995 and closed at $2.15 on that day, a 7.5% premium to the initial public offer price of $2.00[15]. Except for a brief period in the second half of 1996, Qantas shares have traded above the initial offer price:

15 Retail shareholders paid $1.90 per share for the first 20,000 shares for which they applied.



Source: IRESS

During the period from 31 July 1995 to 31 December 2001, a number of major international market shocks occurred including the Asian economic crisis (1997/98) and the terrorist attacks in the United States in September 2001 as well as the collapse of Qantas' full service domestic competitor Ansett in September 2001[16] and the re-emergence of low cost carriers in Australia (Impulse Airlines which commenced jet operations in June 2000 and was acquired by Qantas in November 2001 and Virgin Blue Holdings Limited ("Virgin Blue") which commenced operations in August 2000). Over this period, Qantas shares traded in a range of $1.79-5.40, at a weighted average price of $3.21. Up to 1999, the shares largely traded in the $2.00-3.00 range. After a strong rise in 1999 to over $5.00, they generally traded in the range $3.00-4.00. Major factors which influenced the Qantas share price during this period included:

- applicants to the initial public offer were entitled to receive one share for every 25 shares allocated and held continuously until 1 June 1996 (subject to a maximum of 800 shares per applicant). There was an increase in the number of transactions post June 1996 (albeit only a marginal increase in volume) which depressed the share price for the balance of 1996;

- Qantas exceeded its prospectus forecast for the year ended 30 June 1996 by 4.1% and was targeting increased cost reductions to drive profit growth despite lower expected revenue growth in 1996/97. Consequently, Qantas shares traded up to around $2.80-3.00. However, uncertainty as to the impact of the Asian economic crisis on earnings dampened the share price to around $2.50 during 1998;

- Qantas reported a 20.7% increase in profit after tax for the year ended 30 June 1998 on the back of substantial cost savings. This result, together with the expectation of further cost savings and strong Australian economic conditions, resulted in the Qantas shares trading higher during 1999. The share price hit an intra day high of $5.40 – its highest price since listing, on 25 August 1999 in the week after Qantas' 1998/99 profit announcement which included a 38.6% increase in net profit after tax and the declaration of a final dividend of 11 cents per share (4 cents higher than the previous year) plus a 13.5 cents per share special dividend;

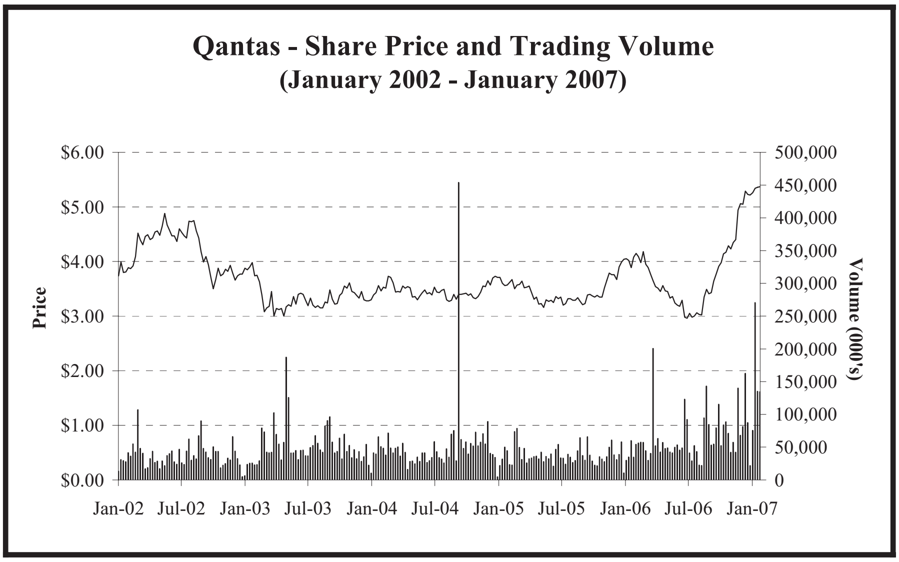
16 Ansett did continue to operate a limited number of routes until March 2002.

- following the September 1999 incident involving a Qantas aircraft at Bangkok Airport and the November 1999 announcement that Virgin Group Limited would launch a domestic low fare airline in Australia, the Qantas share price fell sharply to below $4.00 a share;

- rising jet fuel prices, a weakening Australian dollar and the emergence of new low cost competitors held the price in a range around $3.60 during 2000. Outlook statements made by Qantas in February and March 2001 highlighting ongoing challenges resulted in a sharp decline in the share price to a low of $2.34 in March 2001 although it recovered to trade broadly in the range of $3.20-3.40 prior to September 2001; and

- the terrorist attacks in the United States on 11 September 2001 and the collapse of Ansett on 12 September 2001 (following a period of considerable uncertainty) initially saw a jump, but then a drop in the Qantas share price. Notwithstanding these events, the Qantas share price rose to trade around $4.00 by late 2001.

Since 1 January 2002, Qantas shares have continued to trade in the general range of $3.00-4.00 per share as shown below:



Source: IRESS

From late 2001 Qantas took action to strengthen its business and increase capacity. It commenced an aircraft acquisition program and announced the launch of a low cost international carrier under the *Australian Airlines* brand. Qantas also raised approximately $1.1 billion in equity through an institutional placement in 2001 and a combined institutional and retail entitlement offer in 2002. Following the announcement of the entitlement offer in August 2002, Qantas shares traded down to below $4.00. The share price declined further in February 2003 following Qantas' interim 2002/03 profit announcement which noted a downturn in forward bookings due to the continued threat of terrorism and international tension over Iraq.

From early 2003 until mid 2005, the Qantas share price was locked in a fairly narrow range around $3.50. During this period Qantas implemented a number of initiatives:

- formed joint ventures to acquire an engine maintenance facility near Tullamarine Airport, Melbourne (September 2003) and Star Track Express (December 2003);

- introduced a fuel surcharge (from May 2004) and commenced a restructure of its travel agent commission structure (from September 2004);
- launched Jetstar (May 2004); and
- continued to pursue an alliance with Air New Zealand.

However, the war in Iraq and its impact on fuel prices limited profit growth.

Following the release of improved traffic statistics and the announcement of a review of Qantas Engineering, the Qantas share price increased to around $4.00 by late 2005. However, the share price declined during the first half of 2006 to around $3.00 as the continued rise in fuel prices (to over US$90 per barrel for jet fuel at its peak) impacted on 2005/06 profitability. The share price reached a three year low of $2.91 in June 2006 and again in July 2006. A recovery began from August 2006 as fuel prices began to decline and Qantas released its 2005/06 results which included guidance that the result for 2006/07 was expected to be in line with the 2005/06 result. The subsequent announcement at the annual general meeting in October 2006 that given recent improvements in trading conditions, Qantas now expected the results for 2006/07 to exceed the results in 2005/06 also fuelled the share price. Following reductions in fuel prices and the announcement of a delay in the delivery of the new A380 aircraft market sentiment towards Qantas improved and its share price returned to around $4.00.

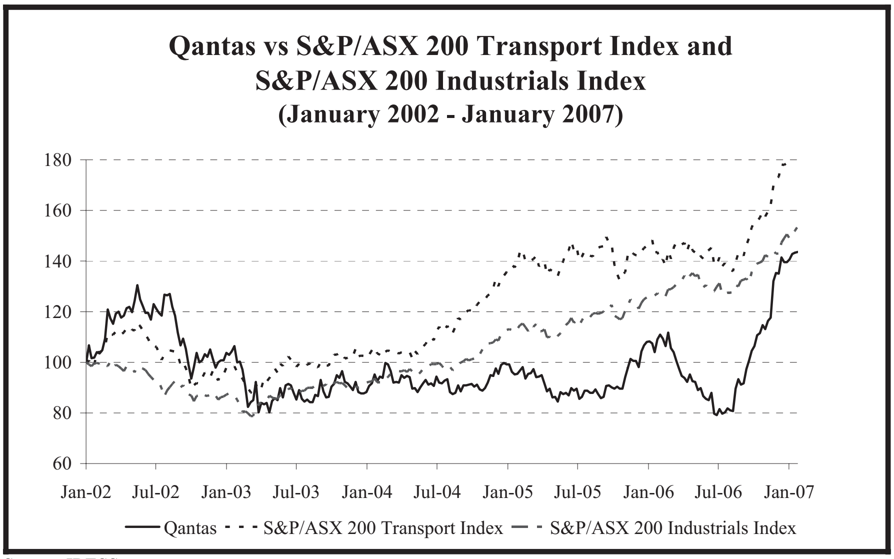
The Qantas share price on 6 November 2006, the day prior to the first media speculation of an offer closed at $4.20. The price increased slightly over the next two weeks but then rose sharply to around $5.00 following confirmation, on 22 November 2006, of an approach by Macquarie Bank and TPG on behalf of a consortium. On 1 December 2006, Qantas announced that it expected reported profit before tax in 2006/07 to be 25-30% above 2005/06 subject to fuel prices remaining at around current levels. Qantas shares closed at $5.09 on 13 December 2006, the day prior to the official announcement of the APA Offer. Since announcement of the APA Offer, Qantas shares have traded in the range $5.18-5.40, at a weighted average price of $5.30. The discount to the offer price of $5.60 probably represents the impact of the time value of money given investor estimates of payments under the APA Offer and some allowance for the risk of the APA Offer not proceeding.

3.8.2 Liquidity

Prior to British Airways realising its 18.25% interest in Qantas in September 2004 Qantas' free float was restricted to 81.75%. Since then there have been no specific restrictions on Qantas' free float, although the restrictions on foreign ownership contained in Qantas' Constitution are considered to negatively influence Qantas' share price as they limit the extent to which foreign institutions can acquire shares. Nevertheless, Qantas is a liquid stock. Average weekly volume over the twelve months prior to the announcement by Qantas of an approach from a consortium on 22 November 2006 represented approximately 3.0% of average shares on issue or annual turnover of around 155% of total average issued capital.

3.8.3 Relative Performance

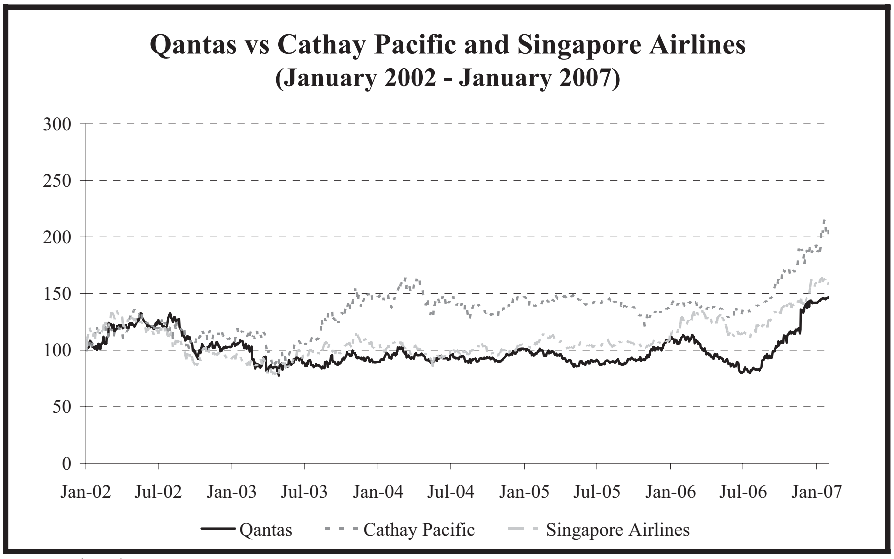
Qantas is a top 50 ASX listed company and is a member of key Australian indices. The following graph illustrates the performance of Qantas shares since January 2002 relative to the S&P/ASX 200 Transport Index (of which it represents approximately 21.9%) and the S&P/ASX 200 Industrials Index (of which it represents approximately 1.2%):



Source: IRESS

After initially outperforming both indices, Qantas has underperformed the S&P/ASX 200 Transport Index since April 2003 and underperformed the S&P/ASX 200 Industrials Index since April 2004, particularly in the period of increasing fuel prices since early 2005.

Over the last five years, Qantas has generally performed in line with the both the major Asian full service carriers and its European based peers on a relative basis[17]. Qantas' performance relative to the Asian full service carriers is shown below:

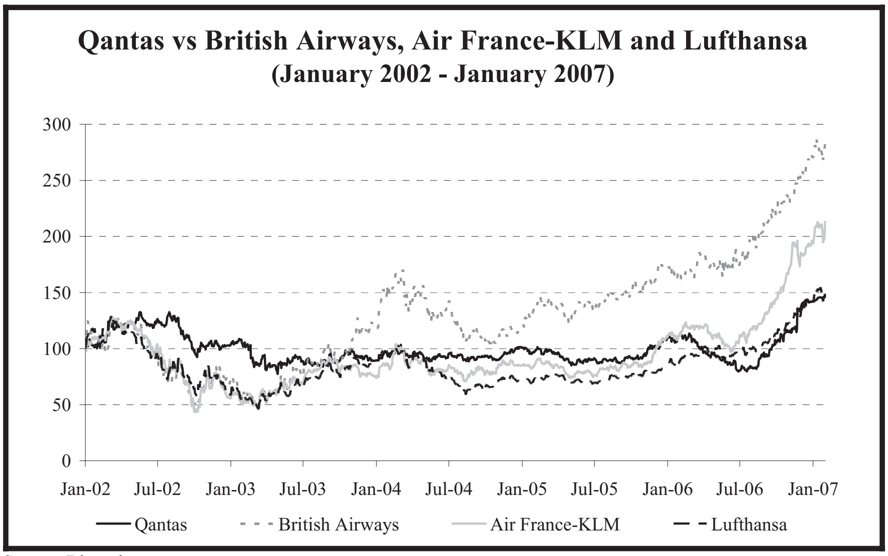


Source: Bloomberg

[17] Share prices converted to a common base as at 1 January 2002 from unadjusted share prices in local currency.

Cathay Pacific Airlines Limited ("Cathay Pacific") had underperformed its peers since reporting a loss in 1998. Its relative outperformance in mid to late 2003 reflected a stronger than expected recovery following the SARS crisis.

Qantas' performance relative to its European peers over the last five years is shown below:

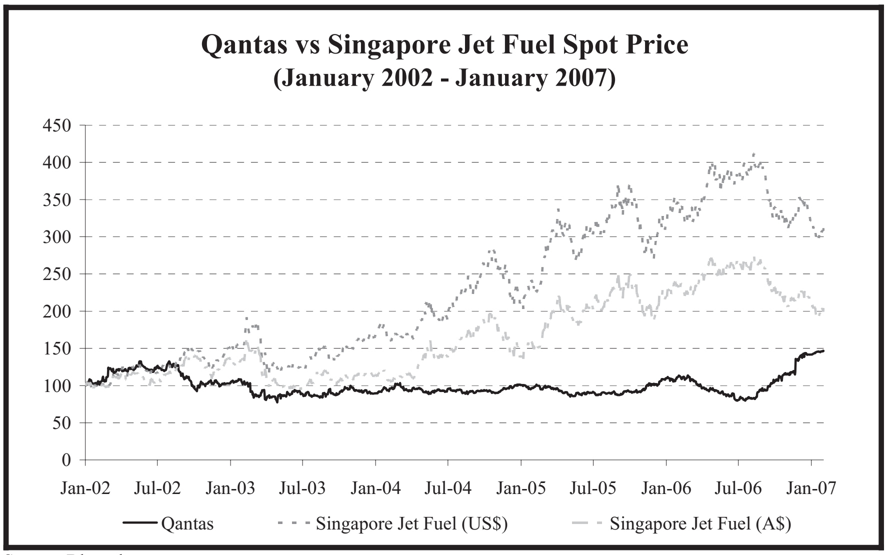


Source: Bloomberg

In relation to the major European carriers:

- British Airways suffered from very poor performance over the period from 1998 to 2001. Its outperformance relative to other European carriers over recent years reflects the turnaround in its performance over this period; and
- Societe Air France ("Air France") merged with KLM Royal Dutch Airlines NV ("KLM") in May 2004. Cost savings from this merger have significantly contributed to recent share price increases.

As fuel represents approximately 30% of aircraft operating costs, airline stocks are sometimes regarded as hedges against fuel prices. The Qantas share price performance compared to movements in the Singapore Jet Fuel Spot Price since January 2002 is shown below:



Source: Bloomberg

However, the relationship between fuel prices and share price is not straightforward. During the recent period of high and increasing fuel prices (2004 to mid 2006), the Qantas share price performance has been relatively stable, reflecting the ameliorating impact of Qantas' fuel hedging programs and the introduction of fuel surcharges as well as the many other factors that affect operating performance and the share price (i.e. it is far from a perfect hedge). As fuel prices fell in late 2006 (and prior to the announcement of the APA Offer), the Qantas share price did increase as expected.

4 Airline Industry Overview

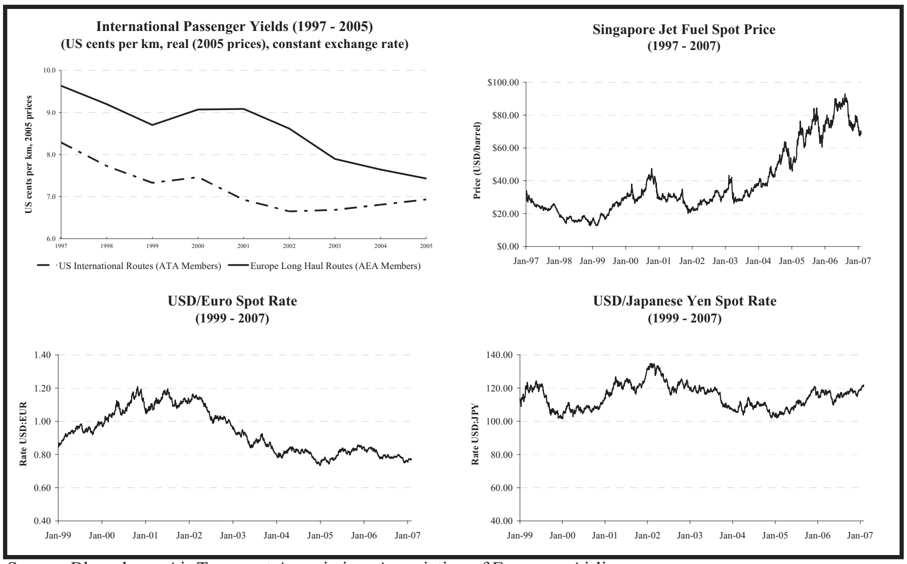
4.1 General Characteristics

The airline industry generally exhibits a number of distinct characteristics:

- it is a complex business to manage in relation to both day to day operations (flight scheduling and logistics, staff planning, passenger movement handling, safety and securities issues etc.) and long term capital planning (e.g. fleet planning and financing);

- the business has a high degree of operating leverage as most operating costs are fixed at least in the short to medium term (while the fuel price varies consumption is relatively fixed). This exacerbates the effects of changes in key revenue drivers such as passenger volumes and yields. Similarly, changes in the price of major cost items such as fuel can also have a substantial impact on earnings;

- key variables have shown significant volatility:



Source: Bloomberg, Air Transport Association, Association of European Airlines

All international operators generate revenue in multiple currencies and are heavily exposed to fluctuations in foreign exchange rates.

- it is subject to substantial levels of government regulation and policy (particularly in relation to international traffic rights and ownership restrictions). Decisions are not always based on economic or rational criteria;

- it is highly capital intensive with a constant demand for fleet replacement, upgrading and capacity increases. In addition, the long lead times for ordering aircraft and the importance of fleet based decisions coupled with fluctuations in demand mean periods of excess capacity are not uncommon;

- net cash flows are extremely volatile as a result of both variability in operating cash flows and the lumpy nature of capital expenditure on aircraft. This results in substantial challenges for financing and cash flow management;

- it is labour intensive with large, highly unionised workforces. Changes to work practices have often met with stiff resistance and strikes are not uncommon in some markets;

- competitors include government owned national "flag carriers" for whom airline profitability has been considered less important than the flow on effects for national economic development (e.g. tourism, trade facilitation); and

- perhaps more than any other industry, it is susceptible to external shocks that, when combined with the operating and financial leverage, can have devastating consequences for profitability (or even solvency). In recent years, the airline industry has been impacted by potential pandemics (such as SARS) and global terrorism, both of which affected the propensity to travel, as well as dramatic movements in the fuel price (also, in turn affected by terrorism). While the industry has flexibility to respond, this is difficult to achieve in a timely fashion given the operational complexities and fixed cost base.

As a result of the structural characteristics and the regular occurrence of external shocks, earnings in the airline industry have been extremely volatile despite the relatively consistent long term growth in passenger demand. The industry has seen job losses, corporate failures and significant shareholder wealth destruction over many years. A number of developments and initiatives have taken place in recent years, including:

- deregulation of both the domestic and international industry through the gradual opening up of traffic rights;

- emergence of two clear alternative business models, full services carriers and low cost carriers (see Section 4.2 below);

- stimulation of demand through the low fares offered by low cost carriers;

- consolidation of operators within single economic markets to achieve scope and scale benefits (e.g. Air France/KLM, Lufthansa/Swiss International Air Lines, Cathay Pacific/Air China/Dragonair, US Airways/America West Airlines and Qantas/Impulse Airlines) with more initiated recently;

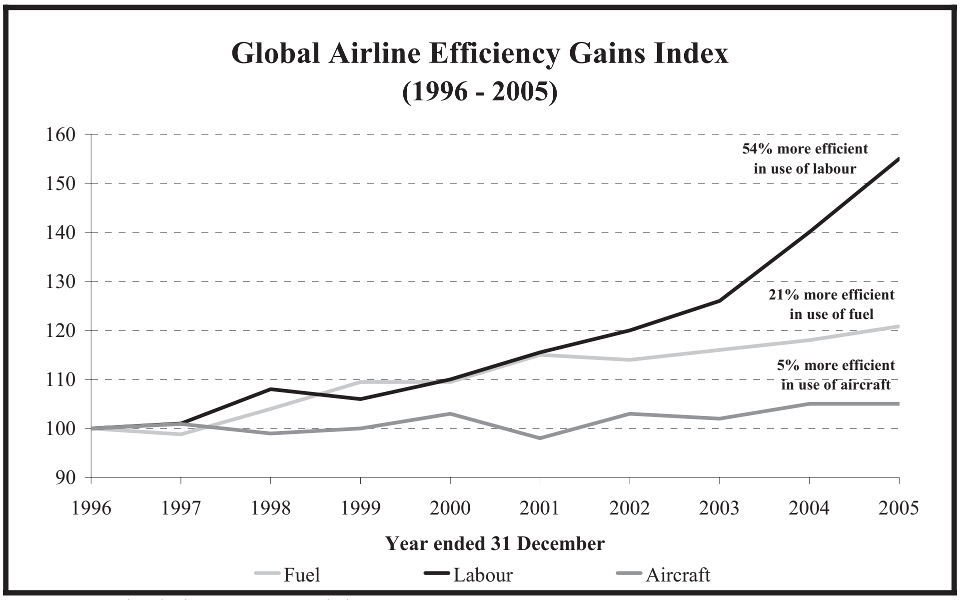
- continued development of more efficient aircraft, particularly in terms of fuel efficiency;

- restructuring and reform, particularly in the United States where four of the five largest carriers have been or are subject to Chapter 11 bankruptcy protection, which has allowed them to restructure their businesses, reducing costs and capacity;

- increased focus on route profitability rather than network profitability and a more aggressive approach to capacity reduction on unprofitable routes; and

- substantial operating cost reductions, particularly through manpower efficiencies and process re-engineering.

The effect has been an acceleration of efficiency improvements within the industry as illustrated in the graph below:



Source: International Air Transport Association

Despite these improvements, sustained and consistent profitability across the industry as a whole and adequate returns on capital have proved elusive, in large part because of continued competitive pressure on fares, rises in fuel costs and external shocks.

However, it is important to note that these travails have not afflicted the industry uniformly. There is considerable regional and sector variation. In very broad terms, the worst performing regions have been:

- the United States, where the domestic market is highly competitive, the effect of terrorism on demand has been the greatest and the labour force has been the most difficult to restructure; and
- Europe, where a number of inefficient government owned and other established carriers have struggled to compete with new low cost carriers in a very fragmented (and generally short haul) market.

In contrast, carriers in the Asia Pacific region have generally performed relatively well with the major participants such as Singapore Airlines Limited ("Singapore Airlines") Cathay Pacific and Qantas enjoying strong underlying demand growth, modern fleets meeting customer service expectations, operational efficiency levels amongst the best in the industry and relatively strong financial positions. In short, the industry in this region is healthier than almost any other. The superior performance of full service carriers in the Asia Pacific region may in part be attributed to:

- a greater degree of government regulation of traffic rights than exists in Europe or the United States; and
- a lower intensity of competition from low cost carriers.

Most of the new low cost carriers have demonstrated strong profitability and reasonable returns on capital. This is largely attributable to:

- high load factors[18] driven by the lower fare structures (in some cases extremely low); and
- much lower cost structures as they start without any of the legacy issues facing established carriers.

18 Load factor is a means of measuring aircraft utilisation. It is calculated as RPKs divided by ASKs.

4.2 Business Models

Two primary business models have developed in the global airline industry in response to the trading environment:

- **full service carriers** – are also called legacy carriers and in many countries are the incumbent dominant airline service. They generally provide a high level of passenger service with a number of in-cabin service classes and a range of complimentary services. Their market positions are often attributable to their history as government owned enterprises which operated in highly regulated airline markets. As deregulation in global airline markets has occurred, many full service carriers have either been fully or partially privatised; and

- **low cost carriers** – although there is no strict definition of a low cost carrier, the core concept is that by maintaining a lower cost base (by limiting the scope of service provided, e.g. single class of travel) an airline will be able to offer lower airfares and this will stimulate greater demand for air travel. Carriers have adjusted the low cost business model to cater for the dynamics of the region and/or markets in which they operate and therefore a wide range of variations of the business model have emerged.

The typical features of each business model are summarised below:

Typical Features of Airline Business Models

Full Service Carrier	Low Cost Carrier
Range of in-flight service classes	Single in-flight service class
Wide range of complimentary and other services (including meals, entertainment, frequent flyer programs)	Do not provide additional services, or provide on a user pays basis
Higher fares reflecting service level and higher proportion of full fare business travellers	Comparatively lower fares
Fleet comprised of a range of aircraft types to support variety of markets and sector lengths	Utilise a single aircraft type which reduces maintenance costs and increases turnaround times
Operate a system incorporating one or more hub and spoke networks	Usually operate a point to point network structure High level of aircraft utilisation (i.e. less time spent on the ground) with higher load factors
Focus on network profitability	Focus on route profitability
Operate from leading airports in major cities	Operate from airports in cities with a lower cost of living or from secondary airports resulting in reduced terminal costs and congestion
Work force often characterised by restrictive work practices	Less restrictive work practices
Wide range of distribution channels including via international alliances with other full service carriers	High proportion of internet bookings
Passenger revenues supplemented by air freight services	Seek to maximise revenue from ancillary sources (e.g. from in-flight sales and advertising)
Strong brand development	Strong brand development with a strong corporate culture reflected in all aspects of the business

Source: Broker and industry reports

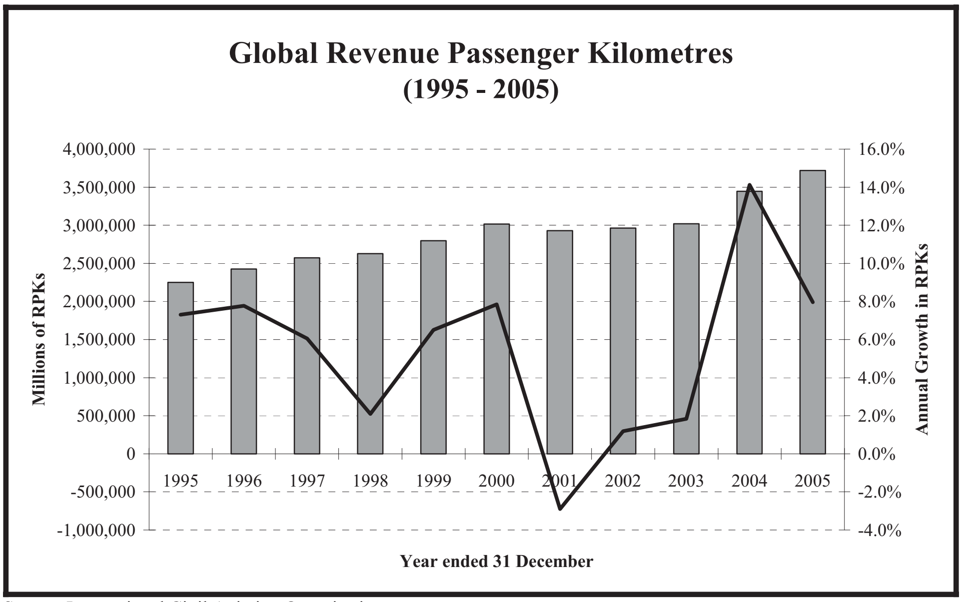
The spectrum of low cost carrier business models that have emerged range from:

- **deep discount airlines -** the goal of which is to be the lowest cost airline in the industry providing no other services to passengers (but which may derive revenue from ancillary services such as commissions on car hire and accommodation); to

- **value-based airlines -** which focus on maximising yields by utilising dynamic fares while keeping operating costs below the cost level of full service carriers.

4.3 Outlook

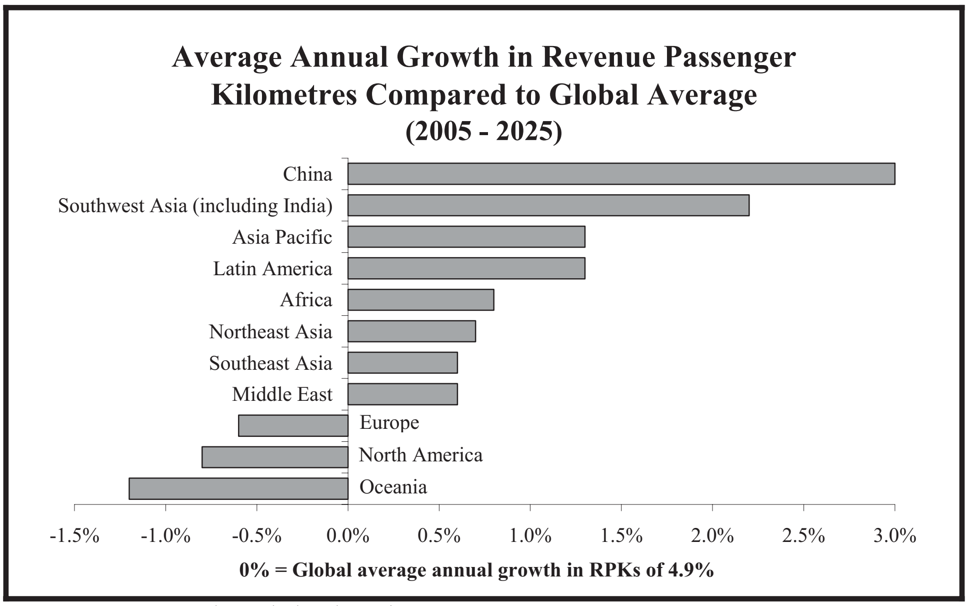
The size of the global passenger airline industry is estimated by the International Air Transport Association ("IATA") at approximately US$325 billion in annual revenue terms. Over the long term the industry has enjoyed consistently high levels of growth in demand (as measured by RPKs) above the levels of general economic or population growth. A number of market shocks in recent years (e.g. the terrorist attacks in the United States in September 2001, the SARS crisis and the war in Iraq in March 2003) resulted in the global airline industry recording negative or low growth in RPKs throughout 2001, 2002 and 2003. However, a generally strong global economy, rapid development of new and emerging markets, increased penetration of low cost carriers and growing deregulation has led to a return to reasonably high growth in RPKs in 2004 and 2005:



Source: International Civil Aviation Organisation

During 2006, ongoing security concerns and more stringent security measures are expected to have impacted RPK growth. However, analysts are forecasting growth in RPKs of approximately 5% per annum in the period to 2025 primarily as a consequence of the growing world economy, world trade and airline competition in deregulated markets.

The positive outlook for growth in RPKs is underpinned by the relatively benign conditions exhibited throughout much of the developed world – low inflation (despite some upward pressure), low interest rates and low unemployment (albeit not uniformly so). Again, however, there are significant regional variations with the strongest growth expected to be in Asia (particularly from the emerging markets of China and India):



Source: "2006 Current Market Outlook", The Boeing Company

Average annual growth for China in the period from 2005 to 2025 is forecast by the Boeing Company at 7.9% and for India at 7.1%. Forecasts by Airbus are not dissimilar, with average annual growth globally forecast at 4.8%, 7.2% in China and 7.7% in India. The main drivers of this growth, in addition to the strong economic outlook in these countries, are:

- the rise in middle class consumers as a result of urbanisation (particularly in China where the middle class is still relatively small compared to a large middle class in India) with greater disposable income (influenced by a relaxation of the attitude to household saving);

- an increase in both inbound and outbound tourism. By 2020, China is forecast to be the world's most popular tourist destination, with 180 million tourists each year and one of the fastest growing outbound travel markets, with more than 100 million outbound travellers each year (with Australia and Europe the destinations of choice). The global coverage received by sporting events such as the 2008 Olympic Games in Beijing can also be expected to provide long term benefits to tourism and growth in air traffic in China; and

- deregulation of the airline industry, particularly in India, where there has always been strong demand for transport given the size of the country and the limited road infrastructure. Rail has previously been the main means of transport. The launch of a number of new airlines and reduced fares has resulted in very high traffic growth. Air traffic has grown at 20% per year in the period from 2003 to 2005 in both the tourism and business markets. Domestic air traffic growth is forecast to remain strong for the next 10 years after which it is forecast to grow at a rate more in line with Indian economic performance.

As to whether or not global demand growth will be accompanied by stronger profitability and adequate returns on capital is open to considerable debate. There are some positive factors:

- the delays in delivery of the A380 aircraft has resulted in a tightening of capacity on major international routes which will assist in increasing load factors and yields for airlines servicing these routes for the next 2-3 years;

- profitability will be assisted by the recent easing of the fuel price. The Singapore Jet Fuel price was generally in the range US$85-90 per barrel during most of 2006 (May to September) but has now fallen to around US$75-80 per barrel;

- the general trend to relax some of the excess regulation affecting the industry is likely to continue and could accelerate (although this varies from region to region);
- government involvement in ownership and operation of airlines is likely to continue to diminish further over time although government ownership remains a feature of some regions (e.g. the Middle East);
- industry consolidation is almost certain to continue within economic markets. Consolidation should bring increased rationality and stability in pricing as well as generating substantial operating efficiencies. Consolidation across borders is also conceivable (and would offer substantial benefits to the airlines involved) but will take substantial changes in government policies across the globe;
- cost reduction will remain a major focus for established airlines. Most still have substantial scope for improvements in operational efficiency; and
- new generation aircraft will bring operating efficiencies.

On the other hand:

- economic cycles are likely to continue to recur. While current conditions remain relatively buoyant, the global economy has generally been in a long upward cycle over the last 15 years (albeit with a few minor hiccups along the way). This is unprecedented in recent economic history and a downturn at some point is almost inevitable (and more likely the longer the upturn continues). A major contributor has been China, fueling both demand for commodities and lowering global inflation through low cost production of goods exported to developed economies. At some stage the ability to lower costs will diminish with adverse consequences for inflation and interest rates as underlying inflation in domestic goods and services remain relatively high in many countries;
- the growth in demand and the need to replace existing fleets will require a massive capital investment by airlines. At 31 December 2005, air carriers globally had ordered 2,140 jet aircraft, representing a financial commitment of approximately US$160 billion[19];
- the benefits from the A380 aircraft delay are temporary and when they do start to come on stream in meaningful numbers there will be significant increases in capacity;
- fuel prices will remain volatile with arguably more risk of increases rather than decreases;
- deregulation such as “open skies” may lead to substantial capacity increases and new entrants on key routes and drive down yields for existing operators;
- irrespective of open skies, new airlines continue to emerge, particularly out of Asia (including South East Asia) and the Middle East. Inevitably these airlines seek to gain market share through aggressive pricing and are in some cases supported by their respective governments through financial or regulatory means. In any event, a number of existing airlines from those regions are planning substantial capacity increases ahead of demand growth;
- changes in government policies allowing cross border consolidation are likely to take a considerable period of time. For example, the United States Government recently reversed initiatives to allow greater than 49% ownership of United States airlines. The change to a Democrat controlled legislature arguably makes liberalisation even less likely;
- competition means that more efficient aircraft tend to drive down yields rather than create better margins for operators;

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19 Source: “Annual Review of Civil Aviation”, International Civil Aviation Organisation Journal, September/October 2006.

- there is the potential for governments to introduce carbon emission regulation in response to climate change, which may increase the cost base of airlines; and

- if anything, the potential for inherently unpredictable external shocks is probably greater looking forward than it has been historically. For example, the growing accessability of air travel globally has increased the potential severity of infectious disease pandemics spread by air travellers.

4.4 Australian Airline Industry

While the underlying trend in the Australian airline industry has been for increased use of air transport both within and to and from Australia, factors such as industry regulation, introduction of low cost carriers, competition and pricing, changing cost structures and shifting consumer preferences have resulted in a continuously changing industry environment.

The Australian airline industry has grown considerably in this environment, with passenger numbers increasing from 49 million in 2000 to 62 million in 2005 (a compound annual growth rate of 4.7%). The Australian airline industry is made up of the domestic (including regional) airline market, the international airline market and the general aviation market.

The domestic airline market accounts for a greater proportion of the overall Australian airline market in terms of passenger movements than the international airline market. In the year ended 31 December 2005, approximately 66% of all passenger movements in the Australian airline market were in the domestic segment[20]. While both segments have grown over the past few years, the international airline market has grown more rapidly, with average compound growth of 5.1% per annum since 2000 compared to 4.5% per annum for the domestic airline market.

In recent years, the Australian airline market has been affected by a number of key structural changes and events:

- **deregulation** – prior to 1990 the domestic airline market operated as a legislatively protected duopoly of Australian Airlines (acquired by Qantas in 1992) and Ansett. In 1990, the domestic airline market was deregulated and, as a consequence, new operators entered including Compass Airlines and Southern Cross Airlines (Compass II) which both operated for brief periods in the early 1990's before ceasing operations due to financial difficulty. Impulse Airlines commenced operations as a budget airline in June 2000 and serviced high capacity domestic routes for 12 months before entering into a commercial relationship with Qantas in May 2001, and being acquired by Qantas in November 2001. Virgin Blue commenced operations in August 2000. OzJet Airlines Pty Ltd ("OzJet") commenced operations as a business class airline in November 2005 but ceased operations in March 2006 and now operates as a private charter company;

- **collapse of Ansett** – following Ansett's collapse in September 2001[21], Qantas became Australia's only full service domestic and international carrier. Ansett's collapse resulted in the domestic airline sector returning to a duopoly market (albeit unprotected) between Qantas and Virgin Blue;

- **emergence of domestic low cost carriers** – historically Australian domestic air routes were operated predominantly by full service carriers and a number of budget airlines (most of which had a limited operating life). In 2000, Virgin Blue introduced a low cost, user-pays carrier model to the Australian domestic market, which stimulated new consumer markets, increased capacity and promoted new levels of price competition. Qantas established Jetstar in 2004 as a second low cost carrier to compete with Virgin Blue; and

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20 Source: Airline, Issue No. 8, June 2006, Department of Transport and Regional Services.

21 Ansett did continue to operate a limited number of routes until March 2002.

- **international and regional crises** – in recent years the Australian domestic and international airline markets have been impacted by a series of external shocks, including both global events such as the terrorist attacks in the United States in September 2001 as well as regional events such as the Bali bombings in October 2002, the SARS crisis and the war in Iraq in early 2003 and the Asian tsunami disaster in December 2004. These events have dampened demand for overseas air travel and have had flow-on effects in Australia's domestic travel sector. The impact of these crises has tended to be short lived (6-12 months) but has been disruptive to industry growth.

Australia is an "end of line" destination as opposed to a "regional hub". A hub enables an airline to capture traffic to other destinations from a wide variety of third countries, including traffic from surrounding cities within a region and well as long haul pass through traffic. The major hubs in the Asia Pacific region are Bangkok, Singapore and Hong Kong. Significant investment has also been made in the development of alternative competing hubs in the Middle East (such as Emirates' use of Dubai). Australian carriers are largely limited to carrying traffic in and out of Australia.

5 Qantas Business Operations

5.1 Domestic Airline Operations

5.1.1 Market Overview

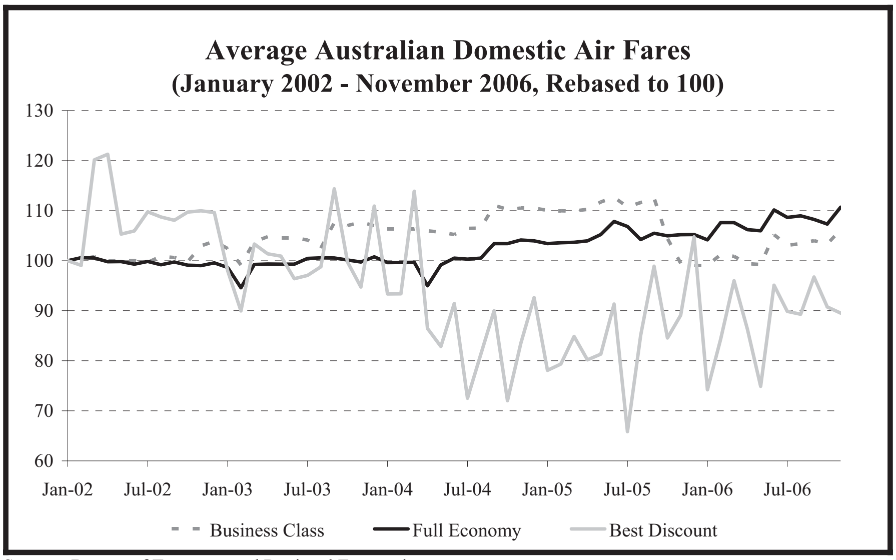
The Australian domestic airline industry comprises:

- the domestic airline market which provides scheduled services between Australia's larger cities and tourist centres;
- the regional airline market which provides scheduled services between Australia's rural centres and its principal cities; and
- the general aviation market which provides non-scheduled services throughout Australia.

The most popular and highly contested domestic routes are those flown between Australia's three east coast key cities of Sydney, Melbourne and Brisbane. The routes between these destinations accounted for approximately 30% of all domestic passengers carried during the year ended 30 June 2006. The main east-west routes of Sydney-Perth and Melbourne-Perth also account for a significant share of air traffic and airline income. According to the Department of Transport and Regional Services, the domestic airline industry is operating at record levels, with passenger numbers for each month of the financial year ending 30 June 2006 higher than numbers recorded in the corresponding month of any prior year.

Business travellers comprise a significant component of the domestic airline market. The business travel market is attracted to carrier features such as on-time performance, frequency of flights and ancillary services and conveniences (i.e. club lounges, auto-ticketing and frequent flyer reward programs), is less volatile and generates higher yields (i.e. higher average fares) than the leisure travel market. The business travel market has become more price sensitive with the entry of lower fare carriers and an increasing number of corporate and government enterprises are fully or partially adopting "best fare of the day" travel policies.

The leisure travel market has shown greater price sensitivity, particularly in recent years as fares have become more commoditised with the emergence of low cost carriers and internet booking services:

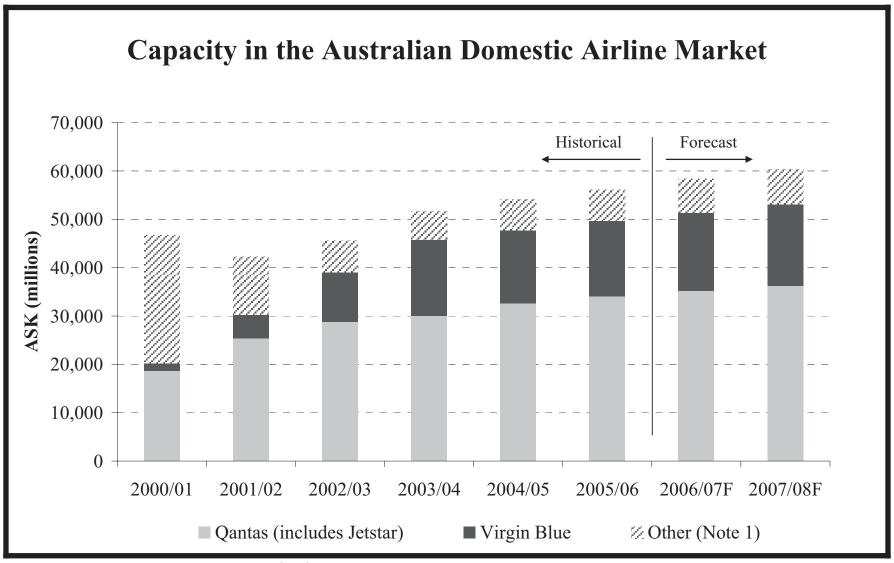


Source: Bureau of Transport and Regional Economics

Following deregulation of the domestic airline market in 1990, there are relatively few regulatory barriers to operating an airline in the scheduled domestic passenger services market. Apart from licensing requirements which are regulated under the Australian Civil Aviation Act 1988, there are no regulatory constraints placed upon domestic carriers as to setting airfares, determining routes, frequency of flights or levels of capacity by the Australian Government. Airlines other than Qantas are not subject to specific ownership restrictions.

The Australian domestic airline market is currently serviced by three major carriers (two of which are owned by Qantas) each targeting different market segments, Qantas full service domestic, Jetstar domestic and Virgin Blue. Virgin Blue is a low cost, value-based, single class domestic carrier. It services all major city routes other than Sydney-Canberra, Sydney-Darwin and Darwin-Perth, and targets the corporate, leisure and tourist markets. Virgin Blue's overall share of the domestic airline market is approximately 30%.

Significant amounts of capacity have been added to the Australian domestic airline market in recent years. Impulse Airlines introduced eight new B717 aircraft to the market from June 2000 to May 2001. On its acquisition by Qantas, these aircraft were included in the Qantas fleet and formed the basis for the launch of Jetstar in May 2004. Qantas has since acquired 24 A320 aircraft (including one aircraft wet leased[22] from Jetstar Asia) for use by Jetstar. Since its launch in August 2000 Virgin Blue has introduced 53 new B737 aircraft, of which four operate under the *Pacific Blue* brand. The following chart shows capacity, measured by Available Seat Kilometres ("ASKs")[23] by Qantas full service domestic, Jetstar domestic and Virgin Blue since 1 July 2000:



Source: Company announcements, brokers' reports
Note 1: Other includes Ansett and Impulse Airlines prior to June 2002 and domestic legs of international flights

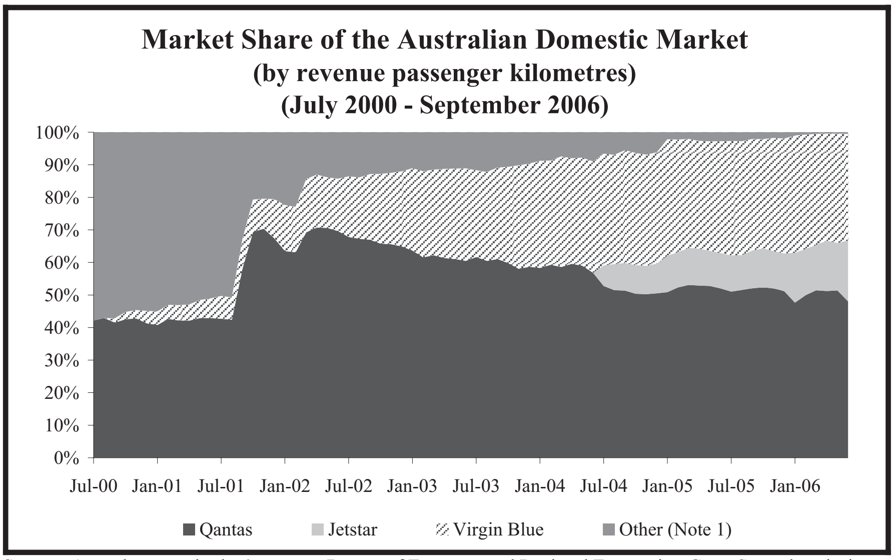
The collapse of Ansett resulted in a reduction in capacity in 2002. Although Qantas and Virgin Blue added capacity in subsequent years, it was not until 2004 that capacity exceeded the levels in existence prior to the 11 September 2001 terrorist attacks. Industry analysts are forecasting industry capacity growth of 3-4% per annum for the years ending 30 June 2007 and 2008.

Qantas' share of the domestic market increased significantly following Ansett's collapse in September 2001 (Qantas was better positioned at the time to absorb Ansett's market share

22 A wet lease refers to the lease of an aircraft where crew, maintenance ad insurance are provided by the lessor.

23 Available Seat Kilometres is the number of seats per aircraft multiplied by the number of kilometres flown.

than any other industry participant) and its acquisition of Impulse Airlines. Qantas' market share declined between 2002 and 2004 as Virgin Blue increased its aircraft fleet. The successful development and launch of Jetstar stabilised Qantas' overall share of the domestic airline market, which has subsequently increased to around 67%:



Source: Annual reports, broker's reports, Bureau of Transport and Regional Economics, Grant Samuel analysis
Note 1: Other includes Ansett and Impulse Airlines prior to June 2002 and domestic legs of international flights

5.1.2 Qantas Full Service Domestic

Overview

Qantas full service domestic comprises main line domestic flights provided by Qantas and regional air services provided by QantasLink (through Airlink, Eastern Australia Airlines and Sunstate Airlines). Qantas full service domestic is a full service carrier providing two class passenger seating on major city and metropolitan domestic routes. Qantas full service domestic accounts for approximately 52% of all domestic passenger movements within Australia.

Recent network and service development initiatives include:

- development of a centralised Integrated Operations Centre in Sydney to provide enhanced network monitoring and management;
- the introduction of additional and/or larger aircraft and more frequent flights on many domestic routes, particularly during peak travel periods; and
- additional investment in initiatives and technologies to increase passenger self service and online options. Qantas full service domestic now has 80 QuickCheck kiosks installed in major domestic airports with additional locations to be introduced in 2007. Improvement and promotion of the qantas.com website has resulted in 42% of all domestic tickets now being booked online and from October 2006, domestic passengers have been able to check in for same day return flights over the internet.

Routes

Qantas full service domestic's main line operations provide approximately 2,300 flights per week to 18 major city destinations and QantasLink provides approximately 1,900 flights per week to 49 metropolitan and regional destinations across Australia.

The destinations covered by Qantas full service domestic as at 31 January 2007 are set out in the table below:

Qantas Full Service Domestic – Destinations Covered			
• Adelaide	• Charleville	• Karratha	• Perth
• Albury	• Coffs Harbour	• Launceston	• Port Hedland
• Alice Springs	• Darwin	• Longreach	• Port Macquarie
• Armidale	• Devonport	• Lord Howe Island	• Rockhampton
• Ayers Rock/Uluru	• Dubbo	• Mackay	• Roma
• Biloela	• Emerald	• Melbourne	• Sydney
• Barcaldine	• Gladstone	• Mildura	• Tamworth
• Blackall	• Gold Coast	• Moree	• Townsville
• Blackwater	• Gove	• Mt Hotham	• Wagga Wagga
• Brisbane	• Hamilton Island	• Mt Isa	• Weipa
• Broome	• Hervey Bay	• Narrabri	• Wollongong
• Bundaberg	• Hobart	• Newcastle	
• Cairns	• Horn Island	• Newman	
• Canberra	• Kalgoorlie	• Paraburdoo	

Source: Qantas

QantasLink flights also link up with services provided by six affiliate regional airlines serving an additional 34 regional and rural destinations.

Operating Statistics

Key operating statistics for the Qantas full service domestic business are summarised below:

Qantas Full Service Domestic – Operating Statistics[24]

	Year ended 30 June					Six months ended 31 December 2006 actual
	2002 actual	2003 actual	2004 actual	2005 actual	2006 actual	
Passengers carried (thousands)	18,704	20,178	20,696	19,203	19,088	10,293
ASKs (millions)	28,707	31,923	32,400	30,674	31,395	16,862
RPKs (millions)	22,525	24,790	25,642	24,351	24,541	13,423
Load factor	78.5%	77.7%	79.1%	79.4%	78.2%	79.6%

Source: Qantas annual reports and half year announcement

Qantas full service domestic showed steady growth in passengers carried, ASKs and RPKs over the three years ended 30 June 2004. Passengers carried in subsequent years reflect the impact of the launch of Jetstar domestic in May 2004 and its full year impact on Qantas full service domestic in the years ended 30 June 2005 and 2006. In the six months ended 31 December 2006, capacity grew as a result of the replacement of A330-200 aircraft (which were transferred to Jetstar domestic) and the full period effect of B737-800 aircraft added during the year ended 30 June 2006. Passengers carried has grown in line with capacity increases, resulting in the load factor remaining in the range 78-79%.

5.1.3 Jetstar Domestic

Overview

Jetstar domestic is a low cost airline offering a single service class. It does not offer complimentary inflight catering or entertainment although food, beverages and video entertainment are available on a user pays basis. Jetstar domestic did not initially offer pre allocated seats but this policy was changed in October 2006. Over 80% of Jetstar domestic's tickets are booked online. Ground handling services for Jetstar domestic flights are tailored to meet fast aircraft turnaround and high aircraft utilisation. Jetstar domestic accounts for approximately 14% of all domestic passenger movements within Australia.

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[24] Qantas Domestic and Jetstar statistics in 2004 and 2005 include the effect of a codeshare arrangement between the two airlines.

Jetstar domestic is operated and marketed largely independently of Qantas full service domestic with a separate staff infrastructure, although routes are co-ordinated with Qantas full service domestic and passengers can earn Qantas Frequent Flyer points on some Jetstar domestic (as well as on some Jetstar international) flights. Jetstar allows the redemption of Qantas Frequent Flyer points on its services.

Jetstar domestic has the potential for expansion and is likely to absorb routes from Qantas full service domestic where Qantas finds it difficult to generate an adequate return.

Routes

Jetstar domestic operates approximately 1,000 flights per week between 20 metropolitan and popular tourist destinations primarily along Australia's east coast. The destinations covered by Jetstar domestic as at 31 January 2007 are set out in the table below:

Jetstar Domestic – Destinations Covered	
• Adelaide	• Mackay
• Ballina – Byron Bay	• Melbourne (Avalon)
• Brisbane	• Melbourne (Tullamarine)
• Cairns	• Newcastle
• Darwin	• Perth
• Fraser Coast (Hervey Bay)	• Rockhampton
• Gold Coast	• Sydney
• Hamilton Island	• Sunshine Coast
• Hobart	• Townsville
• Launceston	• Whitsunday Coast (Prosperpine)

Source: Qantas

Operating Statistics

Key operating statistics for Jetstar domestic are summarised below:

Jetstar Domestic – Operating Statistics[25,26]

	Year ended 30 June			Six months ended 31 December
	2004 actual[28]	2005 actual	2006 actual	2006 actual[27]
Passengers carried (thousands)	315	4,384	5,799	3,781
ASKs (millions)	383	6,004	8,663	6,023
RPKs (millions)	277	4,346	6,410	4,741
Load factor	72.3%	72.4%	74.0%	78.7%

Source: Qantas annual reports and half year announcement

Passengers carried, ASKs and RPKs have increased considerably since Jetstar domestic was launched in May 2004. Increases in capacity (ASKs grew by 44% in the year ended 30 June 2006) have been well matched to increases in demand (as well as reflecting expansion of the network and the transition to an all A320 fleet). In the year ended 30 June 2006 and the six months ended 31 December 2006, growth in demand exceeded growth in capacity, reflected in the increase in the load factor from 72% to 79% over this period.

25 Qantas Domestic and Jetstar statistics in 2004 and 2005 include the effect of a codeshare arrangement between the two airlines.

26 The Jetstar domestic operating statistics includes Trans Tasman flights operated by Jetstar.

27 The Jetstar domestic operating statistics include one month of Jetstar international operations.

28 As Jetstar domestic commenced operations in May 2004, the performance statistics for the year ended 30 June 2004 represent only five weeks of operations.

5.2 International Airline Operations

5.2.1 Market Overview

The Australian international airline market provides scheduled services between Australian and overseas destinations and comprises two segments, Australian based international airlines and overseas based airlines flying to Australia, which compete directly against each other. Accordingly, in contrast to the domestic market, the Australian international airline market has historically had a much greater number of participants.

Historically, Qantas has been the only Australian airline with a truly global network because of the relatively high costs and regulatory hurdles associated with operating international routes from Australia. There are currently three major international airlines operating from Australia, two of which are owned by Qantas – Qantas international, Jetstar international and Pacific Blue. Pacific Blue is Virgin Blue's low cost international carrier servicing New Zealand, Fiji, Vanuatu, the Cook Islands, Samoa and Tonga. Pacific Blue commenced operating in January 2004 and while it has gained market share, it services a relatively small part of the international market.

The regulatory barriers to entry for Australian international airlines involve complex technical and operational licensing requirements. In addition, legislation stipulates that, inter alia, at least 51% of the airline must be owned by Australians. Australian international airlines' commercial and operational opportunities are governed by Australia's bilateral air services agreements with foreign countries. Some of Australia's bilateral air services agreements are restrictive in terms of capacity entitlements and route and traffic rights, as deregulation has not occurred evenly. The bilateral framework is complex, particularly where airline operations involving third countries are concerned. The terms of bilateral air services agreements, in conjunction with domestic policy and legislation, also govern the opportunities for cabotage rights (i.e. the ability of airlines to carry traffic between points in foreign jurisdictions e.g. with own stopover rights, consecutive cabotage or stand alone cabotage). Cabotage opportunities are only available to Australian carriers under Australia's air services arrangements with New Zealand. In contrast, Australia permits wholly foreign owned entities to operate Australian domestic airlines. Australia currently has 63 bilateral agreements/arrangements in force.

Similarly, overseas airlines flying to Australia are governed by bilateral arrangements between Australia and the airline's country of origin as well as third countries where operations other than point-to-point services are conducted.

The number of foreign airlines servicing Australian destinations has increased substantially over the past 20 years and now numbers 47 carriers (including the three Australian international carriers but excluding carriers serving Australia exclusively through codeshare arrangements).

Qantas, excluding Jetstar international, has the largest market share of the Australian international airline market at approximately 30% based on flights departing Australia. The top ten carriers account for approximately 76% of passengers and the top three carriers account for approximately 48% of passengers departing Australia. Qantas, Singapore Airlines and Air New Zealand have held the top three positions for over 10 years. Singapore Airlines is a key competitor on Asian and European routes while Air New Zealand primarily competes on Trans Tasman services (and on the New Zealand/United States route). Qantas' other major competitors include Cathay Pacific (Asia and Europe), Japan Airlines Corporation ("JAL") (Asia), Emirates (Middle East, Europe and Trans Tasman) and UAL Corporation ("United Airlines") (Pacific route). Of these, Emirates has pursued the most aggressive strategy for market share growth in recent years. New Zealand, Japan, the United States, the United Kingdom and China are the top five international destinations to and from Australia.

In February 2006, the Australian Government completed a review of international aviation policy. While the government acknowledges that the desire to maintain and grow Australian based airlines is of significant economic and strategic importance to Australia, it maintains the view that liberalisation of international air service agreements should be progressed on a case by case basis, ensuring that the national interest is upheld. Some of the key points of the review were:

- Australia remains disadvantaged by restricted access to many key markets, particularly in Europe and Japan;
- access to the Pacific route will be negotiated on a case by case basis;
- Singapore Airlines' request for access to the Pacific route will not be granted in the short term; and
- Qantas' request in relation to relaxation of ownership rules will not be changed. Bilateral air service agreements with many countries require airlines to be substantially owned by Australian interests.

5.2.2 Qantas International

Overview

Qantas international is a full service international airline which offers at least two classes of travel on its routes as well as ground and in-flight services, catering and entertainment and targets international business travellers as well as the leisure sector. Qantas uses its extensive domestic network to interconnect with its international routes which increases traffic on both networks. Qantas' global alliance network and codeshare arrangements also provide a source of passengers.

Qantas international is widely regarded as one of the world's leading international airlines. It is consistently rated amongst the top airlines in terms of service and facilities, particularly for its Business Class product.

Qantas international also operates domestic services in New Zealand and Trans Tasman services through its wholly owned subsidiary JetConnect.

Alliances

Qantas is one of the founding members of the **one**world global airline alliance. The **one**world alliance is the world's third largest airline alliance (behind Star Alliance and Skyteam). Its members are AMR Corporation ("American Airlines"), British Airways, Qantas, Iberia Lineus Air De Espana ("Iberia"), Cathay Pacific, LAN, Finnair and Aer Lingus Group Plc ("Aer Lingus") (although Aer Lingus is to withdraw in early 2007). A further 11 airlines are expected to joint the **one**world alliance in 2007 - Japan Airlines plus five of its affiliates, Malév Hungarian, Royal Jordanian, LAN Argentina, LAN Equador and Dragonair. Alliance partners offer codesharing, reciprocal frequent flyer benefits, shared lounges, and co-operation in scheduling, ticketing, flight transfers, spare parts supply and bulk buying where this is commercially feasible and subject to regulatory approval.

Qantas has in place a number of individually negotiated bilateral alliances with other international airlines. The agreements vary in scope and level of cooperation but can include, subject to regulatory approval, codesharing, global freight cooperation, co-ordinated flight scheduling, integrated ticketing, reciprocal frequent flyer benefits, shared lounges and shared operational services (such as sales and retail outlets, ground handling, catering and aircraft maintenance). Commercial alliances are in place with many airlines, including British Airways (since 1995), American Airlines (since 1989) and Air Pacific (since 1997). Efforts to gain regulatory approval for a Trans Tasman alliance and codeshare agreement with Air New Zealand were abandoned in November 2006 following opposition (for the second time) by the ACCC.

Qantas also has in place codeshare agreements with a further 26 international airlines, including British Airways, American Airlines and Air Pacific. Codeshare agreements have been entered into recently with Mexicana de Aviación (effective from July 2006), Jet Airways and Air China (effective from September 2006) and Horizon Air (effective from February 2007).

Routes

Qantas international operates more than 800 flights per week to 85 destinations (more than 50 of which are provided by other airlines under codeshare arrangements) in 39 countries. The international destinations covered by Qantas as at 31 January 2007 are set out in the table below:

Qantas International – Destinations Covered

New Zealand	**Pacific**	**Europe**	**Americas**
• Auckland	• Manila	• Amsterdam[29]	• Boston[29]
• Christchurch	• Nadi[29]	• Athens[29]	• Calgary[29]
• Queenstown	• Norfolk Island[29]	• Berlin[29]	• Cancun[29]
• Rotorua	• Noumea[29]	• Copenhagen[29]	• Chicago[29]
• Wellington	• Papeete[29]	• Düsseldorf[29]	• Dallas/Fort Worth[29]
	• Port Moresby[29]	• Frankfurt	• Denver[29]
Asia	• Port Vila[29]	• Geneva[29]	• Halifax[29]
• Bangkok	• Suva[29]	• Hamburg[29]	• Guadalajara[29]
• Beijing		• Helsinki[29]	• Honolulu
• Delhi[29]	**Middle East**	• Lyon[29]	• Las Vegas[29]
• Denpasar	• Beirut[29]	• Munich[29]	• Los Angeles
• Ho Chi Minh City[29]	• Dubai[29]	• Nice[29]	• Mexico City[29]
• Hong Kong		• Oslo[29]	• Miami[29]
• Jakarta	**United Kingdom**	• Paris[29]	• Montreal[29]
• Mumbai	• Aberdeen[29]	• Rome[29]	• New York
• Nagoya	• Birmingham[29]	• Stockholm[29]	• Ottawa[29]
• Osaka[29]	• Edinburgh[29]	• Vienna[29]	• Phoenix[29]
• Sapporo	• Glasgow[29]	• Warsaw[29]	• Portland[29]
• Seoul[29]	• London		• San Diego[29]
• Shanghai	• Manchester[29]	**South Africa**	• San Francisco
• Singapore	• Newcastle-on-Tyne[29]	• Johannesburg	• San Jose Del Cabo[29]
• Taipei[29]			• Santiago[29]
• Tokyo			• Seattle[29]
			• St Louis[29]
			• Toronto[29]
			• Vancouver
			• Washington DC[29]

Source: Qantas

Qantas' key routes are:

- the Pacific route (Australia-Los Angeles);
- the Kangaroo route (Australia-London);
- Asia and Japan; and
- Trans Tasman routes.

29 Codeshare flight (operated by another airline).

Operating Statistics

Key operating statistics for Qantas international (including Australian Airlines) are summarised below:

Qantas International – Operating Statistics						
	Year ended 30 June					Six months ended 31 December
	2002 actual	2003 actual	2004 actual	2005 actual	2006 actual	2006 actual
Passengers carried (thousands)	8,424	8,568	9,111	9,401	9,188	4,464
ASKs (millions)	67,237	67,522	71,455	77,834	78,012	38,361
RPKs (millions)	52,609	52,397	55,395	58,632	59,948	30,996
Load factor	78.2%	77.6%	77.5%	75.3%	76.8%	80.8%

Source: Qantas annual reports and half year announcement

Passengers carried, ASKs and RPKs increased significantly in the years ended 30 June 2004 and 2005 following the drop off in international travel as a result of the SARS crisis and the war in Iraq in the year ended 30 June 2003. However, the load factor remained at around 78%, in the year ended 30 June 2004, indicating that Qantas was able to delay capacity increases to coincide with the rebound in demand following the SARS crisis. The capacity increase in the year ended 30 June 2005 reflected the addition of A330-300 aircraft, allowing commencement of new routes to India and China. Load factor declined in the year ended 30 June 2005, reflecting the competitive pressure of market capacity growth in excess of demand. Capacity remained relatively flat during the year ended 30 June 2006 prior to the delivery of the A380 aircraft, resulting in increasing RPKs and load factor, even though the number of passengers carried fell. In the six months ended 31 December 2006, load factor increased to 80.8%, primarily reflecting a reduction in capacity as a result of the redeployment of B747-300 aircraft from international to domestic operations.

5.2.3 Jetstar International

Overview

Jetstar international is designed to be a value based airline primarily serving the international leisure market. It offers two service classes on most routes, standard and StarClass (which features increased space, complimentary meals and beverages and in flight entertainment).

Jetstar international commenced international flights on 1 December 2005, initially flying to Christchurch, New Zealand from four Australian cities. In late 2006, Jetstar international commenced the progressive introduction of services to destinations in the Asia Pacific region. Jetstar international plans to aggressively grow its network over the next few years. The objective is to develop a route network that is complementary to the Qantas international network.

Jetstar international makes extensive use of online booking technology in order to minimise sales costs, running alongside the Jetstar domestic system and utilising the same website.

Routes

Jetstar international operates flights to Bangkok, Phuket, Ho Chi Minh City, Bali and Honolulu, with services to Osaka and Kuala Lumpur due to commence in 2007, subject to regulatory approval.

Jetstar international offers codeshare services within Asia through its 45% owned associate Orangestar Investment Holdings Pte Limited (“Orangestar”), which operates the *Jetstar*

Asia and *Valuair* airlines, flying to 12 destinations in nine countries in Asia – Cambodia, Hong Kong, India, Indonesia, Myanmar, the Philippines, Taiwan, Thailand and Vietnam.

In November 2006, Jetstar international announced, subject to regulatory approval, that it would replace Qantas international services from Cairns to Nagoya and Osaka from mid to late 2007 as the Jetstar cost structure and product offering was better suited to those routes.

5.3 Fleet

As at 31 December 2006 Qantas' passenger fleet comprised 216 aircraft (including six temporarily grounded B717-200 aircraft).

Qantas has in place firm orders for 20 A380 aircraft, eight A330-200 aircraft (two of which will be leased to Qantas) and 45 B787 aircraft (comprising a mix of B787-8 aircraft and the larger B787-9 aircraft) with options over a further 20 B787 aircraft. The twin decked A380, currently in the final stages of development, is the world's largest passenger aircraft, capable of carrying approximately 500 passengers (in Qantas' configuration), plus crew and cargo. Its high capacity, long range and fuel efficiency make it suited for use on high volume long haul routes (such as the Kangaroo route and the Pacific route) and at major international passenger airports with space constraints. Delivery of the aircraft has been delayed by approximately two years due to production problems at Airbus. The first A380s are now expected to be delivered to Qantas in August 2008. The B787 aircraft feature increased range and cruising speed and improved fuel efficiency compared to its predecessors. The B787s, which are expected to be delivered from 2008 onwards to Jetstar initially, are intended to progressively replace the existing 767-300 aircraft and to meet planned international route growth (particularly to Asia). The A330-200 aircraft are expected to be delivered in 2007 and 2008 to provide capacity to the growing China and India markets.

Other fleet developments include:

- delivery of two additional Bombardier Q400 aircraft at the beginning of 2008; and
- delivery of five additional B737-800 aircraft in 2008.

5.4 Frequent Flyer Program

The Qantas Frequent Flyer program is the largest Australian based airline loyalty program, with 4.6 million members at 30 June 2006. Members accumulate points through:

- flying with Qantas or Jetstar and 21 domestic and international airline partners, including **one**world alliance airlines; and
- qualifying transactions with program partners including more than 4,000 hotels worldwide, retailers, major car rental companies, travel businesses and providers of financial and business services.

Points earned in the credit card loyalty programs of Diners Club, American Express and selected programs of a number of banks may be converted to Qantas Frequent Flyer points. In addition, holders of selected credit cards including the ANZ Frequent Flyer Visa and Westpac Earth cards can earn Frequent Flyer points directly.

Frequent Flyer points can be redeemed for air travel on Qantas and partner airlines, Qantas Club membership, hotel stays, car hire and at the Qantas Frequent Flyer store.

The Frequent Flyer Program generates cash from the sale of points to program partners, credit card companies and banks. The Qantas Frequent Flyer Program is a marginal program, meaning that award flights are subject to capacity controls and availability is limited as opposed to a firm policy, where points are converted into cash which is used to purchase any available seat on a particular flight.

5.5 Other Businesses

5.5.1 Freight

Freight is an integral part of Qantas' business operations. Qantas Freight offers a variety of services including general and express cargo, airmail, freighters, chartered freight services, terminal handling and customs clearance services. Key customers include Australia Post, approximately 32 other postal services worldwide, freight forwarders, international couriers, commercial customers, passengers and individuals. It directly employs approximately 800 people worldwide (excluding employees of joint ventures and associates).

Qantas Freight carries freight internationally through an integrated network of freight channels, comprising:

- the belly space of Qantas international and Jetstar international passenger aircraft;
- three B747-400 wet leased freighters operating 16 regular scheduled services per week from Australia to New York, Chicago, Toledo, Los Angeles, Honolulu, Frankfurt Hahn, Mumbai, Singapore, Hong Kong, Shanghai, Dubai and Bangkok;
- access to the freight networks of **one**world alliance airlines and under agreements with certain other airlines; and
- access to third party trucking networks throughout the United States and Europe.

Qantas Freight sells the belly space on domestic flights to Australian air Express (which on sells it to other freight operators and customers).

Qantas Freight operates specialised freight handling facilities in Sydney, Melbourne, Brisbane, Perth and Los Angeles and utilises third party facilities at other ports.

In the year ended 30 June 2006, Qantas Freight transported airfreight equivalent to approximately 2.6 billion Revenue Freight Tonne Kilometres ("RFTKs")[30] and generated net freight revenue of $888 million:

Qantas Freight – Operating Statistics

	Year ended 30 June					Six months ended 31 December 2006 actual
	2002 actual	2003 actual	2004 actual	2005 actual	2006 actual	
RFTKs (millions)	1,598	1,530	1,601	2,329	2,633	1,415
Net freight revenue[31] ($ millions)	518.8	511.3	520.5	759.9	887.8	493.8

Source: Qantas annual reports and half year announcement

Qantas plans to develop and expand its freight business and continues to invest in freight network infrastructure to increase capacity and improve services. Recent initiatives have included:

- completion of the redevelopment of the Perth freight terminal in 2006;

[30] Revenue Freight Tonne Kilometres (RFTKs) are the total number of paying freight tonnes carried multiplied by the number of kilometres flown.

[31] Net freight revenue excludes revenue earned by freight joint ventures and associates. From 1 July 2003 onwards, net freight revenue includes freight fuel surcharge. In prior years freight fuel surcharge was disclosed as revenue from other sources. In the year ended 30 June 2004, the impact of this change was to increase net freight revenue by $50.8 million from $469.7 million to $520.5 million. The net freight revenue in the years ended 30 June 2002 and 2003 has not been adjusted.

- commencement of redevelopment and expansion projects at the Sydney and Melbourne freight terminals; and
- the formation of a new, wholly owned subsidiary domestic air freight business, Express Freighters Australia, which commenced operations in October 2006 with one aircraft and will grow to four aircraft during 2007. The first four aircraft will be B737-300 aircraft converted from Qantas' passenger fleet.

5.5.2 Airports

Qantas Airports provides a range of services to Qantas' domestic and international flying businesses and to other international airlines including check-in, lounge facilities, baggage handling and aircraft ground handling services at 15 domestic airports. A wholly owned subsidiary, Express Ground Handling Pty Limited, provides ground handling services to Jetstar and other clients.

Qantas operates domestic terminals on an owned or leased basis in Sydney, Melbourne, Brisbane, Perth, Hobart, Launceston and Gold Coast airports. The buildings are on land leased from the relevant airport authority. Revenue is generated from the leasing of retail and advertising space and from commissions on sales at the retail outlets in both owned and leased facilities. As at 30 June 2006, Qantas terminals offered more than 90 retail and food outlets. At other airports across Australia, Qantas shares facilities at multi-user terminals.

Recent developments in airport services include:

- the introduction of QuickCheck electronic check-in kiosks which reduce check in times, particularly for passengers without check in luggage. QuickCheck kiosks have been installed in terminals at Sydney, Melbourne, Brisbane, Perth and Canberra airports;
- the establishment of airport services at Mumbai, Shanghai, Beijing, San Francisco and Vancouver airports over the last two years on the resumption of Qantas services to these airports; and
- the relocation of airport services to the new international terminal in Bangkok in September 2006.

Qantas Airports also has a number of projects planned or underway in response to the service requirements of the airline business and to improve airport services to passengers and other airlines. These include the preparation of airport facilities to accommodate A380 aircraft, due for delivery from August 2008, including the modification of certain Qantas equipment such as service vehicles, and working with the owners and operators of airport facilities (aircraft gates, baggage systems, etc.) that will need to accommodate A380 aircraft.

5.5.3 Engineering

Qantas has an international reputation for engineering workmanship and safety. Qantas Engineering operates one of the largest aircraft engineering and maintenance organisations in the Asia Pacific region, providing heavy and routine aircraft, engine and component maintenance, inspections, upgrades, refits, inventory management and engineering training primarily for Qantas but also for other airlines. A wholly owned subsidiary of Qantas, Qantas Defence Services Pty Limited ("Qantas Defence Services"), provides maintenance and supply services to the Australian Defence Force and the Australian Government.

Qantas Engineering employs more than 6,000 engineers at 10 sites across Australia, including facilities in Sydney, Melbourne, Avalon and Brisbane. Qantas has invested over $300 million in engineering facilities over the last five years, including most recently a new $85 million B767 heavy maintenance facility in Brisbane and a $55 million materials and logistics distribution centre in Sydney. The core activities undertaken at each of its major facilities are summarised below:

Qantas Engineering - Facilities			
Sydney Airport	**Melbourne Airport**	**Avalon Airport[32] (Melbourne)**	**Brisbane Airport**
▪ aircraft component maintenance ▪ avionics engineering ▪ heavy maintenance of Rolls Royce RB211 engines ▪ general routine maintenance ▪ material and logistics centre	▪ heavy and routine maintenance on narrow body B737 aircraft ▪ aircraft component maintenance ▪ heavy maintenance of all General Electric and CFMI engines (carried out by Jet Turbine Services) ▪ general routine maintenance	▪ project engineering work (including internal fitouts) ▪ overhauls and refurbishments ▪ heavy maintenance of B747 aircraft	▪ heavy maintenance of B767 aircraft ▪ general routine maintenance

Source: Qantas

In 2003, Qantas set up Jet Turbine Services, a 50:50 joint venture with Patrick Corporation Limited (which is now owned by Toll Holdings Limited ("Toll Holdings")). Jet Turbine Services operates from facilities at Tullamarine in Melbourne, providing maintenance services for General Electric CF6 and CFM56 jet engines. Qantas acquired Toll Holdings' 50% interest in Jet Turbine Services in December 2006.

In January 2006, Qantas and SR Technics Holding, a European aircraft engineering and maintenance provider, announced their intention to establish a joint venture to provide A380 component management services to third party A380 operators. The venture is expected to be operating by the end of 2007.

Increased competition and cost pressures in the global airline industry over the last five years have resulted in a trend towards the consolidation and/or outsourcing of heavy maintenance functions by major airlines. In March 2006, Qantas announced the closure of its B747 heavy maintenance operations in Sydney as part of a major review of all of its aircraft engineering operations. As part of this review:

- the future of wide body heavy maintenance facilities remaining in Australia will depend on Qantas Engineering achieving globally competitive benchmarks; and
- a review of the narrow body aircraft heavy engineering operations is being undertaken.

Qantas plans to achieve annual cost savings of around $100 million from restructuring all of its engineering operations through consolidation, process improvements and more flexible work rules. Reviews of targets and cost structures will continue to take place throughout 2007 and 2008.

In November 2006, Qantas announced that it would review whether to invest in major in-house engineering and maintenance operations for its fleet of new aircraft (A330, B787 and A380) over the next 12 months. A decision will be made as to whether to provide A330 maintenance in Brisbane by the second half of 2007.

32 Avalon Airport is located south west of Melbourne and serves as a second domestic airport. The airport is used by Jetstar.

5.5.4 Catering

Qantas provides catering services to Qantas Airways and approximately 30 external customers through its wholly owned subsidiaries Qantas Flight Catering Limited ("QFCL"), Caterair Airport Services Pty. Limited ("Caterair") and Snap Fresh Pty Limited ("Snap Fresh") (collectively, "Qantas Catering"). External customers are airlines and non airline clients and include foreign international airlines, air charter, VIP flight and long distance rail operators. Qantas Airways accounts for approximately 70% of Qantas Catering's output. Snap Fresh specialises in the production of frozen meals for Qantas Airways and other customers and is developing markets in non airline segments, including health care. It operates from centralised production facilities in Brisbane with an annual plant capacity of over 14 million meals.

In the year ended 30 June 2006, Qantas Catering produced approximately 42 million meals from its catering facilities in Sydney (two facilities), Melbourne, Brisbane (2 facilities), Cairns, Adelaide and Perth (including approximately 12 million frozen meals prepared by Snap Fresh). It employs approximately 3,800 people, including over 200 chefs.

Following a strategic review (which included restructuring opportunities and a potential sale of the business), Qantas announced in June 2006 that it would retain Qantas Catering and restructure its operations. The restructure will initially focus on the two facilities in Sydney, which provide the greatest volume of catering and service both Qantas Airways and other airlines, and will involve one facility dedicated to providing Qantas Airways catering requirements and the other providing catering services to all external customers. This is expected to streamline processes and result in efficiency improvements.

The restructure will also involve a review of the supply chain, improving product engineering and demand forecasting, reducing inventory lines, leveraging buying power and improving food production technologies at its other catering facilities (excluding the Snap Fresh facility in Brisbane).

5.5.5 Holidays

Qantas Holidays is a major wholesaler of domestic and international holiday packages in Australia. In the year ended 30 June 2006, it sold holiday packages and products to 1.6 million customers worldwide through a network of over 1,000 locations in Australia, Asia and the United Kingdom and representation in a number of other locations worldwide.

Qantas Holidays trades under two brands in Australia, *Qantas Holidays* and *Viva! Holidays*. *Qantas Holidays* packages and sells holiday products using Qantas Airways for both domestic and international destinations. *Viva! Holidays* packages and sells holiday products for other airlines. The product range covers more than 40 destinations.

Recent developments in the Qantas Holidays business include:

- the launch of an online hotel booking product "*ReadyRooms.com.au*" offering last minute and advance bookings at hotels in Australia and New Zealand, including the ability to earn frequent flyer points at participating hotels; and
- in response to market demand, a twofold increase in the product range for China.

The business has been affected by changes in the travel industry including the emergence of low cost carriers and the growth in popularity of internet booking services. Qantas Holidays will continue to invest in technology improvements and update its business model to address these challenges.

Qantas Holidays also owns a 75% interest in Singapore based Holiday Tours and Travel Pte Ltd, which, through a number of subsidiaries, sells wholesale land packages from Asia to Australia and tours and transfers within Asia.

5.6 Associates and Investments

Airlines

Qantas has interests in a number of other airline businesses:

- 45.0% interest in Orangestar, which owns and operates the Singapore based, low cost airlines *Jetstar Asia* and *Valuair*. Jetstar Asia and Valuair operate flights between Singapore and Cambodia, Hong Kong, India, Indonesia, Myanmar, the Philippines, Taiwan, Thailand and Vietnam and are focused on growth opportunities within the Asian region. Jetstar Asia operates a fleet of five A320 aircraft (one of which is wet leased to Jetstar) and Valuair operates two A320 aircraft;

- 46.3% interest in Air Pacific, the principal airline of Fiji. Air Pacific operates regular flights to Australia, New Zealand, Japan, Kiribati, Samoa, Tonga, Hawaii, the United States and Canada; and

- 220.8 million convertible notes in Air New Zealand which are convertible into 44.2 million shares in Air New Zealand, representing 4.2% of its issued capital. These convertible notes carry a coupon payment equivalent to any dividend declared on Air New Zealand ordinary shares but do not have any voting rights.

Freight

Qantas and Australia Post jointly own two freight businesses:

- Australian air Express, which provides domestic airfreight and airmail services throughout Australia and is one of the leading network providers in the Australian freight industry. Australian air Express interacts directly with end customers. To provide its services, it purchases available belly space from Qantas Freight on Qantas full service domestic, QantasLink and Jetstar domestic flights and also leases a fleet of B727, B737 and BAe146 freighter aircraft from Qantas and other parties. The freight systems of Qantas Freight and Australian air Express are co-ordinated to provide transfer of freight between the international and domestic networks. In March 2006, Qantas announced that it would convert four B737-300 aircraft to freighters to be leased to Australian air Express. The conversion work commenced in April 2006 and is expected to be completed during 2007. The first converted aircraft entered into service in October 2006; and

- Star Track Express, a national express road freight operator which specialises in the distribution of packaged, high value and time sensitive freight for the business-to-business sector. Offering a “one stop” end to end service. It has a national distribution network and services international delivery destinations through third parties. Approximately 90% of revenue is derived from express road freight. The air express and warehousing businesses have grown significantly and it is expected that the contribution from these businesses will increase. Star Track Express is a significant participant in the fragmented freight industry. The business is currently operated on a standalone basis.

Other

In addition to the above investments, Qantas holds investments in a number of other jointly controlled and associated businesses in the tours and travel, freight services, reservations systems and passenger handling services industries. In the six months ended 31 December 2006, the combined net profit after tax of Qantas’ interests in these businesses was $1.4 million. At 31 December 2006, the combined book value of Qantas’ interests in these businesses was $12.1 million.

5.7 Divisional Performance

5.7.1 Qantas Airways

The operating performance of Qantas Airways (including the Frequent Flyer Program, Qantas Freight, Airports and Engineering) for the five years ended 30 June 2006 and the six months ended 31 December 2006 is summarised below:

Qantas Airways - Operating Performance ($ millions)						
	Year ended 30 June					Six months ended 31 December
	2002 actual AGAAP	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2006 actual AIFRS
Revenue	10,618.0	10,930.3	10,750.1	11,495.8	12,290.5	6,757.3
EBITDAR	**1,478.6**	**1,718.8**	**2,214.1**	**2,294.3**	**2,241.1**	**1,412.3**
Non-cancellable operating lease payments	(255.7)	(283.9)	(260.8)	(216.1)	(251.5)	(135.2)
EBITDA	**1,222.9**	**1,434.9**	**1,953.3**	**2,078.2**	**1,989.6**	**1,277.1**
Depreciation and amortisation	(669.0)	(866.3)	(974.0)	(1,223.7)	(1,231.2)	(697.7)
EBIT	**553.9**	**568.6**	**979.3**	**854.5**	**758.4**	**579.4**
Share of profit/(loss) of associates	35.4	9.6	19.7	15.7	38.7	13.4
Amortisation of goodwill	(11.7)	(12.7)	(14.4)	-	-	-
Significant and non recurring items	(10.3)	(115.4)	(7.1)	33.0	(148.9)	(102.0)
Reported EBIT	**567.3**	**450.1**	**977.5**	**903.2**	**648.2**	**490.8**
Statistics						
Revenue growth	*nc*	*2.9%*	*-1.6%*	*nc*	*6.9%*	*nc*
EBITDAR growth	*nc*	*16.2%*	*28.8%*	*nc*	*-2.3%*	*nc*
EBIT growth	*nc*	*2.7%*	*72.2%*	*nc*	*-11.2%*	*nc*
EBITDAR margin	*13.9%*	*15.7%*	*20.6%*	*20.0%*	*18.2%*	*20.9%*
EBIT margin	*5.2%*	*5.2%*	*9.1%*	*7.4%*	*6.2%*	*8.6%*

Source: Qantas annual reports, results media releases, preliminary final reports and half year announcement, Grant Samuel analysis

Qantas Airways is by far the most significant of Qantas' business operations, generally representing more than 90% of Qantas' total EBITDA.

Despite negative circumstances surrounding the airline industry, Qantas Airways reported consistent growth in EBITDAR over the three years ended 30 June 2004. Over this period, revenue remained relatively flat reflecting, initially, the impact of the collapse of Ansett on domestic capacity and the events of 11 September 2001, followed by security alerts, acts of terrorism, the war in Iraq and SARS, which affected both inbound and outbound travel. Revenue was also affected by increased competition and falling yields in the domestic market and yield declines in the international business as pricing was used to stimulate demand. Revenue increased in the years ended 30 June 2005 and 2006 as industry conditions improved. Growth in EBITDAR over this period has been achieved though cost savings generated under the Sustainable Future Program, a successful fuel hedging program (in the years ended 30 June 2003 and 2004) and the introduction of fuel surcharges from mid 2004. These initiatives have been responsible, in part, for the increase in the EBITDAR margin from 13.9% in the year ended 30 June 2002 to 20.0% in the year ended 30 June 2005.

The performance of Qantas Airways in the year ended 30 June 2005 was also impacted by a business reorganisation that resulted in a $98.6 million increase in the costs recharged to Qantas' other business operations (and an equivalent reduction in Qantas Airways' cost base). The recharges reflect a more accurate allocation of airport, distribution and information technology costs and were based on a consumption based review of services provided.

The EBITDAR margin fell from 20.0% to 18.2% in the year ended 30 June 2006, primarily due to the impact of fuel price increases (which represented approximately 16% of operating costs in the year ended 30 June 2004, 20% in the year ended 30 June 2005 and 26% in the year ended 30 June 2006) as well as escalating security charges, which were only offset in part by fuel surcharges and cost savings generated by the Sustainable Future Program ($501 million in the year ended 30 June 2006).

The increase in operating lease charges in the year ended 30 June 2006 reflects a change in the aircraft financing mix from debt funded to operating leases.

In the six months ended 31 December 2006, the EBITDAR margin increased to 20.9%, reflecting the impact of strong demand that saw yield improvements (including the impact of fuel surcharges) which more than offset increases in fuel price and other operating costs.

5.7.2 Jetstar

The operating performance of Jetstar (including Jetstar international) since it commenced operations on 25 May 2004 to the six months ended 31 December 2006 are summarised below:

Jetstar - Operating Performance ($ millions)

	Five weeks ended 30 June	Year ended 30 June		Six months ended 31 December
	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2006 actual AIFRS
Revenue	34.0	515.6	702.6	512.4
EBITDAR	**9.0**	**93.7**	**138.6**	**128.9**
Non-cancellable operating lease payments	(2.7)	(50.7)	(104.2)	(74.7)
EBITDA	**6.3**	**43.0**	**34.4**	**54.2**
Depreciation and amortisation	(5.9)	(7.4)	(9.4)	(4.9)
EBIT	**0.4**	**35.6**	**25.0**	**49.3**
Significant and non recurring items	(23.8)	-	(14.2)	(26.0)
Reported EBIT	**(23.4)**	**35.6**	**10.8**	**23.3**
Statistics				
Revenue growth	*nc*	*nc*	*36.3%*	*nc*
EBITDAR growth	*nc*	*nc*	*47.9%*	*nc*
EBIT growth	*nc*	*nc*	*-29.8%*	*nc*
EBITDAR margin	*26.5%*	*18.2%*	*19.7%*	*25.2%*
EBIT margin	*1.2%*	*6.9%*	*3.6%*	*9.6%*

Source: Qantas annual reports, results media releases, preliminary final reports and half year announcement, Grant Samuel analysis

The growth in EBITDAR over the period reflects the rapid expansion of the Jetstar network in both the domestic and, more recently, the international markets. The decline in EBIT in the year ended 30 June 2006 reflects the impact of higher fuel prices and operating lease charges following the transition to an all A320 fleet.

The EBITDAR margin has increased from 18.2% in the year ended 30 June 2005 to 25.2% in the six months ended 31 December 2006, in line with the ramp up in the business. The higher EBITDAR margin (in comparison to Qantas Airways) is indicative of the low cost nature of the business.

5.7.3 Qantas Catering

The operating performance of Qantas Catering for the five years ended 30 June 2006 and the six months ended 31 December 2006 is summarised below[33]:

Qantas Catering – Operating Performance ($ millions)						
	Year ended 30 June					Six months ended 31 December
	2002 actual AGAAP	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2006 actual AIFRS
Revenue	490.0	505.7	537.2	552.1	534.7	261.9
EBITDA	**80.6**	**84.0**	**81.6**	**32.5**	**44.8**	**19.2**
Depreciation and amortisation	(11.0)	(10.7)	(9.9)	(8.2)	(7.8)	(3.9)
EBIT	**69.6**	**73.3**	**71.7**	**24.3**	**37.0**	**15.3**
Significant and non recurring items	-	-	18.3	-	-	-
Reported EBIT	**69.6**	**73.3**	**90.0**	**24.3**	**37.0**	**15.3**
Statistics						
Revenue growth	*nc*	*3.2%*	*6.2%*	*nc*	*-3.2%*	*nc*
EBITDA growth	*nc*	*4.2%*	*-2.9%*	*nc*	*37.8%*	*nc*
EBIT growth	*nc*	*5.3%*	*-2.2%*	*nc*	*52.3%*	*nc*
EBITDA margin	*16.4%*	*16.6%*	*15.2%*	*5.9%*	*8.4%*	*7.3%*
EBIT margin	*14.2%*	*14.5%*	*13.3%*	*4.4%*	*6.9%*	*5.8%*

Source: Qantas annual reports, results media releases, preliminary final reports and half year announcement, Grant Samuel analysis

Qantas Catering reported growth in EBITDA over the two years ended 30 June 2003 but EBITDA declined slightly in the year ended 30 June 2004. While the war in Iraq and the SARS crisis adversely affected volumes in the year ended 30 June 2003, this was offset in the first half of the year by a recovery in international markets following September 11 and the signing of new contracts with Thai Airways in Sydney and Emirates in Perth. Snap Fresh also commenced sales of economy meals to Cathay Pacific and British Airways during the 2003 financial year.

The decline in earnings in the year ended 30 June 2005 primarily reflected the impact of new segment charges introduced by Qantas which resulted in additional costs of $37.4 million being charged to Qantas Catering. Excluding this impact, underlying EBITDA declined by $11.7 million due to price reductions to Qantas and other clients and changes in revenue mix to lower margin products and services.

Revenue and earnings increased in the year ended 30 June 2006, although this was primarily a result of changes in the method used by Qantas to allocate segment charges, which resulted in a reduction of $11.8 million in the costs borne by Qantas Catering and recovered by Qantas in comparison to the previous year. Excluding the impact of this adjustment, EBITDA increased only marginally to $33.0 million although the EBITDA margin increased 6.2%. The year ended 30 June 2006 saw the transfer of a number of domestic sectors to Jetstar (which sources meals from Gate Gourmet, Inc), the loss of business from Malaysia Airlines and Queensland Rail and a reduction in Thai Airways business, although this was largely offset by increases in volumes from Emirates and Singapore Airlines.

Revenue, earnings and margins declined in the six months ended 31 December 2006, reflecting the loss of a contract and the transition of Australian Airlines to Jetstar.

[33] The operating performance of Qantas Catering includes profit earned on services provided to Qantas Airways.

5.7.4 Qantas Holidays

The operating performance of Qantas Holidays for the five years ended 30 June 2006 and the six months ended 31 December 2006 is summarised below[34]:

Qantas Holidays - Operating Performance ($ millions)

	Year ended 30 June					Six months ended 31 December
	2002 actual AGAAP	2003 actual AGAAP	2004 actual AGAAP	2005 actual AIFRS	2006 actual AIFRS	2006 actual AIFRS
Revenue	1,126.1	1,034.2	994.4	941.5	909.4	502.1
EBITDA	**43.5**	**45.3**	**55.5**	**52.9**	**31.0**	**18.7**
Depreciation and amortisation	(1.8)	(1.7)	(1.4)	(2.0)	(1.4)	(0.7)
EBIT	**41.7**	**43.6**	**54.1**	**50.9**	**29.6**	**18.0**
Share profit/(loss) of associates	0.7	-	-	-	0.2	0.1
Reported EBIT	**42.4**	**43.6**	**54.1**	**50.9**	**29.8**	**18.1**
Statistics						
Revenue growth	*nc*	*-8.2%*	*-3.8%*	*nc*	*-3.4%*	*nc*
EBITDA growth	*nc*	*4.1%*	*22.5%*	*nc*	*-41.4%*	*nc*
EBIT growth	*nc*	*4.6%*	*24.1%*	*nc*	*-41.8%*	*nc*
EBITDA margin	*3.9%*	*4.4%*	*5.6%*	*5.6%*	*3.4%*	*3.7%*
EBIT margin	*3.7%*	*4.2%*	*5.4%*	*5.4%*	*3.3%*	*3.6%*

Source: Qantas annual reports, results media releases, preliminary final reports and half year announcement, Grant Samuel analysis

Qantas Holidays reported growth in earnings over the three years ended 30 June 2004. Growth in domestic passengers in the years ended 30 June 2002 and 2003 and the acquisition of new reseller business in the year ended 30 June 2004 more than offset the reduced demand for international tourism following the SARS crisis and the Bali bombings in the year ended 30 June 2003. Earnings also benefited from the implementation of cost saving measures (reflected in the EBITDA margin increasing from 3.9% to 5.6%) over this period. In the year ended 30 June 2002, performance was also impacted by the devaluation of the A$ against major trading currencies, which made Australia a relatively cheap holiday destination.

The decline in performance in the year ended 30 June 2005 relates to the impact of the new segment charges implemented by Qantas which resulted in an additional $7.6 million of costs being allocated to Qantas Holidays. EBITDA improved by 9% after adjusting for this impact, reflecting a change in mix to higher margin land only outbound products and a stronger A$. The decline in earnings in the year ended 30 June 2006 was driven by lower air travel customers, particularly in the domestic market, increased use of online bookings and the impact of the October 2005 Bali bombings. These factors continued to impact performance in the six months ended 31 December 2006, although they were offset by improved margin management and stronger inbound and reseller activity.

[34] The operating performance of Qantas Holidays includes profit earned on services provided to Qantas Airways.

5.7.5 Freight Associates

Australian air Express

The financial performance of Australian air Express for the five years ended 30 June 2006 is summarised below:

Australian air Express - Financial Performance ($ millions)					
	Year ended 30 June				
	2002 actual AGAAP	**2003 actual AGAAP**	**2004 actual AGAAP**	**2005 actual AIFRS**	**2006 actual AIFRS**
Revenue	379.8	411.4	464.9	513.1	550.7
EBITDA	**48.6**	**13.3**	**53.3**	**54.5**	**54.3**
Depreciation and amortisation	(4.5)	(5.4)	(14.5)	(12.8)	(12.8)
EBIT	**44.1**	**8.0**	**38.8**	**41.7**	**41.5**
Net interest expense	0.7	1.0	(0.2)	0.4	0.5
Operating profit before tax	**44.8**	**9.0**	**38.6**	**42.2**	**42.0**
Income tax expense	(13.6)	(2.8)	(11.7)	(12.6)	(12.8)
Operating profit after tax	**31.3**	**6.1**	**26.9**	**29.6**	**29.2**
Statistics					
Revenue growth	*31.7%*	*8.3%*	*13.0%*	*nc*	*7.3%*
EBITDA growth	*71.8%*	*-72.6%*	*299.8%*	*nc*	*-0.5%*
EBIT growth	*85.3%*	*-82.0%*	*387.1%*	*nc*	*-0.6%*
EBITDA margin	*12.8%*	*3.2%*	*11.5%*	*10.6%*	*9.9%*
EBIT margin	*11.6%*	*1.9%*	*8.3%*	*8.1%*	*7.5%*

Source: Company filings with ASIC, Grant Samuel analysis

Australian air Express has reported consistent growth in revenue over the last five years, achieving an average annual growth rate of almost 10%. However, earnings have not followed the same growth path, falling significantly in the year ended 30 June 2003 as a result of a negotiated increase in rates paid for freight capacity leased from Qantas in that year. While performance recovered in the year ended 30 June 2004, EBITDA has remained flat at around $54 million over the last two years and the EBITDA margin has declined from 11.5% to 9.9%. The EBITDA performance reflects the competitive nature of the freight and logistics market.

In addition, during the year ended 30 June 2005, Australian air Express committed to a capital reinvestment program for improvements and upgrades to systems and infrastructure. The resulting increase in infrastructure costs as well as increased aircraft operating costs due to maintenance requirements affected performance in that and subsequent years.

Star Track Express

The financial performance of Star Track Express from acquisition in December 2003 to the year ended 30 June 2006 is summarised below:

Star Track Express - Financial Performance ($ millions)			
	Six months ended	**Year ended 30 June**	
	30 June 2004 actual AGAAP	**2005 actual AIFRS**	**2006 actual AIFRS**
Revenue	191.6	459.5	492.4
EBITDA	**39.5**	**86.9**	**92.8**
Depreciation and amortisation	(9.2)	(26.7)	(26.1)
EBIT	**30.4**	**60.1**	**66.7**
Net interest expense	(10.3)	(19.2)	(19.6)
Amortisation of intangible assets	(15.6)	-	-
Operating profit before tax	**4.5**	**40.9**	**47.1**
Income tax expense	(5.9)	(12.4)	(13.9)
Operating profit after tax	**(1.4)**	**28.5**	**33.1**
Statistics			
Revenue growth	*nc*	*nc*	*7.2%*
EBITDA growth	*nc*	*nc*	*6.8%*
EBIT growth	*nc*	*nc*	*10.9%*
EBITDA margin	*20.6%*	*18.9%*	*18.8%*
EBIT margin	*15.8%*	*13.1%*	*13.5%*

Source: Company filings with ASIC, Grant Samuel analysis

Since acquisition, Star Track Express has performed consistently, growing revenue and earnings and maintaining EBITDA margins at around 19%.

6 Valuation of Qantas

6.1 Summary

Qantas has been valued in the range $10.3-11.9 billion which corresponds to a value of $5.18-5.98 per share. The valuation represents the estimated full underlying value of Qantas assuming 100% of the company was available to be acquired and includes a premium for control. The value exceeds the price at which, based on current market conditions, Grant Samuel would expect Qantas shares to trade on the ASX in the absence of a takeover offer.

The value for Qantas is the aggregate of the estimated market value of Qantas' operating businesses and other assets less external borrowings and non-trading liabilities. The valuation (on a pre dividend basis[35]) is summarised below:

Qantas – Valuation Summary ($ millions)			
	Section Reference	Valuation Range	
		Low	High
Airline operations and related businesses	6.4	14,500.0	16,000.0
Interests in jointly controlled entities, associates and investments	6.5	689.2	769.4
Cost savings (listed company costs)	6.6	67.0	80.4
Other assets and liabilities	6.7	(318.3)	(315.8)
Enterprise Value		**14,937.9**	**16,534.0**
Net borrowings at 31 December 2006	6.8	(2,073.6)	(2,073.6)
Present value of future operating lease payments at 31 December 2006	6.8	(2,548.9)	(2,548.9)
Value of equity		**10,315.4**	**11,911.5**
Fully diluted shares on issue[36] (millions)		1,990.6	1,990.6
Value per share		**$5.18**	**$5.98**

The bottom of the range ($5.18) represents the threshold price. An offer price above that level is fair from a financial point of view. However, an offer price below that level would not be fair.

The value range is relatively wide. However, precision in the valuation of Qantas is unrealistic and potentially misleading given:

- that airline revenue largely reflects discretionary expenditure by both business and leisure travellers and is affected by general economic conditions. A large part of the market is also relatively price sensitive and therefore, in order to maintain load factors, yield can fluctuate materially depending on economic conditions and competitor activity, particularly in the international sector where there is intense competition;

- the volatility of earnings as a result of the operating leverage inherent in the airline business. Approximately 70-80% of operating costs are fixed (including fuel – although the price fluctuates, consumption is relatively fixed). Accordingly, small changes in key variables such as load factor or yield can cause material movements in earnings and cash flows. Similarly, variations in fuel prices flow directly through to profitability (except to the extent of hedging and the utilisation of fuel surcharges). This volatility is evident from Qantas' own results over the last few years:

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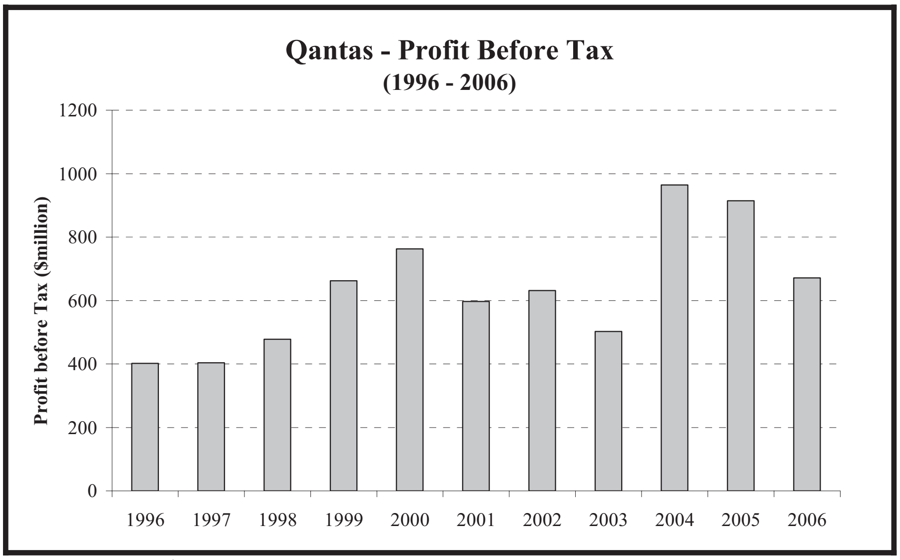
35 Before the 15 cents per share special dividend declared by Qantas. The value range is equivalent to $5.03 to $5.83 on an ex dividend basis.

36 Fully diluted shares on issue at 31 January 2007 of 1,990,607,560 includes Qantas' 1,984,027,311 issued ordinary shares, 5,021,800 rights to Qantas shares that convert on a one for one basis and 1,559,499 Qantas shares that would be issued if the 6,329,620 entitlements to Qantas shares were converted into Qantas shares.



Source: Qantas annual reports

- the difficulty in making any reliable long term forecasts for key variables such as fuel, foreign exchange rates or yield (given its dependence on competitor activity and capacity changes). The realistic range of potential outcomes for these variables is wide. This can clearly be seen from examining the historical record which shows how much these variables have changed over time, sometimes without any particular pattern.

Accordingly, any valuation of Qantas should be considered as a broad judgement rather than a definitive estimate. These issues apply to both of the methodologies utilised which means that it is not sensible to rely on any single approach and that, in any event, considerable caution should be exercised in relying on the output of either methodology.

Qantas' business operations were valued by reference to the results of two methodologies:

- discounted cash flow analysis based on a high level 10 year model developed with input from Qantas. The future cash flows were largely based on the 2007 Forecast and Projections provided by Qantas (but with some adjustments) and then extended by Grant Samuel on the basis of its judgements following discussions with Qantas management and others; and

- multiples of earnings, including EBITDAR, EBIT and price earnings ("PE") multiples. Most weight was placed on EBITDAR multiples as this is the primary metric used by analysts and others in valuing airlines but PE multiples are also commonly used. Values were ascribed separately to standalone investments.

Despite the uncertainties associated with discounted cash flow, weight should be given to it as it is the only methodology that explicitly captures the effect of the substantial level of capital expenditure planned by Qantas over the next 5-10 years.

The value includes a premium for control. Takeover premiums are typically in the range 20-35% depending on the individual circumstances. Synergies available to acquirers such as cost savings through merging operations are normally a significant factor in justifying their ability to pay a meaningful premium over market prices (although in more recent times private equity buyers of listed companies have also paid significant premiums despite the apparent absence of synergies). However, in this case, there are few synergies available as:

- buyers who could achieve substantial synergies such as other international airlines are not able to acquire control of Qantas because of the ownership restrictions under the Qantas Sale Act; and

- there are no local trade buyers of sufficient size or similarity of operations to acquire Qantas. Inevitably, the acquirers would be consortia such as APA where there would be no opportunities to merge operations.

Accordingly, the level of premium for control can be expected to be less than in other takeover situations.

6.2 Methodology

6.2.1 Overview

Grant Samuel's valuation of Qantas has been estimated by aggregating the estimated market value of its operating businesses together with the realisable value of non-trading assets and deducting external borrowings and non-trading liabilities as at 31 December 2006. The value of the operating businesses has been estimated on the basis of fair market value as a going concern, defined as the maximum price that could be realised in an open market over a reasonable period of time assuming that potential buyers have full information.

The valuation of Qantas is appropriate for the acquisition of the company as a whole and, accordingly, incorporates a premium for control. The value is in excess of the level at which, under current market conditions, shares in Qantas could be expected to trade on the sharemarket. Shares in a listed company normally trade at a discount of 15-25% to the underlying value of the company as a whole (but this discount does not always apply).

The most reliable evidence as to the value of a business is the price at which the business or a comparable business has been bought and sold in an arm's length transaction. In the absence of direct market evidence of value, estimates of value are made using methodologies that infer value from other available evidence. There are four primary valuation methodologies that are commonly used for valuing businesses:

- discounting of projected cash flows;
- capitalisation of earnings or cash flows;
- industry rules of thumb; and
- estimation of the aggregate proceeds from an orderly realisation of assets.

Each of these valuation methodologies has application in different circumstances. The primary criterion for determining which methodology is appropriate is the actual practice adopted by purchasers of the type of business involved.

Nevertheless, valuations are generally based on either or both discounted cash flow or multiples of earnings and Grant Samuel has had regard to both methodologies.

However, earnings in the airline industry are volatile as a result of the high operating leverage. Declining average fares in most markets have served to exacerbate earnings volatility. These factors, combined with a highly competitive environment and a susceptibility to external shocks, results in large swings in earnings in the industry. In recent years, the low cost carrier business model has reduced the effect of operating leverage and low cost carriers have reported more consistency in earnings although significant volatility remains. Industry volatility means that earnings and cash flow predictability for the industry is low and therefore both short and long term forecasts of financial performance are notoriously unreliable.

Accordingly, because of the difficulty in creating reliable long term discounted cash flow models, investors and analysts following the airline industry tend to also put emphasis on multiples of current earnings or short term prospective earnings and, rather than invest long term, often treat airline stocks as a trading opportunity based on:

- discrepancies in relative ratings between airlines;
- current performance trends and changes in the short term outlook; and
- other events (e.g. fuel price changes).

Notwithstanding the difficulties of making reliable forecasts of financial performance for airlines, Grant Samuel has also considered the discounted cash flow methodology in valuing Qantas' operating businesses. Qantas has undertaken some medium term (3-5 years) planning which provides a base from which to make longer term forecasts and the discounted cash flow analysis is able to provide some useful insights into value including:

- identification of the key drivers of value;
- demonstration of the value impacts of changes in key parameters; and
- explicitly allowing for the capacity increases and the cash cost of Qantas' planned capital expenditure on aircraft over the next decade.

6.2.2 Discounted Cash Flow

Discounting of projected cash flows has a strong theoretical basis. It is the most commonly used method for valuation in a number of industries, including resources, and for the valuation of start-up projects where earnings during the first few years can be negative but it is also widely used in the valuation of established industrial businesses. Discounted cash flow valuations involve calculating the net present value of expected future cash flows. This methodology is able to explicitly capture the effect of a turnaround in the business, the ramp up to maturity or significant changes expected in capital expenditure patterns. The cash flows are discounted using a discount rate which reflects the risk associated with the cash flow stream.

Considerable judgement is required in estimating future cash flows and it is generally necessary to place great reliance on medium to long term projections prepared by management. The discount rate is also not an observable number and must be inferred from other data (usually only historical). None of this data is particularly reliable so estimates of the discount rate necessarily involve a substantial element of judgement. In addition, even where cash flow forecasts are available, the terminal or continuing value is usually a high proportion of value. Accordingly, the multiple used in assessing this terminal value becomes the critical determinant in the valuation (i.e. it is a "de facto" cash flow capitalisation valuation). The net present value is typically extremely sensitive to relatively small changes in underlying assumptions, few of which are capable of being predicted with accuracy, particularly beyond the first two or three years. The arbitrary assumptions that need to be made and the width of any value range mean the results can be not meaningful or reliable. Notwithstanding these limitations, discounted cash flow valuations are commonly used and can at least play a role in providing a check on alternative methodologies, not least because explicit and relatively detailed assumptions as to expected future performance need to be made.

6.2.3 Capitalisation of Earnings or Cash Flows

Capitalisation of earnings or cash flows is the most commonly used method for valuation of industrial businesses. This methodology is most appropriate for industrial businesses with a substantial operating history and a consistent earnings trend that is sufficiently stable to be indicative of ongoing earnings potential. This methodology is not particularly suitable for start-up businesses, businesses with an erratic earnings pattern or businesses that have unusual capital expenditure requirements. This methodology involves capitalising the earnings or cash flows of a business at a multiple that reflects the risks of the business and the expected profile of the stream of income that it generates. These multiples can be applied to a number of different earnings or cash flow measures including EBITDAR, EBITDA, EBIT or net profit after tax. These are referred to respectively as EBITDAR, EBITDA multiples, EBIT multiples and PE multiples. PE multiples are commonly used in the context of the sharemarket. EBITDAR, EBITDA and EBIT multiples are more commonly used in valuing whole businesses for acquisition purposes where gearing is in the control of the acquirer but are also extensively used in sharemarket analysis.

Application of this valuation methodology involves:

- estimation of earnings or cash flow levels that a purchaser would utilise for valuation purposes having regard to historical and forecast operating results, non-recurring items of income and expenditure and known factors likely to impact on operating performance; and

- consideration of an appropriate capitalisation multiple having regard to the market rating of comparable businesses, the extent and nature of competition, the time period of earnings used, the quality of earnings, growth prospects and relative business risk.

The choice between the parameters is usually not critical and should give a similar result. All are commonly used in the valuation of industrial businesses. EBITDA can be preferable to EBIT if depreciation or non-cash charges distort earnings or make comparisons between companies difficult. On the other hand, EBIT can better adjust for differences in relative capital expenditure intensity. In the case of airlines, the use of EBITDAR ensures that off balance sheet debt (as represented by long term aircraft operating leases) is taken into consideration in the value of the airline and allows for more reliable comparisons between airlines where there are differences in their financing structures (e.g. heavier use of operating leases). Accordingly, it is the primary earnings multiple methodology used in the airline industry.

Determination of the appropriate earnings multiple is usually the most judgemental element of a valuation. Definitive or even indicative offers for a particular asset or business can provide the most reliable support for selection of an appropriate earnings multiple. In the absence of meaningful offers it is necessary to infer the appropriate multiple from other evidence.

The usual approach is to determine the multiple that other buyers have been prepared to pay for similar businesses in the recent past. A pattern may emerge from transactions involving similar businesses with sales typically taking place at prices corresponding to earnings multiples within a particular range. This range will generally reflect the growth prospects and risks of those businesses. Mature, low growth businesses will, in the absence of other factors, attract lower multiples than those businesses with potential for significant growth in earnings.

An alternative approach used in valuing businesses is to review the multiples at which shares in listed companies in the same industry sector trade on the sharemarket. This gives an indication of the price levels at which portfolio investors are prepared to invest in these businesses. Share prices reflect trades in small parcels of shares (portfolio interests) rather than whole companies and it is necessary to adjust for this factor.

The analysis of comparable transactions and sharemarket prices for comparable companies will not always lead to an obvious conclusion as to which multiple or range of multiples will apply. There will often be a wide spread of multiples and the application of judgement becomes critical. Moreover, it is necessary to consider the particular attributes of the business being valued and decide whether it warrants a higher or lower multiple than the comparable companies. This assessment is essentially a judgement.

6.2.4 Industry Rules of Thumb

Industry rules of thumb are commonly used in some industries. These are generally used by a valuer as a "cross check" of the result determined by a capitalised earnings valuation or by discounting cash flows. While they are only used as a cross check in most cases, industry rules of thumb can be the primary basis on which buyers determine prices in some industries. Grant Samuel is not aware of any commonly used rules of thumb that would be appropriate to value the business operations of Qantas. In any event, it should be recognised that rules of thumb are usually relatively crude and prone to misinterpretation.

6.2.5 Net Assets/Realisation of Assets

Valuations based on an estimate of the aggregate proceeds from an orderly realisation of assets are commonly applied to businesses that are not going concerns. They effectively reflect liquidation values and typically attribute no value to any goodwill associated with ongoing trading. Such an approach is not appropriate in Qantas' case.

6.3 Treatment of Business Units

Qantas has a number of operating business units and accordingly, the issue arises as to whether or not these units should be separately valued (i.e. a break up valuation). The first issue is whether the two airlines (Qantas, Jetstar) should be separately valued as they are two distinct businesses. Public comments have also been made about the possible separation (or sale) of certain businesses including:

- Qantas Freight;
- Qantas Engineering;
- terminals;
- Qantas Catering;
- Qantas Holidays; and
- the frequent flyer program.

Some of the public commentary has suggested that there is "hidden value" in some of these assets.

Grant Samuel has carefully considered this issue but while there is some superficial appeal in trying to assess individual values for businesses, has decided to value all of the operating businesses as one integrated business because:

- some of the businesses are not realistically separable and are integral to the business. For example, while Jetstar is run as a separate organisation it is not stand alone. Its routes are co-ordinated with Qantas to avoid cannibalisation of the existing business and its prospective earnings profile reflects this strategy. Any separation would raise significant issues about the impact on Qantas full service domestic (e.g. potential competition on main trunk routes). In addition, Jetstar international provides the Qantas group with strategic route network options. Separation or realisation is not part of Qantas' current strategy. Put alternatively, the value of the two businesses is greater under one umbrella than as two separate businesses. However, at the same time it is necessary to ensure the growth potential provided by Jetstar is reflected in the overall earnings multiple.

  Grant Samuel does not believe it is appropriate to separate out Qantas Freight or Qantas Engineering. Freight is essentially the sale of belly space in passenger aircraft, together with a small contribution from dedicated freighters (which is only marginally profitable), and is clearly an integrated business. Engineering is not a business at all, but a cost centre for Qantas. Any sale value could only be created artificially by having a profitable contract back with Qantas. Unless the new operator was substantially more efficient and was prepared to share that value with Qantas through lower costs or an up front premium there is no value gain. There is no evidence to support such a view. In any event, engineering is a politically sensitive topic. There are two engineering businesses with third party income but they are either very small (Jet Turbine Services) or strategically important to retain (Qantas Defence Services).

Similarly, with ownership of the terminals, Qantas has complete control of the product and passenger experience. A third party owner may not share Qantas' objectives (e.g. introducing more retail may be detrimental to Qantas' desired positioning or presentation) although it should be recognised that Qantas' leases over the Melbourne and Sydney terminals expire in 2018 and 2019 respectively;

- earnings estimates for these individual businesses are not available on a basis that would produce reliable values:
  - virtually all business units receive significant allocations of central costs or interdivisional charges. These costs may be substantially different if determined on a stand alone basis;
  - for some businesses (engineering, terminals, catering), the value is circular in the sense that it depends on the terms of contracts that would be negotiated. For example, Qantas would have the flexibility (within certain bounds) to determine the rental for the terminal (or the passenger charge) and therefore the value (i.e. higher rental means a higher value but a higher ongoing cost). Furthermore, as there is no current proposal or transaction a range of other factors which would also be critical in determining value (rental escalators, review periods, termination rights) are unknown. Similarly, no reliable value could be determined for the catering or engineering businesses until the key elements of a contract were in place; and
  - businesses such as Qantas Catering and Qantas Holidays are undergoing significant restructures designed to restore adequate profitability but at this juncture it is difficult to gauge the extent or likelihood of the turnaround. Airline catering is a difficult business. Third party catering is highly tailored and Qantas' requirements (the bulk of the business) are complex (much more so than, for example, the services provided by Gate Gourmet to Jetstar). Qantas Holidays has suffered a sharp decline in profitability and is reshaping and repositioning its business. In these circumstances reliable valuation is difficult;
- while some of the businesses could clearly be sold, and could be sold by APA if the APA Offer is successful, simply monetising assets is not the same as finding "hidden value" as sale results in either loss of earnings or substitution of a new expense (e.g. a lease cost). The only value gain is if the business is sold for a substantially higher value than is implicit in the valuation of Qantas (e.g. at a higher earnings multiple). In this context:
  - with the exception of the frequent flyer program there is little or no evidence that higher multiples would be achievable. The sale of businesses such as engineering, terminals or catering would be based on contracts with Qantas. A business that comprises a contract with one party is unlikely to attract a premium multiple; and
  - Qantas has explored sales of its terminals and Qantas Catering. The proposed sale of the terminals failed to produce a price and terms where the implied cost of capital was lower than Qantas' assessment of its own cost of capital (i.e. there was no value increment). The proposed sale of Qantas Catering did identify scope for some cost savings but the offers did not fully reflect the potential turnaround in the business; and
- the listed peer groups, which are used as the primary reference point for assessing the earnings multiple for Qantas, also have a broad mix of activities. Virtually all of the major full service airlines have in house freight and engineering businesses (particularly Singapore Airlines and Deutsche Lufthansa AG ("Lufthansa")), frequent flyer programs and catering (Lufthansa has a substantial third party catering business).

The one area where there could be material additional value (i.e. over and above the value implicit in Qantas) would be the frequent flyer program. ACE Aviation Holdings Inc. ("ACE Aviation"), the majority owner of Air Canada Inc ("Air Canada"), floated 25% of its frequent flyer program as a stand alone loyalty program business in June 2005. Aeroplan Income Fund ("Aeroplan") currently trades at an EBITDA multiple of more than 15 times. While this precedent does exist, and could ultimately be followed by Qantas, Grant Samuel does not believe it is possible to determine a reliable value for the Qantas frequent flyer program as a separate business at the present point in time:

- there is no definitive measure of the earnings of the program on a stand alone business. It is not as simple as taking current contribution measures (which are impacted by complex internal allocation issues). Separation would involve a substantial restructuring which could materially affect profitability;
- separation involves critical strategic issues and questions (e.g. the potential impact on customer loyalty). Even if the frequent flyer element was retained (i.e. the third party loyalty program was sold and Qantas bought points from the new entity for its flyers) there are questions about whether it could maintain the terms of the current program. Qantas has examined the Aeroplan concept but such a plan does not form part of its current strategy. In addition, as some analysts have noted, separation of the frequent flyer program may detract from the value of the airline;
- the program itself would have to be restructured and turned into a "firm seat" program rather than Qantas' current "marginal seat" basis. It is not certain this change is viable and, in any event, it would take a considerable period of time to achieve; and
- involvement by third party partners (e.g. credit card companies) is already extensive and the Qantas frequent flyer program has a very high level of participation. It is by far the largest loyalty program in Australia. Dramatic growth from this point is relatively unlikely.

Accordingly, Grant Samuel's approach was to value the Qantas business in one line except for stand alone investments (freight joint ventures, Air New Zealand, Air Pacific etc).

Another issue that has been commented on is the potential for Qantas to sell its entitlements to future aircraft (particularly the B787) for a significant profit in view of the high global demand for these aircraft and Qantas' preferred position. While this is possible it would then have a material effect on Qantas' ability to grow capacity in line with its plans. The discounted cash flow analysis makes specific allowance for this capacity and reflects the favourable terms on which Qantas will acquire the aircraft.

6.4 Value of Business Operations

6.4.1 Overview

A value of $14.5-16.0 billion has been attributed to Qantas' business operations. This valuation is a subjective judgement having regard to both discounted cash flow analysis and earnings multiple analysis. The discounted cash flow analysis is based on a 10 year financial model. Despite the issues around the reliability of any long term forecasts in the industry, the analysis provides some useful insights into value. The earnings multiple analysis is based primarily on comparable listed companies because of the lack of relevant transaction evidence.

6.4.2 Discounted Cash Flow Analysis

Grant Samuel undertook a discounted cash flow ("DCF") analysis of Qantas' business operations. The analysis forecasts nominal after tax cash flows (before operating lease payments) from 1 January 2007 to 30 June 2016, a period of nine and half years, with a terminal value calculated to represent the value of cash flows in perpetuity. The terminal value has been calculated as 4.0-4.5 times forecast EBITDAR for the year ending 30 June 2017. A multiple of EBITDAR was chosen to calculate the terminal value as the usual alternative of capitalising net after tax cash flows based on a perpetual growth assumption ("the perpetuity method") resulted in a wide range of implied EBITDAR multiples (because of the combined effect of operating leverage and the sensitivity to the assumed level of capital expenditure in the terminal year). As EBITDAR is a standard airline valuation metric with some evident consistency it was decided this approach would give more reliable outcomes. The values were reconciled against the implied terminal growth rates to ensure that the implied growth rate was not unreasonable but it should be noted that despite the 4.0-4.5 multiple appearing to be relatively low, it still gives a higher value than the perpetuity method (assuming long term growth of, say, 3.5%). This outcome reflects the high level of capital expenditure (as a proportion of EBITDA) required to sustain the growth profile in the terminal year. A discount rate (weighted average cost of capital) in the range 9.0-9.5% has been used. The rationale for selection of this discount rate is set out in Appendix 1.

The model is necessarily a high level model, intended to demonstrate the effect on value of variances in several key revenue and cost drivers. An airline is an inherently complex business, with its performance depending on a very large number of variables such as ticket pricing and passenger numbers on each route, seat capacity of each aircraft and landing charges at many different airports. It is neither feasible nor instructive to simulate this scope of data in a valuation exercise.

The main features of the financial model include:

- key parameters such as ASKs, RPKs and yields are modelled for each business line (Qantas full service domestic, Qantas international etc). Variable operating costs are segmented and modelled on a per ASK basis;
- capacity growth is based on Qantas' fleet plan, which forecasts growth in total ASKs of approximately 6% per annum between 30 June 2006 and 30 June 2014, including substantial increases in capacity between 2009 and 2012. Capacity is assumed to grow at 3.5% per annum in the final two years;
- gross capital expenditure is similarly based on Qantas' fleet plan, with a total of approximately $20 billion forecast between 30 June 2006 and 30 June 2014. Capital expenditure of $6 billion is assumed in the final two years. Given the complexities of the fleet planning process it was not practical to be able to develop sensitivities to capacity and capital expenditure (i.e. they are fixed for all scenarios);
- allowance is made for:
  - additional cost savings from the Sustainable Future Program in the years ending 30 June 2008 and 30 June 2009 which are then assumed to be retained in subsequent years (the costs of the program are included in other assets and liabilities);
  - fuel price hedging and the flow through of fuel price changes to passenger surcharges; and
  - efficiency gains over time from new generation aircraft, the increasing proportion of Jetstar and scale generally; and
- the model is based on "business as usual" and assumes no structural changes in the industry (such as regulatory change allowing consolidation) or sale of business units.

Forecasts of operational assumptions up to ten years into the future are highly uncertain and subject to factors outside the control of Qantas. There is significant scope for differences in opinion on key assumptions (e.g. fuel costs). Accordingly, Grant Samuel has analysed a number of scenarios that represent differing combinations of assumptions. Each scenario assumes as a starting point that the 2007 Forecast will be achieved. Longer term assumptions have been made by Grant Samuel with reference to the Projections and following discussion with Qantas management.

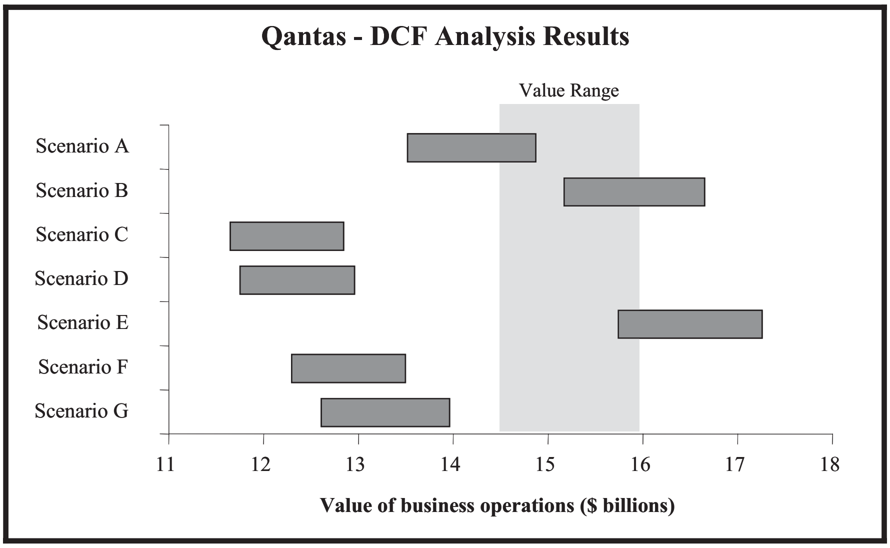
A description of each scenario is outlined in the table below. More detailed lists of key assumptions underlying each scenario are set out in Appendix 2.

Summary of DCF Scenarios	
Scenario A	Scenario A represents as closely as possible a "base case" (i.e. the set of forecasts judged most likely to occur). The key assumptions in this scenario include: ▪ no external shocks; ▪ load factors are maintained at close to 80%; ▪ yields (both domestic and international) grow at an average of 0.7% per annum (excluding the fuel surcharge), after some specific changes in the first four years. While this is below the expected rate of inflation it should be recognised that: • the long term trend for yields has been down (both domestically and internationally). In effect increasing operating efficiencies (including from new generation aircraft) get passed back to passengers; • while Qantas' yields have strengthened over the last 2-3 years this has coincided with: - strong economic conditions; - minimal increases in capacity on domestic routes; and - reduced capacity on routes into and out of Australia as smaller participants withdrew from the market; ▪ manpower costs per ASK grow at a nominal 3% but an efficiency gain (in part reflecting the Sustainable Future Program) is then assumed to partially offset this. This efficiency gain exceeds the nominal growth rate in 2007/08 and 2008/09; ▪ cost savings are achieved over the next three years consistent with Qantas forecasts; ▪ fuel costs follow the forward curve, rising to US$65 per barrel (for WTI crude) in 2010, then remaining flat.
Scenario B	Scenario B differs from Scenario A in that it assumes Qantas is able to extract somewhat higher yields (ticket prices) from the domestic market over the short to medium term (an incremental 2% per annum in each of 2007/08 and 2008/09), with price growth returning to normal levels in the long term. This assumption is predicated on a scenario where: ▪ the Australian economy continues to expand and consumer spending continues at strong levels; and ▪ no new domestic competitors emerge and Virgin Blue continues to act as a "rational" competitor rather than aggressively pursuing market share.
Scenario C	Scenario C represents the case of substantially increased capacity introduced into the domestic market. This would occur if either: ▪ Virgin Blue undertook an aggressive expansion plan to increase market share; or ▪ a new carrier entered the domestic market. While Qantas is not assumed to lose a significant number of passengers, its domestic yields are assumed to fall by 5% over two years (relative to Scenario A) and it also loses market share as additional capacity is created. This scenario also assumes Qantas is able to recoup a lesser amount of fuel cost increases through ticket surcharges than in Scenario A.
Scenario D	Scenario D represents the effect of a more liberal regulation of foreign airlines' traffic rights by the Australian Government. This does not represent a full "open skies" policy, rather the Government either: ▪ gradually opens up key routes, such as Sydney/Los Angeles, to further competition; or ▪ grants some of Qantas' key competitors their requests for substantial increases in capacity on existing routes. Under this scenario, Qantas' international yields fall by 5% over a period of two years (relative to Scenario A) and no fuel cost increases are passed on to international passengers. As an offsetting factor, Scenario D assumes Qantas is able to achieve some manpower cost reductions.

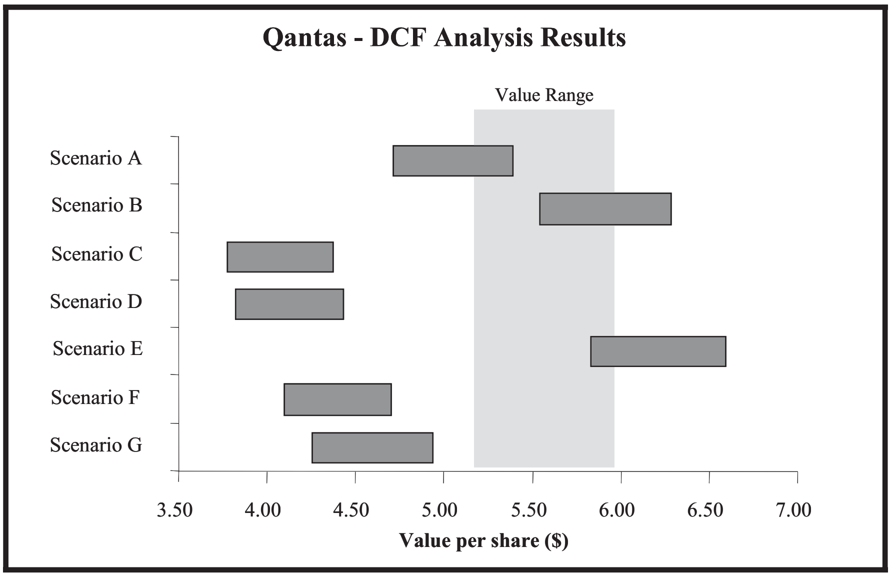
Summary of DCF Scenarios	
Scenario E	Scenario E assumes Qantas is able to achieve somewhat higher yield growth on international flights over the next three years. Incremental yield growth of 2% per annum is assumed in each of 2007/08 and 2008/09 relative to Scenario A. This assumption is predicated on several factors including: ▪ the Australian Government does not pursue the liberalisation of international traffic rights; ▪ demand for travel between Australia and Asia continues to grow strongly; and ▪ the effects of the A380 delay on tightening of capacity being stronger than expected.
Scenario F	Scenario F captures the effect of oil prices rising faster than assumed in Scenario A. Following three years of the forward curve, fuel prices are assumed to rise at 2.5% per annum. Qantas is able to recover a proportion of increased fuel costs through ticket surcharges in line with current arrangements.
Scenario G	Scenario G attempts to model the impact of an external shock to the airline industry at a particular point in time. 2010 has been chosen as the year in which the shock takes place. The shock is assumed to be material (e.g. a major terrorism attack) but not devastating (e.g. an attack on a Qantas aircraft). Under this scenario, Qantas's load factors fall by approximately 8% on both domestic and international routes, and yield is reduced by 4%. These variables are assumed to return to normal levels within one to two years. As an offsetting factor, wage growth is assumed to pause in 2010, recovering in the following years.

The output of the DCF analysis is summarised below. The net present values calculated are before deducting capitalised operating lease obligations:

Qantas – Net Present Value Analysis ($ billions)					
Discount rate		**9.5%**		**9.0%**	
Terminal EBITDAR multiple		**4.0x**	**4.5x**	**4.0x**	**4.5x**
Scenarios					
Scenario A	Base case	13.5	14.4	13.9	14.9
Scenario B	Higher domestic yields	15.2	16.2	15.6	16.6
Scenario C	New domestic competitor/existing competitor expands	11.6	12.5	12.0	12.8
Scenario D	Further deregulation of traffic rights for foreign carriers	11.8	12.6	12.1	13.0
Scenario E	Stronger international market	15.7	16.8	16.2	17.3
Scenario F	Higher fuel costs	12.3	13.1	12.6	13.5
Scenario G	External shock in 2010	12.6	13.5	13.0	14.0

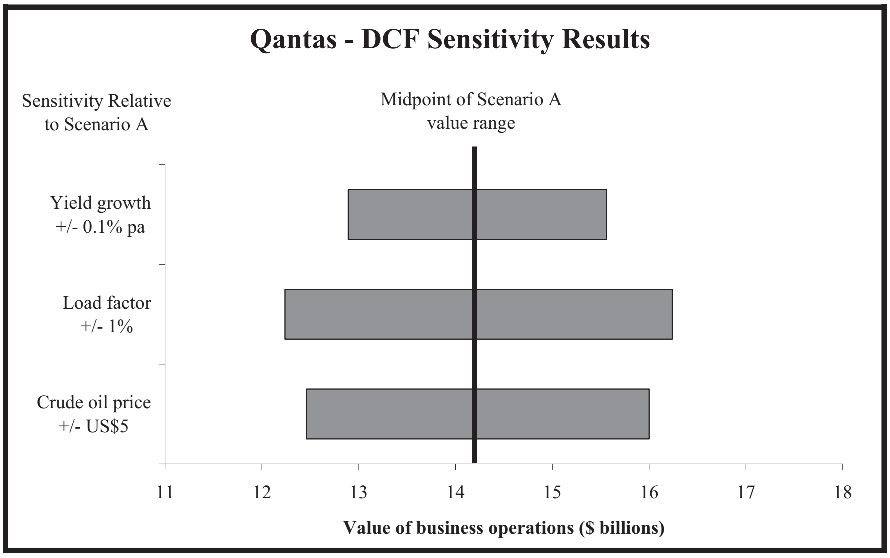


These values have been converted into a value per share by adding the mid point values for investments and joint venture interests, listed company cost savings and other assets and liabilities and deducting net borrowings and capitalised operating leases:



In addition, Grant Samuel has undertaken a sensitivity analysis based on Scenario A. This analysis examines the sensitivity of this scenario to global changes to key variables:

- yield growth 0.1% higher or lower each year;
- load factor 1% higher or lower each year; and
- fuel price US$5 per barrel higher or lower each year (after 30 June 2009).



As discussed above, net present values from discounted cash flow analyses are subject to significant limitations and should always be treated with considerable caution. The net present values show a relatively wide range across the different scenarios, highlighting the sensitivity to relatively small changes in assumptions. In particular, the analysis shows the very high sensitivity to yields and fuel prices.

The range of net present values produced by the scenarios is significantly wider than the value range Grant Samuel has placed on Qantas' business operations of $14.5-16.0 billion. Grant Samuel has considered the outcome of all the scenarios in determining its value range for Qantas' business operations. However, it should be noted that:

- the assumption of a more robust international market in Scenario E could be considered optimistic. Australia is currently served by over 30 international airlines, a large number of participants for any industry. Recent aggressive expansion proposals by several major airlines, in particular Emirates, does not point to lessening of competition in the foreseeable future;
- the deregulation of international traffic rights envisaged by Scenario D is not currently and has never been Government policy. However Government policy may change, and a general trend towards open skies is apparent in several overseas markets;
- some analysts predict crude oil price rises dramatically higher than those assumed in Scenario F, however predictions of lower fuel prices also exist. On balance, fuel prices represent a significant downside risk to the value of Qantas as the balance of risks for the fuel price are more towards increases from current levels;
- while it is nearly impossible to place a meaningful probability on an external shock occurring at any particular point in time, it should be noted that the airline industry has experienced at least three such shocks in the last decade. The effect of a more direct shock occurring in Australia or on a Qantas aircraft would be significantly greater than this scenario suggests; and
- the sensitivity analysis isolates a limited number of assumptions and shows the impact of expressed variations to those assumptions. No opinion is expressed as to the probability or otherwise of those expressed variations occurring. Actual variations may be greater or less than those modelled. In addition to not representing best and worst outcomes, the sensitivity analysis does not, and does not purport to, show the impact of all possible variations to the business model. The actual performance of the business may be negatively or positively impacted by a range of factors including, but not limited to:

- changes to the assumptions other than those considered in the sensitivity analysis;
- greater or lesser variations to the assumptions considered in the sensitivity analysis than those modelled; and
- combinations of different variations to a number of different assumptions that may produce outcomes different to the combinations modelled.

Grant Samuel's value range lies within the upper portion of values produced by the DCF analysis, spanning the values produced by Scenarios A and B. This is considered appropriate in determining a value in a change of control transaction. Grant Samuel's value range is consistent with the view that:

- Scenario A represents the most likely outcome for Qantas, barring changes to Government policy, major changes in the competitive landscape or external shocks;
- better performance of the domestic business is possible and should be given some weight in considerations; and
- while risks such as higher fuel prices, increased competitive intensity and external shocks are real and should be considered, their occurrence is not certain and Qantas has operated within the context of these challenges for some time.

In summary, a set of reasonably optimistic assumptions is required to generate a value at the upper end of Grant Samuel's valuation range while assumptions that do not appear to be excessively conservative give rise to values at the lower end of or below Grant Samuel's valuation range.

6.4.3 Earnings Multiples Analysis

Interpretation of Multiples

Earnings multiples are normally benchmarked against two primary sets of reference points:

- the multiples implied by the share prices of listed peer group companies; and
- the multiples implied by the prices paid in acquisitions of other companies in the same industry.

In interpreting and evaluating such data it is necessary to recognise that:

- multiples based on listed company share prices do not include a premium for control and are therefore often (but not always) less than multiples that would apply to acquisitions of similar companies. However, while the premium paid to obtain control in takeovers is observable (typically in the range 20-35%) it is inappropriate to simply add a premium to listed multiples. The premium for control is an outcome of the valuation process, not a determinant of value. Premiums are paid for reasons that vary from case to case and may be substantial due to synergy or other benefits available to the acquirer. In other situations premiums may be minimal or even zero. There are transactions where no corporate buyer is prepared to pay a price in excess of the prices paid by sharemarket investors;
- acquisition multiples from comparable transactions are therefore usually seen as a better guide when valuing 100% of a business but the data tends to be less transparent and information on forecast earnings is often unavailable;
- the analysis will give a range of outcomes from which averages or medians can be determined but it is not appropriate to simply apply such measures to the company being valued. The most important part of valuation is to evaluate the attributes of the

specific company being valued and to distinguish it from its peers so as to form a judgement as to where on the spectrum it appropriately belongs;

- acquisition multiples are a product of the economic and other circumstances at the time of the transaction. However, each transaction will be the product of a unique combination of factors, including:
  - economic factors (eg. economic growth, inflation, interest rates) affecting the markets in which the company operates;
  - strategic attractions of the business - its particular strengths and weaknesses, market position of the business, strength of competition and barriers to entry;
  - the company's own performance and growth trajectory;
  - rationalisation or synergy benefits available to the acquirer;
  - the structural and regulatory framework;
  - investment and sharemarket conditions at the time; and
  - the number of competing buyers for a business;
- acquisitions and listed companies in different countries can be analysed for comparative purposes, but it is necessary to give consideration to differences in overall sharemarket levels and ratings between countries, economic factors (economic growth, inflation, interest rates) and market structures (competition etc) and the regulatory framework. It is not appropriate to adjust multiples in a mechanistic way for differences in interest rates or sharemarket levels;
- acquisition multiples are based on the target's earnings but the price paid normally reflects the fact that there were synergies available to the acquirer (at least if the acquirer is a "trade buyer" with existing businesses in the same or a related industry). If the target's earnings were adjusted for these synergies, the effective multiple paid by the acquirer would be lower than that calculated on the target's earnings;
- while EBITDAR/EBITDA multiples are commonly used benchmarks they are an incomplete measure of cash flow. The appropriate multiple is affected by, among other things, the level of capital expenditure (and working capital investment) relative to EBITDAR/EBITDA. In this respect:
  - EBIT multiples can in some circumstances be a better guide because (assuming depreciation is a reasonable proxy for capital expenditure) they effectively adjust for relative capital intensity and present a better approximation of free cash flow. However, capital expenditure is lumpy and depreciation expense may not be a reliable guide. In addition, there can be differences between companies in the basis of calculation of depreciation; and
  - businesses that generate higher EBITDAR/EBITDA margins than their peer group companies will, all other things being equal, warrant higher EBITDAR/EBITDA multiples because free cash flow will, in relative terms, be higher (as capital expenditure is a smaller proportion of earnings).

In addition, there are some specific features of the airline industry:

- it is necessary to distinguish between airlines based on their business model. Low cost carriers have generally demonstrated more robust earnings (because of more flexible cost bases) and better growth profiles (at least until they reach maturity). Accordingly, they are accorded higher earnings multiples by the sharemarket at the present point in time and acquisition transactions involving low cost airlines have occurred at higher multiples;

- airlines suffer from significant volatility in earnings. Accordingly, it is necessary to carefully consider each company's earnings profile. Where an airline is experiencing depressed profitability or is in the midst of a crisis it will show relatively high earnings multiples (reflecting the expectation of a turnaround) but these are not appropriate to apply to airlines enjoying consistent profitability at reasonable margins; and

- there are substantial regional differences in terms of performance and growth outlook. In particular, the Asian region (incorporating China and India) offers far higher growth prospects for airlines over the next 20 years compared to mature markets such as Europe or the United States. Each regional market is also affected differently by the regulatory environment, geographic and demographic factors, consumer preferences and the competitive environment.

Transaction Evidence

Details of acquisitions of airlines in recent years are set out in Appendix 3. Very few of these are directly relevant to Qantas. Many of the transactions involve acquisitions of regional airlines or low cost carriers. These have generally shown higher EBITDAR multiples, in the range 6-10 times, but this reflects:

- the higher growth prospects and stronger business models of low cost carriers; and

- the extent of synergies available where regional carriers are merged with other regional carriers (e.g. MidWest/AirTran, ASA/Skywest) or where they are acquired by their major affiliate (e.g. Delta/Comair, American Airlines/Reno).

These transactions cannot be meaningfully compared to an acquisition of Qantas.

In October 2006, Ryanair Holdings plc ("Ryanair") bid for the newly listed Aer Lingus Group plc ("Aer Lingus"). Since 2001, Aer Lingus has effectively transformed itself into a low cost carrier so cannot be compared to Qantas. In any event, Ryanair's bid has been withdrawn because of competition issues.

In June 2006, Cathay Pacific acquired the 82.2% of Hong Kong Dragon Airlines Limited ("Dragonair") that it did not already own at a multiple of 10.9 times historical EBITDAR. Dragonair is a high yield, high cost airline with a strong position in the Hong Kong/China market. However:

- this acquisition was one element of a wider transaction rearranging ownership of the major Hong Kong/China aviation companies;

- Dragonair was facing pressure on its business model from increased competition in the Chinese aviation market; and

- substantial revenue benefits and cost savings are expected by Cathay Pacific (albeit emerging gradually over time). If synergies are allowed for the effective EBITDAR multiple would decrease materially.

There are also two transactions involving major United States airlines:

- in 2005, America West Holdings Corp ("America West") acquired US Airways Group Inc ("US Airways") at an implied forecast EBITDAR multiple of almost 12 times; and

- US Airways has recently offered to acquire Delta Airlines Inc ("Delta"). The offer implies a forecast EBITDAR multiple of 6.4 times.

However:

- US Airways was in Chapter 11 bankruptcy protection at the time of acquisition by America West. Synergies of over US$600 million were expected. If these synergies are fully allowed for, the effective forecast EBITDAR multiple reduces to approximately 5 times; and

- Delta is currently in Chapter 11 bankruptcy protection. US Airways anticipates annual synergies of US$600 million. If these synergies are allowed for in full, the effective forecast EBITDAR multiple falls to around 4 times. In any event, the offer was withdrawn on 31 January 2007.

Perhaps the most relevant transaction is the 2003 acquisition of KLM by Air France. KLM was acquired at approximately 7 times prospective EBITDAR. However:

- both KLM and Air France were underperforming airlines with weak operating margins. KLM was under some financial pressure;

- substantial synergies of approximately €400-500 million per annum were expected to be generated. If these are allowed for in full (they were anticipated to take several years to realise), the multiple falls to less than 4 times; and

- the multiple of net tangible assets was around 1.0 times.

Given these circumstances, any financial parameters will shed little light on the appropriate benchmarks for a profitable, stand alone airline such as Qantas. Accordingly, Grant Samuel has placed limited weight on transaction multiples although they do indicate that effective forecast EBITDAR multiples for full service airlines have been below 5 times.

Sharemarket Evidence

The multiples of selected listed airlines are set out in Appendix 4. It covers both full service airlines and low cost carriers and includes all of Qantas' key competitors except for Emirates which is privately owned. Most of the full service airlines also have a spread of ancillary businesses, including freight, engineering, catering and airport services although none has a mix that is exactly the same as Qantas. While multiples based on share prices do not include a premium for control, they are nevertheless a useful guide for Qantas as there are structural reasons why, for Qantas, a premium for control is likely to be lower than normal (the absence of synergies). The data is summarised below:

Sharemarket Ratings of Selected Airlines										
Company	Market Capitalisation[37] (million)	EBITDAR Multiple[38] (times)			EBIT Multiple[39] (times)			Price Earnings Multiple[40] (times)		
		2006	2007	2008	2006	2007	2008	2006	2007	2008
Full Service Carriers										
Singapore Airlines	S$22,697	7.0	6.8	6.1	14.6	14.0	11.1	19.3	18.1	15.1
Cathay Pacific	HK$81,199	10.2	7.6	7.2	19.4	15.7	12.8	22.9	18.4	14.9
ANA	¥857,982	8.1	7.9	7.5	16.0	16.6	15.4	22.7	21.1	17.6
JAL	¥691,293	10.7	8.8	7.9	nc	141.4	50.5	nc	nc	126.2
Korean Air	KRW2,522,783	7.2	6.6	6.0	17.9	14.6	11.9	27.3	15.7	9.1
Thai Airways	THB73,269	8.0	6.1	5.6	25.0	14.3	12.4	14.7	9.0	7.4
Air New Zealand	NZ$2,013	6.1	5.2	4.8	15.4	10.6	9.2	16.0	13.6	11.1
Lufthansa	€9,671	6.5	5.7	5.1	16.2	12.0	10.1	21.9	15.5	12.5
British Airways	£6,162	5.7	5.6	5.3	11.2	10.9	9.8	14.3	11.9	10.8
Air France-KLM	€8,794	4.8	4.2	4.0	11.8	9.2	8.6	15.5	11.8	10.1
Iberia	€2,878	6.7	6.0	5.2	15.4	11.0	7.2	17.8	21.5	14.0
SAS	SEK21,550	9.2	7.5	6.3	37.5	15.4	9.5	116.8	13.0	7.2
American Airlines	US$9,375	10.8	7.6	6.5	36.1	13.6	9.9	nc	10.9	6.6
United Airlines	US4,870	11.0	6.7	5.2	109.2	12.6	7.7	nc	20.1	6.8
ACE Aviation	C$3,639	6.9	5.8	5.2	13.9	10.5	8.7	18.2	12.9	12.7
Air Canada	C$1,809	6.0	5.4	4.3	15.7	11.0	7.7	41.8	9.8	7.5
Low Cost Carriers										
Virgin Blue	A$2,729	nc	9.0	7.8	nc	13.8	10.8	nc	20.1	15.3
Ryanair	€8,641	15.0	13.1	9.7	21.0	18.3	13.2	27.7	24.0	16.5
easyJet	£2,855	11.9	9.5	8.0	20.3	13.5	10.2	29.4	20.0	15.2
Southwest	US$13,399	8.8	7.5	6.5	14.0	11.4	9.4	23.1	18.4	15.5

Source: Grant Samuel analysis (see Appendix 4)

The implied multiples shown above should be treated with some caution as to their reliability:

- many of the airlines have been undertaking restructurings, acquisitions and sales. Several have substantial investments and associated company interests and many have significant or non recurring items. Accordingly, calculations of multiples involved a significant degree of judgement and incomplete information. In this context, Grant Samuel has observed material disparities in estimates of multiples between brokers;

- share prices of airlines have risen materially over the last 2-3 months as the fuel price has fallen. However, analysts have not yet released a full suite of revised forecasts to reflect this benefit. To this extent, the multiples may be overstated. The rises in some cases may also be the result of speculation about the possibility of takeovers following the announcement of the APA Offer (which may have changed views about the possibility of such transactions);

- depreciation policies differ between airlines. This can impact on the comparability of EBIT and PE multiples. Some analysts have noted that Singapore Airlines appears to be very conservative (i.e. leading to an overstated EBIT or PE multiple) but that British Airways appears to have book values for aircraft above market values (i.e. understating its EBIT and PE multiples);

37 Market capitalisation based on sharemarket prices as at 26 January 2007.

38 Represents gross capitalisation (that is, the sum of the market capitalisation adjusted for minorities, plus borrowings less cash as at the latest balance date plus aircraft operating leases (capitalised at 7 times forecast aircraft rentals)) divided by EBITDAR.

39 Represents gross capitalisation divided by EBIT.

40 Represents market capitalisation divided by net profit after tax (before goodwill amortisation and significant and non-recurring items).

- the PE multiples of airlines based in countries with low tax rates (e.g. Singapore Airlines, Cathay Pacific which both enjoy corporate tax rates of 20% or less) will be understated relative to other airlines; and

- many of the airlines have 31 December year ends. In order to align the data with Qantas' 30 June year end, Grant Samuel averaged the earnings of 31 December year end companies to create notional results to 30 June. This is a relatively crude adjustment which may be inaccurate and distort the result but, in the absence of available forecasts for the first half of the years ending 30 June 2007 and 30 June 2008, is better than no adjustment. In particular, the 2007 forecast earnings will be affected by the first half results of the 2006 calendar year (which were weak for many airlines).

Nevertheless, the data provides some insight into valuation parameters for listed airline companies.

The data indicates some diversity of multiples reflecting the particular circumstances of each airline and the growth prospects for the market in which it operates. For full service airlines:

- forecast EBITDAR multiples are broadly dispersed in the range 4-9 times with a median of around 6 times;

- forecast EBIT multiples are generally in the range 9-17 times 2007 earnings but with a cluster around 11-13 for non Asian airlines with slightly highly multiples for key Asian airlines. The range for 2008 earnings is 7-15 times but most between 9 and 13 times; and

- forecast PE multiples fall in a fairly wide range reflecting the impact of large depreciation, amortisation and financing charges which magnify differences at the net profit level as well as the effect of carried forward tax losses for some companies.

In very broad terms, the Asia Pacific based full service airlines, with the exception of Air New Zealand, show slightly higher multiples than the European or United States based airlines, reflecting their better market conditions and strong growth outlook. The chart in Section 4.3 (page 30) provides a clear demonstration of the higher growth prospects of China, South West Asia and Asia Pacific (all with growth rates 1.3-3.0% above the global average) compared to Europe and North America (both 0.5-1.0% below the global average) and this factor is probably a significant contributor to this premium.

Arguably, the two airlines most directly comparable to Qantas are Air New Zealand and Air Canada:

- Air New Zealand predominantly operates in the same economic region as Qantas and competes directly with Qantas on Trans Tasman routes. Moreover:

  - it has a significant domestic business (that competes with Qantas) including regional operations as well as an international airline;

  - it operates a low cost carrier (Freedom Air); and

  - it is an "end of line" carrier in a similar way to Qantas and has to compete against regional hub operators. Its competitors are substantially the same as those of Qantas.

  However, Air New Zealand's market rating may be adversely affected by:

  - its turbulent history. It had to be recapitalised by the New Zealand Government in 2001;

- the New Zealand Government's 80% ownership which limits the free float; and
- the continuing pressure from well capitalised competitors.

In addition, Air New Zealand is substantially smaller than Qantas; and

- Air Canada also has a significant domestic business where it controls over 60% of the Canadian domestic market with one major lower cost competitor (Westjet). Canada has similar characteristics to Australia in terms of geographic size and population. Air Canada also has a substantial international business (approximately 43% of all travel to and from Canada), particularly between Canada and the United States (approximately 38%) and a strong position in the busy Canada/North Asia routes. However, Air Canada's market rating may be adversely affected by:

  - Air Canada's history. It filed for bankruptcy protection in 2003 and emerged from bankruptcy through the float of ACE Aviation in 2004. ACE Aviation subsequently floated 25% of Air Canada in November 2006;
  - the limited free float. ACE Aviation owns 75% of Air Canada so the free float is limited (less than C$500 million);
  - recent trading in Air Canada has been negatively impacted by the potential stock overhang when ACE Aviation's lock up period ends (mid February 2007) and due to arbitrage trading around ACE Aviation's four listed entities (ACE Aviation, Aeroplan, Air Canada Jazz and Air Canada); and
  - the impact of the loss of direct control of its frequent flyer program (which is owned by the separately listed Aeroplan, of which ACE Aviation owns 50%).

  Further, Air Canada does not own its regional affiliate Air Canada Jazz (which is separately listed with ACE Aviation owning 79%), owns only 51% of its tour operator and does not have engineering activities (it obtains aircraft maintenance, repair and overhaul services from a wholly owned subsidiary of ACE Aviation).

  The table also includes multiples for ACE Aviation, Air Canada's parent. Subject to complexities around measurement of its multiples (because of recent transactions), it shows slightly higher multiples, perhaps reflecting the absence of some of the issues outlined above (i.e. on a consolidated basis it operates a full suite of aviation activities).

In addition, Singapore Airlines and Cathay Pacific can be regarded as very important comparables (albeit with some significant differences). Both operate primarily in the Asia Pacific region and compete directly with Qantas on several of its most important international routes. Their international operations are of similar size to Qantas:

Scale Comparison of Airlines[41]

	Singapore Airlines	Cathay Pacific (ex Dragonair)	Qantas international (inc Australian Airlines)	Qantas
Passengers carried	16,995,000	15,438,000	9,188,000	34,075,000
RPKs	82,741,700	65,109,800	59,948,000	90,899,000
Aircraft (at year end)	118	96	65	216
Revenue (A$)	11,153,000	8,371,000	na	13,542,300

Source: Company reports and announcements

[41] Latest full financial year: Singapore Airlines (31 March 2006), Cathay Pacific (31 December 2005) (i.e. prior to the acquisition of Dragonair) and Qantas (30 June 2006). Converted to A$ at exchange rates on 26 January 2007.

The key differences are that:

- both Singapore Airlines and Cathay Pacific operate out of "regional hubs" (Singapore and Hong Kong respectively) whereas Qantas is an "end of line" operator. A regional hub location creates the opportunity for an airline to capture traffic to other destinations from a wide variety of third countries (under a single carrier service which is always attractive to passengers). For example, both Singapore Airlines and Cathay Pacific carry passengers from Europe or the United States (and Australia) through their hubs and onto smaller cities throughout Asia where there are no direct services, particularly mainland China (in the case of Cathay Pacific) and South East Asia (in the case of Singapore Airlines). They can also compete effectively with airlines such as Qantas or Air New Zealand on routes to Europe because of the need for a stopover (i.e. if Qantas could fly non stop to Europe it would have a stronger competitive position on Australia/Europe traffic). End of line carriers are effectively limited to traffic into or out of their country of origin (although Qantas is able to compete on Europe/Asia routes and some intra Asia routes); and

- neither has any domestic airline businesses although both have significant short haul operations to nearby Asian destinations. In particular, Cathay Pacific has recently acquired full control of Dragonair which gives it a substantial short haul business from Hong Kong into China (and within China).

However, there are some issues regarding the multiples for both companies:

- Cathay Pacific's acquisition of Dragonair effective from September 2006 makes analysis difficult as limited guidance has been provided to the market about the expected earnings impact. Substantial synergies were anticipated to emerge over time and Dragonair's contribution may not be fully reflected in broker forecasts for 2007, thus overstating Cathay Pacific's multiples. In any event, the 2007 figures only include a part year effect of the acquisition; and

- Singapore Airlines owns 49% of Virgin Atlantic. This is a significant investment and needs to be adjusted to determine the effective multiple for Singapore Airlines' operating business. However, there is little publicly available information from which to estimate a market value for this business. Grant Samuel has assumed a value of S$2 billion. To the extent this estimate is conservative, Singapore Airlines' multiple would be lower.

Other companies that could be considered as appropriate benchmarks would include Air France-KLM S.A. ("Air France-KLM"), British Airways, Lufthansa and American Airlines. They are all full service airlines with substantial international operations. However, it should be noted that:

- their operations are concentrated in Europe (Air France-KLM, British Airways, Lufthansa) and North America (American Airlines), although they also operate longer haul businesses (e.g. Trans Atlantic, South America, Africa, Middle East and Asia). Of the three, British Airways has the largest component of long haul international services;

- they all have substantial domestic and/or short haul businesses that operate in highly competitive markets, particularly Air France-KLM, British Airways and Lufthansa, which face strong competition from low cost carriers for intra European services. In its domestic market American Airlines competes with United Airlines, Delta, US Airways, Continental and Southwest amongst others.

- the synergy benefits from the formation of Air France-KLM in 2003 are emerging and should drive strong profit growth but are not expected to be fully realised until 2011;

- British Airways is one of the world's largest international airlines and is the largest operator on the Trans Atlantic route. It has a powerful position at London's Heathrow Airport which is arguably the most important gateway into and out of Europe (particularly for Trans Atlantic and Asian traffic) and dominates the London business traveller market; and

- American Airlines is recovering from near collapse in the 2000-2001 period and growth in earnings is expected. In addition, its ratings may reflect market expectations of rationalisation in the United States airline industry (with benefits for all operators). The PE multiples are understated because no tax charge has been forecast due to carried forward tax losses (around 10-11 times if earnings are notionally taxed).

The other airlines have been included in the table for the sake of completeness but there are a number of issues which affect their ability to be used as comparables for Qantas:

- JAL's multiples are high as the notional 2007 year includes 2006 results which involved losses at the EBIT and net profit levels and only a gradual recovery in earnings over the forecast period as management initiatives are implemented;

- Korean Air Lines Co Ltd ("Korean Air") experienced difficult trading conditions in the 2004-2006 period including a stagnant export market (it derives 30% of revenue from cargo) and industrial disputes. Improved trading conditions and a major internal restructuring mean that significant growth in earnings through 2008 is expected. In addition, the PE multiples are understated as the tax charge forecast is below the corporate tax rate;

- Thai Airways International Public Company Limited's ("Thai Airways") profit declined in 2006 as a result of increased fuel prices, staff bonuses and the appreciation of the Thai Baht. Significant growth in profitability is forecast but concerns remain regarding political instability in Thailand and teething problems being experienced at the new Bangkok airport. Its multiples may also be distorted by a substantial level of investments and associates;

- Iberia experienced difficult trading conditions in 2005 and 2006 including industrial disputes (which has affected the multiple based on notional earnings to 30 June 2007). Earnings are expected to improve materially over the next two years but increased competition is expected in its key markets from at least three low cost carrier entrants (including Ryanair and easyJet plc ("easyJet")). Iberia's multiples may also be distorted by a substantial level of investments;

- SAS Group ("SAS") only returned to profitability in 2006 after radically redirecting its business model and implementing various cost reduction programmes in 2003. It is also divesting non-core businesses (e.g. it floated its hotel operations in December 2006). Earnings are expected to improve significantly over the next few years. The forecast PE multiples are understated by low tax charges due to tax losses (around 16 and 9 times in forecast 2007 and 2008 if earnings are notionally taxed); and

- United Airlines emerged from bankruptcy in February 2006 and its market rating probably reflects the potential for significant additional cost savings through continued restructuring.

In summary, the 2007 multiples for these airlines are not necessarily representative of the multiples that would apply if they were in a "steady state".

The multiples of low cost carriers are generally higher than those of the full service airlines reflecting their more attractive attributes and performance. However, the multiples would also reflect their current stage of development. As these businesses mature their multiples are likely to moderate. These airlines could be compared to Jetstar but it is critical to recognise that Jetstar is not a fully stand alone airline and would not be realised separately under Qantas' current strategy.

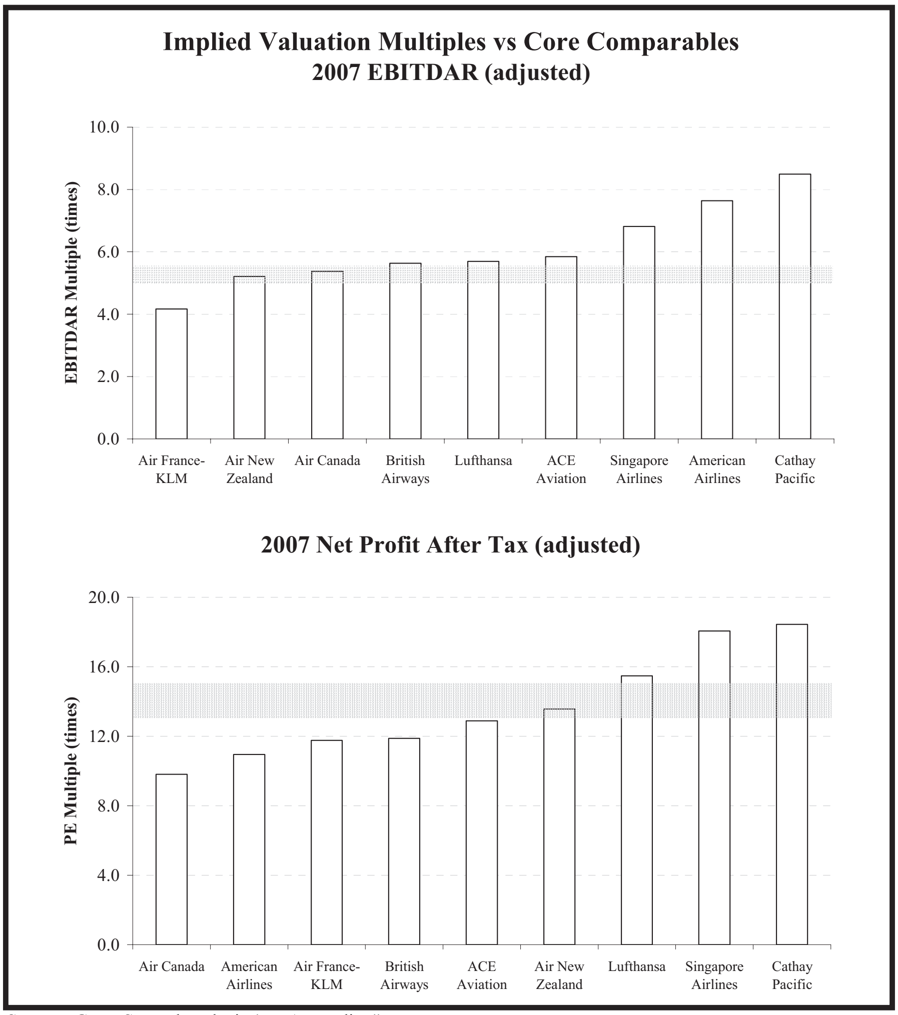
Analysis and Conclusion

The valuation of Qantas's airline operations of $14.5-16.0 billion implies the following multiples:

Qantas' Airline Operations – Implied Valuation Parameters			
	Variable ($ million)	Low	High
Multiple of EBITDAR			
Year ended 30 June 2006 (reported)	2,292.4	6.3	7.0
Year ended 30 June 2006 (adjusted[42])	2,455.5	5.9	6.5
Year ending 30 June 2007 (broker consensus)	2,770.4	5.2	5.8
Year ending 30 June 2007 (broker consensus, adjusted)	2,928.6	5.0	5.5
PE Multiple			
Year ended 30 June 2006 (reported)	479.5	21.5	24.8
Year ended 30 June 2006 (adjusted)	593.7	17.4	20.1
Year ending 30 June 2007 (broker consensus)	649.0	15.9	18.4
Year ending 30 June 2007 (broker consensus, adjusted)	787.0	13.1	15.1

The multiples of historical 2006 earnings are high but this reflects the substantial growth in earnings now anticipated in the year to 30 June 2007. The current year is therefore a better basis for valuation. While Qantas has made guidance statements about net profit before tax, it has not released specific forecasts of net profit or divisional profits for the year ending 30 June 2007 or beyond. Accordingly, the implied prospective multiples set out above are based on median broker forecasts (see Appendix 5 for details). These forecasts are sufficiently close to Qantas' 2007 Forecast to be useful for analytical purposes. The multiples have been calculated based on earnings before and after significant items. While earnings before significant items would generally be regarded as the better benchmark, an argument can be made that in the airline industry significant items such as restructuring costs are a regular feature. These adjusted multiples are compared to the core comparables for Qantas in the charts below:

[42] The adjusted multiples have been calculated before significant and non recurring items.



Source: Grant Samuel analysis (see Appendix 4)

In Grant Samuel's opinion, the implied multiples for Qantas are reasonable relative to the market evidence on comparable companies. As there is no realistic prospects of synergies being achieved by acquirers of Qantas under the current regulatory regime (as those that could realise them are prohibited from acquiring Qantas) it can be argued that there is no compelling case for attributing multiples significantly above those of listed comparable companies (some of which may have been affected by takeover speculation in any case).

Multiples of EBITDAR are useful because they allow for operating leases and ensure "like for like" comparison. However, it is important to recognise their significant limitations because they do not take any account of relative differences in the intensity of capital expenditure requirements between airlines (i.e. how much cash flow is consumed by capital expenditure and other items). This is a significant issue in the airline industry.

The charts indicate that the value range generally places Qantas on similar or higher multiples of 2007 EBITDAR and higher PE multiples than Air New Zealand, Air France-KLM and Air Canada. Qantas has a number of attributes that warrant a premium relative to these peers, including:

- a substantial and profitable domestic business which operates in an effective duopoly market. This provides a robust underpinning of earnings as it is far less volatile than international operations;

- a growing low cost carrier in Jetstar and Jetstar international. While Jetstar is not a stand alone business its earnings contribution has a more attractive growth profile than the full service business. In particular, there are growth opportunities for Jetstar international such as the United States market (once B787 aircraft become available). As can be seen from multiples of listed low cost carriers, this kind of business is currently rated more highly by the market than full service couriers. On the other hand, because of the constraints on the business (e.g. limited ability to pursue main trunk routes) its growth may be less than other low cost carriers. At the same time, it is important to recognise that Jetstar represents a relatively small proportion of Qantas and is likely to be less than 20% of Qantas ASK's even after 10 years;

- the growth potential of the freight business. Using the base of its own freight business and the two joint ventures with Australia Post, Qantas has the platform to develop a broadly based freight business (across all modes) leveraging the existing operations and market position; and

- the opportunities for further cost savings which are being targeted through the Sustainable Future Program. Qantas is targeting additional savings of $750 million in years subsequent to 2006/07.

In addition:

- relative to Air New Zealand, it has a more profitable and robust business with a much better domestic operation and better longer term exposure to the growth markets in Asia (e.g. Air New Zealand has no European services through Asia except through codeshares);

- Air France-KLM faces weak economic conditions and slow growth in its home markets; and

- Air Canada does not own its regional affiliate, its frequent flyer program or its aircraft engineering function.

On the other hand:

- the 2007 multiples for these airlines reflect significant operating improvements anticipated over the next 2-3 years as they restructure and their steady state level may be materially lower. For example, Air France-KLM has indicated it will take 3-4 years to realise the full synergies from the KLM merger and other restructurings;

- Qantas' 2006/07 earnings reflect strong conditions particularly in the domestic market. Capacity increases, both domestically and internationally, have been limited. These conditions may not be sustained going forward;

- Qantas faces a capital expenditure spend over the next few years that is probably higher than any of these airlines. Based on the Qantas fleet plan, total capital expenditure over the next 10 years (as assumed in the discounted cash flow model) totals more than $25 billion compared to current EBITDAR of around $2.5-3.0 billion; and

- in view of the constraints of the Qantas Sale Act there is less scope for Qantas to participate in consolidation opportunities than some of the other airlines (e.g. those operating within the European Union).

The implied EBITDAR multiples are slightly below those of British Airways and Lufthansa. However, the implied PE multiples are higher than for British Airways while Lufthansa is at levels slightly above the top of the valuation range. Both of these are very well positioned airlines (despite some issues around current performance and other matters such as pension liabilities). British Airways has been the subject of speculation about a potential buy out similar to the APA Offer which has bolstered its share price and multiples. Solid growth is anticipated for Lufthansa in the near term, with the German economy evidencing signs of a recovery. In addition, Lufthansa enjoys a material earnings contribution from engineering (where it is a world leader) and other activities. Forecast growth over the three years to 2009 is 13% at the EBITDAR level and over 30% at the net profit level.

The multiples across all parameters are below those of Singapore Airlines and Cathay Pacific. Notwithstanding the positive attributes outlined above, there are reasons that would lead to lower multiples for Qantas compared to these two airlines:

- both Singapore Airlines and Cathay Pacific are better placed to capitalise on what will be the key growth markets of the next 20 years, China and India. While Qantas will undoubtedly benefit significantly from growth in both these markets it will be largely Australia/China or Australia/India traffic whereas Singapore Airlines and Cathay Pacific are geographically well positioned to capture a significant share of all global traffic into these regions;

- irrespective of the specific growth opportunities available to Singapore Airlines and Cathay Pacific, a hub operator is a more attractive investment than an end of line carrier such as Qantas;

- Singapore Airlines and Cathay Pacific enjoy lower corporate tax rates. In addition, Singapore Airlines is able to depreciate its aircraft purchases over a three year period, giving it much better cash flows from such purchases;

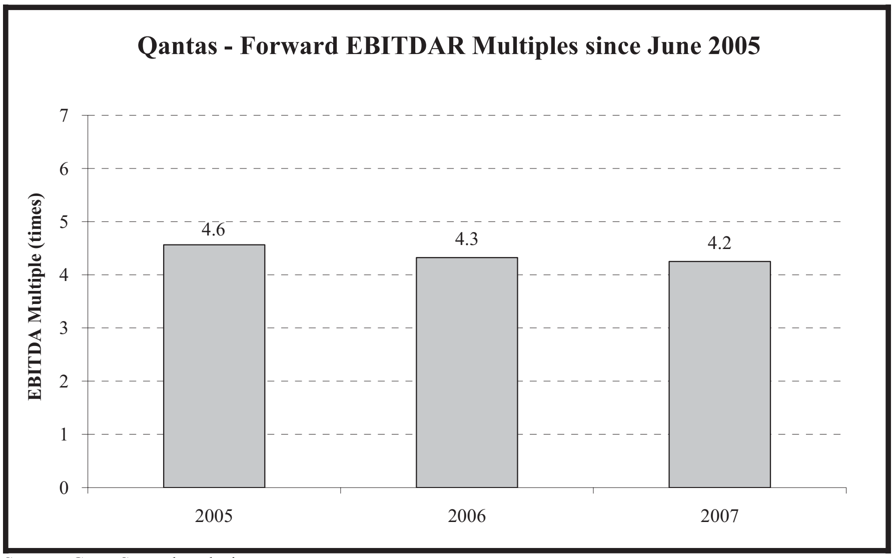
- both airlines have limited free floats. Singapore Airlines is 56% owned by the Singapore Government while four shareholders control 75% of Cathay Pacific. The tight liquidity may help their respective market ratings;

- Singapore Airlines has a much lower average fleet age (approximately 6 years). As a consequence it faces less pressure in coming years from increasing maintenance costs; and

- Cathay Pacific's multiples are also impacted by the recent Dragonair acquisition. Cathay Pacific is expected to grow earnings substantially over the next 2-3 years from this acquisition and the associated synergies. Analyst forecasts show forecast growth over the three years to 2009 of 17% per annum at the EBITDAR level and 21% at the net profit after tax level. The 2007 multiple is overstated as it only includes a part year effect of the acquisition and, in any event, may not fully reflect the earnings contribution in that year as little information has been released. In other words, Cathay Pacific's normalised, steady state multiples would be materially lower than the 8.5 times multiple for 2007.

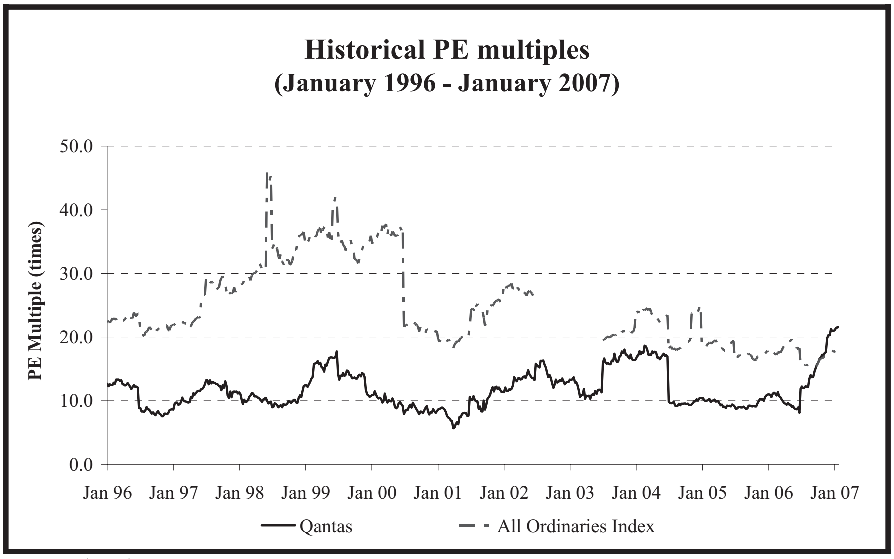
Market multiples over a long period of time would suggest that full service airlines in relatively stable situations have generally traded in the range 4-6 times EBITDAR depending on individual airlines circumstances and the stage of the cycle. These are low multiples but reflect the impact of the heavy capital expenditure on net cash flows. On this basis, the implied multiples for Qantas do not look unreasonable particularly in the light of the current strong trading conditions.

Another perspective is to consider Qantas' own EBITDAR multiples over time. The following chart shows that Qantas has generally traded at relatively low forecast multiples since 2005 and well below the levels implied by the valuation:



Source: Grant Samuel analysis

The PE multiples implied by the valuation are less than the average PE multiples of Australian listed companies. However, it is necessary to recognise that, until the last six months, Qantas has consistently traded at multiples well below the Australian market averages reflecting the challenges and performance of the airline industry:



Source: Bloomberg

Indeed, airlines worldwide generally trade at material discounts to their respective markets.

6.5 Investments

6.5.1 Freight Associates

50% interest in Australian air Express

Qantas' 50% interest in Australian air Express has been valued in the range $170.5-195.5 million. This value range is based on a value of $325.0-375.0 million for 100% of the business of Australian air Express on an ungeared basis. The ungeared value range implies the following multiples:

Australian air Express – Implied Valuation Parameters

	Variable ($ millions)	Low	High
Multiple of EBITDA			
Year ended 30 June 2006	54.3	6.0	6.9
Multiple of EBIT			
Year ended 30 June 2006	41.5	7.8	9.0

The value attributed to Australian air Express reflects market evidence of transactions involving other freight businesses, as well as specific factors relating to Australian air Express's domestic air freight and air mail services business.

A selection of recent transactions in the Australian and New Zealand freight and logistics industry are set out in the table below:

Recent Transactions in the Freight and Logistics Industry

Date	Target	Transaction	Consid-eration[43] ($ millions)	EBITDA multiple		EBIT multiple	
				historical	forecast	historical	forecast
Aug 2005	Patrick Corporation	Acquisition by Toll Holdings	6,334.1	14.7	11.9	22.2	17.6
May 2005	Owens Group	Acquisition of 20.3% not already owned by Mainfreight	66.2	4.8	na	10.5	na
Dec 2003	Star Track Express	Acquisition by Qantas and Australia Post	493.2	na	8.9	na	11.5
Jul 2003	Owens Group	Acquisition of 79.7% by Mainfreight	63.0	7.7	5.3	na	11.6
Nov 2002	Mayne Logistics	Acquisition by Linfox, DHL and Toll Holdings	456.0	4.5	4.5	7.0	7.1
Jul 2001	TDG Logistics	Acquisition by Patrick Corporation	45.8	5.4	6.9	9.7	16.0
Dec 2000	Cootes Holding	Acquisition by Iron Carbide	30.0	4.6	4.7	8.8	7.1
Nov 2000	Finemore Holdings	Scheme of arrangement with Toll Holdings	121.8	4.4	4.6	14.2	16.1
Mar 2000	MPG Logistics	Acquisition of 25% not already owned by Mayne Nickless	248.0	10.8	6.3	20.7	12.1

Source: IRESS, Bloomberg, company announcements, transaction documents, Grant Samuel analysis

[43] Implied equity value of 100% if the company or business has been acquired.

There have been no recent transactions in Australia or New Zealand involving the acquisition of an air freight business, except for distressed assets such as Ansett's air freight business, where the transaction evidence is not meaningful.

The transaction evidence shows a wide range of EBITDA and EBIT multiples, in the range 4-15 times historical EBITDA (at a median of approximately 5 times) and 5-22 times historical EBIT (at a median of approximately 10 times). Generally speaking, businesses that generate higher EBITDA margins have changed hand at higher multiples (reflecting the reasonably high operating leverage of freight businesses).

The most recent transaction involving an air freight business was Toll Holdings Limited's ("Toll Holdings") acquisition of Patrick Corporation Limited ("Patrick Corporation") which was completed in July 2006. The multiples implied by this acquisition were very high but this acquisition is not comparable to Australian air Express. Patrick Corporation's freight business was primarily ports and rail, although it also owned a 62.4% interest in Virgin Blue (which has a relatively small air freight business). Market commentary at the time considered that Toll Holdings had paid a full price, reflecting the strategic importance of the acquisition (it created an integrated logistics company with a dominant position in the Australian market) and the synergies expected to be generated from the acquisition of $60 million per annum (although analysts expected much higher synergies in the range $90-200 million). Patrick Corporation also earned very high EBITDA margins of around 17-18% (compared to 10-11% on average for the transactions listed above).

In contrast, Australian air Express is a single mode freight business (i.e. air freight only) which depends on Qantas for belly space and the lease of freighter aircraft (although aircraft are also leased from third parties). EBITDA margins have fallen from 11.5% in the year ended 30 June 2004 to 9.9% in the year ended 30 June 2006 and EBITDA has been relatively flat for the last three years. On the other hand, Australian air Express is one of the leading network providers in the Australian freight industry and has a dominant market share in the express air freight market. In addition, part of the reason for the flat EBITDA performance over the last three years has been the costs associated with a capital reinvestment program, the benefits of which should be seen in earnings in future years.

Taking these factors into account, implied multiples of 6.0-6.9 times historical EBITDA and 7.8-9.0 times historical EBIT are considered reasonable for Australian air Express. The reasonably low EBIT multiples reflect the relatively low depreciation charge incurred by Australian air Express.

Australian air Express had net cash at 31 December 2006 of $15.9 million, which has been added to the business valuation to arrive at a value for the equity in Australian air Express.

Qantas owns a 50% interest in Australian air Express. The agreement with Australia Post contains provisions in relation to management of the business and pre-emptive rights that are typical in joint ownership agreements.

A 50% interest does not typically warrant the same value, on a pro rata basis, as 100% ownership of a company because of the lack of absolute control and the transferability issues. However, given that the asset does not represent a significant proportion of the enterprise value of Qantas, no allowance has been made to reflect this situation.

50% interest in Star Track Express

Qantas' 50% interest in Star Track Express has been valued in the range $423.9-448.9 million. This value range is based on a value of $825.0-875.0 million for 100% of the business of Star Track Express on an ungeared basis. The ungeared value range implies the following multiples:

Star Track Express – Implied Valuation Parameters			
	Variable ($ millions)	Low	High
Multiple of EBITDA			
Year ended 30 June 2006	92.8	8.9	9.4
Multiple of EBIT			
Year ended 30 June 2006	66.7	12.4	13.1

The value attributed to Star Track Express reflects market evidence of transactions involving other freight businesses, particularly those operating in the time-sensitive or express road freight sector of the industry.

Road freight is a highly fragmented market. While there has been considerable consolidation activity over recent years, this has largely taken place at the smaller end of the market where information on transactions is unavailable or not particularly meaningful. Star Track Express is a significant participant in this fragmented market and has a dominant market share in the attractive express road freight market.

The most useful transaction multiples are those implied by Qantas' and Australia Post's acquisition of Star Track Express for $750 million (including assumed debt) in December 2003. This acquisition took place at multiples of 8.9 times forecast EBITDA and 11.5 times forecast EBIT. Star Track Express is a high quality business with superior technology and service levels which operates in a high growth market. It also earns relatively high EBITDA margins of approximately 19%.

Taking these factors into account, implied multiples of 8.9-9.4 times historical EBITDA and 12.4-13.1 times historical EBIT are considered reasonable for Star Track Express.

Star Track Express had net cash at 31 December 2006 of $22.9 million (excluding shareholder loans), which has been added to the business valuation to arrive at a value for the equity in Star Track Express.

Similar restrictions apply to Qantas' 50% investment in Star Track Express as apply to its investment in Australian air Express, however given that the asset does not represent a significant proportion of the enterprise value of Qantas, no allowance has been made to reflect this situation.

6.5.2 Other Investments

Air New Zealand

Qantas' 220.8 million convertible notes in Air New Zealand are convertible into 44.2 million shares in Air New Zealand. The investment in Air New Zealand has been valued at its market value on 31 January 2007 of $78.2 million, which has been calculated using an Air New Zealand share price of NZ$1.99 and an A$/NZ$ exchange rate of 1.12425.

Air Pacific

Qantas' 46.3% investment in Air Pacific has been valued in the range $0-30 million. The high end of the valuation range represents a 48% discount to the book value of Qantas' investment in Air Pacific at 31 December 2006 of $57.7 million. This value range is considered reasonable given the current performance of the business, the uncertain political environment in Fiji and the possible impact on tourism and therefore air transport.

Other Associates, Joint Ventures and Investments

Other associates and joint ventures are largely immaterial and have been valued at their book value at 31 December 2006 of $16.6-16.8 million. The low end of the range includes no value for Qantas' investment in Orangestar on the basis that it is loss making.

6.6 Cost Savings

Qantas incurred listed company costs (excluding costs associated with the Board of Directors given the provisions of the Qantas Sale Act) of $6.7 million in the year ended 30 June 2006. These costs represent the costs associated with being a listed company and include annual reports and shareholder communications, share registry and listing fees and dividend processing.

Any acquirer of Qantas would be able to save listed company costs. Grant Samuel has adjusted the enterprise value of Qantas to add back listed company costs, which have been capitalised at an EBIT multiple of 10-12 times.

6.7 Other Assets and Liabilities

Qantas' other assets and liabilities at 31 December 2006 have been valued in the range $(315.8)-(318.3) million and represent:

- $(15.1) million provision for onerous contracts, which is based on the balance of the provision at 31 December 2006, taxed at 30%;
- assets held for resale (properties and aircraft) with an estimated market value of $9.6 million;
- the present value of after tax restructuring costs to be incurred as part of the Sustainable Future Program in the six months ending 30 June 2007 and the years ending 30 June 2008 and 2009 of $(341.1)-(343.6) million;
- the present value of after tax amounts receivable from the aircraft manufacturer in relation to the delay in delivery of the A380 aircraft of $141.3 million. While this amount has been brought to account as income for accounting purposes, it has not yet been received;
- the fair value of hedge positions (excluding those relating to debt) of $(162.3) million, taxed at 30%;
- at 31 December 2006, Qantas had carried forward tax losses of $67.5 million. Of this amount, $26 million was brought to account as an asset on the balance sheet and the tax saving of $7.8 million has been included as a surplus asset. The remaining $41.5 million of tax losses exist in relation to Qantas' New Zealand operations and have not been brought to account in the balance sheet. No value has been attributed to these tax losses on the basis that it is not probable that taxable profit will be generated in the future against which the losses could be utilised; and
- outside equity interests in subsidiaries that are not wholly owned by Qantas, which have been valued at their book value at 31 December 2006 of $4.7 million. Outside equity interests represent a 25% interest in Singapore based Holiday Tours and Travel Pte Ltd. The outside equity interests are a deduction from the value of Qantas.

Qantas has a number of other assets and liabilities on its balance sheet that have not been included in other assets and liabilities for the following reasons:

- no asset has been recognised in relation to Qantas' defined benefit superannuation plan surplus. Under AIFRS, the superannuation expense in the statement of financial performance has been less than the required contribution as a result of the amortisation of the deferred surplus (i.e. the net expense was lower in the years ended 30 June 2005 and 2006 than it would have otherwise been). No adjustment has been made to Qantas' earnings to remove this impact. Therefore, the statement of financial performance implicitly reflects the defined benefit superannuation surplus;
- the provision for insurance and other (including the provision for workers' compensation insurance) of $128.9 million has not been included in other liabilities as it is an operating liability relating to self insurance by Qantas; and

- the $128.2 million loan to Star Track Express has not been included as a surplus asset as Qantas' share of the enterprise value of Star Track Express (net of Qantas' share of Star Track Express's cash and external borrowings) is included in the enterprise value of Qantas. As a result, the loan to Star Track Express has implicitly been recognised in Qantas' enterprise value.

As part of its business operations, Qantas is and could potentially become involved in litigation, including announced potential actions in relation to travel agent's commissions and international freight price fixing. No amount has been recognised in Qantas' balance sheet for these potential liabilities. Contingent liabilities in relation to legal claims are difficult to assess with any reliability. Grant Samuel has made no allowance for potential legal claims in its valuation of Qantas. It should be recognised that there is a risk that such liabilities may arise in future years, but at this point in time, there is no basis for determining a value for any potential legal claims.

6.8 Net Borrowings and Capitalised Operating Leases

Qantas' net borrowings for valuation purposes are $2,073.6 million. This amount reflect Qantas' net borrowings at 31 December 2006 of $2,336.9 million, adjusted for the after tax fair value of hedges relating to debt of $263.3 million.

In addition, the value of Qantas' business operations includes the value generated by utilising aircraft that are subject to operating lease (i.e. effectively off balance sheet debt). Consequently, in deriving a value for the equity in Qantas, an allowance has been made to reflect the capitalised value of the operating leases. This allowance was calculated as the present value of future non-cancellable operating lease payments, which, at 31 December 2006, was $2,548.9 million.

6.9 Franking Credits

No value has been attributed to franking credits. At 31 December 2006, Qantas had a franking account balance of $263.7 million. The special dividend of 15 cents per share will reduce Qantas' franking account balance to nil.

7 Evaluation of the APA Offer

7.1 Conclusion

Grant Samuel has estimated the full underlying value of Qantas to be in the range of $5.18 to $5.98 per share. On this basis, the APA Offer of $5.60 is fair and therefore is also reasonable.

Grant Samuel's value range is relatively wide, reflecting the volatility of value depending on the assumptions made about the future performance of the business. This is the unavoidable reality of the airline business. It is simply not possible to definitively determine value within a narrow range. Precision in the valuation of Qantas is unrealistic if not potentially misleading.

In this context, it is quite conceivable that others will have materially different opinions about the current value of Qantas (higher or lower) because of different views about:

- the outlook for revenues (capacity, loads, yield);
- future operating costs such as fuel prices and the ability to substantially reduce manpower costs;
- the risks of the business; and
- the possibilities of deregulation and industry restructuring.

However, these are matters of personal judgement about an inherently uncertain future.

On the other hand, Grant Samuel does not believe that the bottom end of its value range, which is the threshold for measuring whether or not the APA Offer is fair, is premised on excessively conservative assumptions. Indeed, it would be quite possible to derive a value range with a lower bottom end.

In considering the fairness and reasonableness of the APA Offer of $5.60, Grant Samuel also took the following factors into account:

- it provides a premium of 33% over the price at which Qantas shares were trading prior to the initial press reports of the potential offer;
- the multiples of EBITDAR and net profit after tax implied by the $5.60 offer price. Based on broker consensus forecast for the year ending 30 June 2007, the APA Offer represents EBITDAR multiples of approximately 5.3 times and a PE multiple of approximately 14.2 times. These multiples are above many of Qantas' peers but are below some of its key competitors such as Singapore Airlines and Cathay Pacific (whose prices do not include a premium for control). However:
    - Singapore Airlines or Cathay Pacific have better short and long term growth prospects than Qantas. These two airlines in particular are better positioned to capture the opportunities in China and elsewhere in Asia;
    - Qantas has historically traded at multiples well below the level implied by the APA Offer (and below its peers); and
    - there are no significant synergy benefits available to APA and there are structural impediments for those buyers that could capture synergies; and
    - it is supported by discounted cash flow analysis. The nature of the airline business means that any calculation of net present value is extremely sensitive to small changes in key assumptions and it is therefore inappropriate to rely entirely on discounted cash flow analysis. However, Grant Samuel's analysis demonstrates that a net present value of $5.60 requires a set of assumptions that are consistently reasonably optimistic.

At the same time, it is clear there are significant upsides within the business. Qantas' plans could, if realised, and growth opportunities support a value of $5.60 or more in due course but there are significant execution and other risks. It is Grant Samuel's judgement that the balance of potential return and risk suggests that shareholders are likely to be better off accepting $5.60 now rather than waiting for such a price to be achieved over time through other means. In effect, shareholders will capture a reasonable share of the upside potential by accepting the APA Offer.

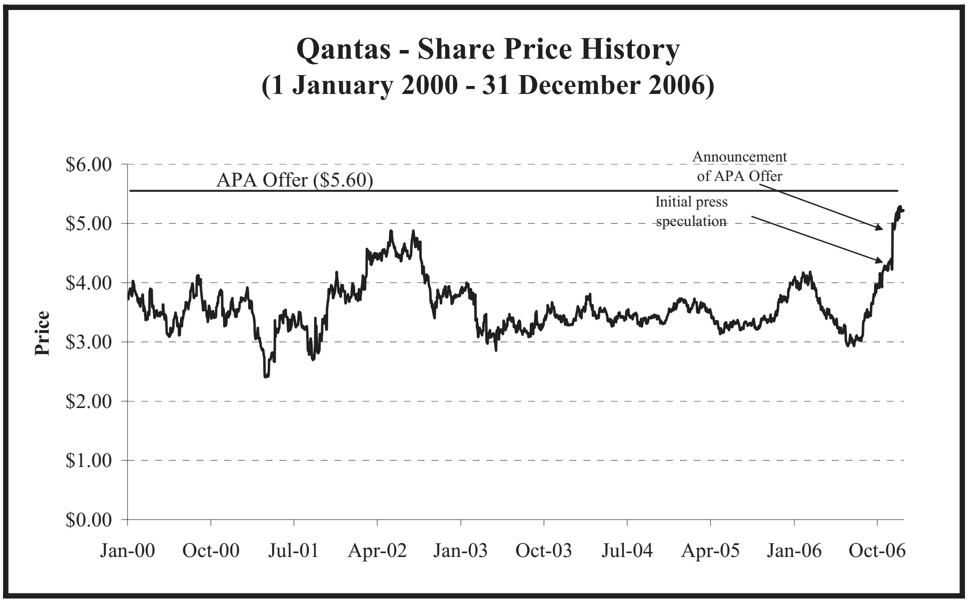
APA may generate high returns on its investment (at $5.60) but this:

- will require a "following wind" in a volatile and difficult industry;
- will reflect the much higher financial leverage, with its attendant increase in financial risk, to levels unlikely to be acceptable to public company investors;
- may result from future actions that could be difficult to achieve in a publicly listed environment; and
- may arise from consolidation or other opportunities flowing from future regulatory change.

7.2 Premium for Control

Qantas is a well traded stock and the market appears to have a good understanding of its strategies and plans. The share price should therefore represent a reasonably well informed market judgement about value in the current circumstances.

The APA Offer of $5.60 provides shareholders with a substantial premium over the pre bid share price:



Source: IRESS

The premium implied by the offer price has been calculated on two bases:

- relative to prices in the period up to the close of business on 6 November 2006, being the date prior to the first day on which there was media speculation as to a potential offer for Qantas; and
- relative to prices in the period up to the close of business on 21 November 2006, the date prior to the day on which Qantas announced that it had received an approach from Macquarie Bank and TPG.

Implied Premium of APA Offer over Share Price		
Date/Period	**Share Price**	**Premium (%)**
Closing price on 6 November 2006	$4.20	33.3%
1 week ended 6 November 2006 (vwap[44])	$4.23	32.3%
1 month ended 6 November 2006 (vwap)	$4.13	35.6%
3 months ended 6 November 2006 (vwap)	$3.72	50.5%
Closing price on 21 November 2006 (vwap)	$4.35	28.7%
1 week ended 21 November 2006 (vwap)	$4.36	28.5%
1 month ended 21 November 2006 (vwap)	$4.28	30.7%
3 months ended 21 November 2006 (vwap)	$3.87	44.9%

The period up to 6 November 2006 is the more relevant but, in any event, they all show premiums which are consistent with control premiums typically seen in takeover offers despite the absence of synergies. The circumstances of Qantas would suggest that a premium less than usually observed in takeovers would be a realistic expectation. However, this is not the case.

Qantas shares have not traded at prices above $5.00 since 1999 (when they briefly touched $5.34)[45] and were as low as $2.91 as recently as July 2006. The APA Offer of $5.60 represents a premium of 90% over this low point.

7.3 Alternative Offers

The APA Offer has been declared final in the absence of a proposal from a third party.

Under the Qantas Sale Act, shareholdings by foreign parties are limited to 25% of Qantas' voting capital and 49% in aggregate. In addition, individual foreigners are limited to less than 15% of Qantas shares under the Foreign Acquisitions and Takeovers Act (and 40% in aggregate) without approval from the Federal Treasurer. In view of the national interest issues involved, it is likely that any such investment would be carefully scrutinised.

Accordingly, there is unlikely to be an alternative or higher offer for Qantas unless the Australian Government was to change the Qantas Sale Act:

- there are no domestic trade buyers of sufficient size. The equity value of Qantas (at $5.60) is $11.1 billion. The only other large transport company is Toll Holdings with a market capitalisation of approximately $11.5 billion (but which, in any event, already owns Virgin Blue and is undergoing its own proposal to split into two listed companies);

- it would be difficult to find sufficient domestic financial investors to provide 51% (or more) of the local equity content for an alternative consortium (in the order of $1.5 billion depending on the level of debt utilised in the structure). This is a very substantial level of Australian sourced equity for an airline investment even in the current climate; and

- foreign trade buyers (i.e. other international airlines) are likely to want more than 15% and would ideally seek to own 100%. Even if some kind of merger was to be pursued (e.g. of international business with a view to generating substantial operating synergies) the partner would need an interest in the merged business of more than 15% to make it worthwhile from their point of view. British Airways did initially own 25% of Qantas but it is unlikely it could have increased this interest substantially. It is therefore difficult to see how a foreign trade buyer could ever participate in such a way as to deliver a fully valued offer to Qantas shareholders.

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44 vwap = volume weighted average price.

45 Price adjusted for the dilutionary impact of subsequent rights offering under a share purchase plan.

There is no reason to believe that the Australian Government is likely to change the key terms of the Qantas Sale Act in the foreseeable future in a manner that facilitates much higher levels of ownership by foreign airlines.

7.4 Market Price in Absence of the APA Offer

In view of the limited prospects of an alternative or higher offer, the fundamental question for shareholders is whether there is a reasonable prospect of Qantas shares trading at a price higher than $5.60 within the foreseeable future if the APA Offer is not successful.

Qantas shares have largely been locked in a trading range of $3.00-4.00 for much of the past six years and are likely, at least initially, to fall back towards the pre bid levels of around $4.20. The share price may not fall all the way back to $4.20. There appears to have been some changes in market sentiment towards Qantas (and airlines generally) resulting from:

- continuation of strong load factors and overall yield improvement through the period to 31 December 2006;
- the positive earnings guidance announced by Qantas since the initial announcement on 22 November 2006;
- the fall in the fuel price from US$85-90 per barrel (Singapore Jet Fuel Price) during much of 2006 to around US$75-80 per barrel; and
- increasing appreciation of the benefits of the A380 delay in tightening capacity on Qantas' key international routes over the next 2-3 years.

In addition, the overall sharemarket has risen as have the prices of Qantas' peer group airlines. On the other hand, despite the shift in sentiment, the price is unlikely to trade at anywhere near $5.60 in the short term in the absence of the APA Offer. Realistically, fundamental long term value is unlikely to have changed materially since late 2006:

- the load and yield growth seen over the last couple of years are the result of particularly favourable circumstances (a combination of economic strength and limited capacity increases in both domestic and international markets). These conditions will not always prevail and the general trend in yields over the longer term has been down;
- Qantas has fully hedged a majority of its fuel price exposure until 30 June 2007[46] and for a proportion of the following year (and therefore does not capture the full short term benefit from the current fall) and the forward curve still shows an upward trend in fuel prices;
- the A380 benefits are temporary and when deliveries commence at full production there will be a material increase in capacity; and
- none of the other issues affecting the industry (e.g. volatility, capital demands, capacity increases, regulation) have changed.

Nevertheless, there is a possibility that the shares could trade at levels approaching the offer price of $5.60 at some future date but it may take some time and would require a confluence of favourable outcomes including most, if not all, of the following:

- continuation of strong economic conditions both in Australia and globally that enable growth in demand and enhancement of yields;
- capacity increases on key domestic and international by competitors generally in line with demand growth and no irrational behaviour from competitors;

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[46] The balance of Qantas' fuel requirements for the 2006/07 year are largely covered by options which give it some exposure to lower fuel costs but at the cost of option premiums paid.

- no adverse changes in the regulatory framework or government policies (e.g. in relation to access to the Pacific route);
- successful implementation of the strategic plan including in particular:
  - further development of the Jetstar international business; and
  - further significant reduction in operating costs, primarily staff;
- no material rise in fuel prices; and
- no other external shocks (such as significant terrorism events or pandemics).

While there is considerable growth potential, the capital cost to realise it is substantial. Qantas' current program calls for total capital expenditure of more than $10 billion over the next five years and $25 billion over the next ten years. Similarly, while there is significant cost saving potential, this will be needed to offset the expected limited growth in yield at well below inflation. In addition, while the potential for Jetstar international is readily apparent, it will still be a relatively small proportion of the total business and profitable expansion is not straightforward. New routes require virtually daily flights (at acceptable load factors) to be profitable and the fleet configuration will need to be managed effectively.

Shareholders also need to recognise that despite the generally positive outlook for Qantas and the quality of its business, the market price will inevitably reflect the somewhat jaundiced view investors have about the industry. The share price will be "risk adjusted" to reflect the industry's turbulent history. This experience tempers any investor exuberance and will serve as a constraint on the re-rating potential of the shares.

The share price could also strengthen if there are any significant changes in industry structure or regulation. For example, relaxation of ownership restrictions which allow operational consolidation with other international airlines could create significant value either through:

- Qantas acquiring or merging with another overseas airline (or merging part of the operations) where there are significant operational synergies; or
- Qantas being acquired by another international airline at a substantial premium (reflecting the potential synergies).

However, there is no basis for being confident this will occur within the next 2-3 years.

7.5 Shareholder Decision

The decision of each shareholder as to whether to accept the APA Offer is a matter for individual shareholders based on each shareholder's views as to value and expectations as to future market conditions, and their particularly circumstances including risk profile, liquidity preference, investment strategy, portfolio structure and tax position. In particular, taxation consequences may vary from shareholder to shareholder. If in any doubt, shareholders should consult an independent professional adviser.

8 Qualifications, Declarations and Consents

8.1 Qualifications

The Grant Samuel group of companies provide corporate advisory services (in relation to mergers and acquisitions, capital raisings, debt raisings, corporate restructurings and financial matters generally), property advisory services and manages specialist funds. The primary activity of Grant Samuel & Associates Pty Limited is the preparation of corporate and business valuations and the provision of independent advice and expert's reports in connection with mergers and acquisitions, takeovers and capital reconstructions. Since inception in 1988, Grant Samuel and its related companies have prepared more than 375 public independent expert and appraisal reports.

The persons responsible for preparing this report on behalf of Grant Samuel are Stephen Wilson MCom (Hons) CA (NZ) SF Fin and Jaye Gardner BCom LLB (Hons) CA SF Fin. Each has a significant number of years of experience in relevant corporate advisory matters. Tim Archer BE (Hons) BSc, Rory Burdon BCom (Hons) A Fin, Joan Coffey BEc (Hons), James Lilico BSc (Hons) MSc and Tina Fendl BCom CFA assisted in the preparation of the report. Each of the above persons is an authorised representative of Grant Samuel pursuant to its Australian Financial Services Licence under Part 7.6 of the Corporations Act.

8.2 Disclaimers

It is not intended that this report should be used or relied upon for any purpose other than as an expression of Grant Samuel's opinion as to whether the APA Offer is fair and reasonable to Qantas shareholders. Grant Samuel expressly disclaims any liability to any Qantas shareholder who relies or purports to rely on the report for any other purpose and to any other party who relies or purports to rely on the report for any purpose whatsoever.

This report has been prepared by Grant Samuel with care and diligence and the statements and opinions given by Grant Samuel in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading. However, no responsibility is accepted by Grant Samuel or any of its officers or employees for errors or omissions however arising in the preparation of this report, provided that this shall not absolve Grant Samuel from liability arising from an opinion expressed recklessly or in bad faith.

Grant Samuel has had no involvement in the preparation of the Target's Statement issued by Qantas and has not verified or approved any of the contents of the Target's Statement. Grant Samuel does not accept any responsibility for the contents of the Target's Statement (except for this report).

8.3 Independence

Grant Samuel and its related entities do not have at the date of this report, and have not had within the previous two years, any shareholding in or other relationship with Qantas or APA that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the APA Offer. Grant Samuel advises that:

- Grant Samuel Property Pty Limited ("Grant Samuel Property"), a related company of Grant Samuel, has been retained by Qantas to provide corporate real estate services;
- Grant Samuel Property has been retained to provide corporate real estate services to Macquarie Bank and certain of its subsidiaries;
- Grant Samuel prepared an independent expert's report dated 15 March 2005 for the shareholders of Record Investments Limited ("Record") in relation to a share placement to a member of the Allco group of companies ("Allco"), changes to the Record board of directors and amendments to the terms of the Record Management Agreement;
- Grant Samuel prepared an independent expert's report dated 1 May 2006 for the shareholders of Record in relation to the merger of Record and Allco to form Allco Finance Group Limited; and

- Grant Samuel Corporate Finance Pty Limited, a related company of Grant Samuel, was retained by Allco in March 2005 to review the business model of a telecommunications company and in May 2005 to review five competitive global sales for broadband wireless access spectrum.

The Grant Samuel group of companies has a corporate scheme for Qantas Club membership and individual executives are members of the Qantas Frequent Flyer program. In addition, three Grant Samuel group executives hold a total of less than 155,000 Qantas shares.

Grant Samuel had no part in the formulation of the APA Offer. Its only role has been the preparation of this report.

Grant Samuel will receive a fixed fee for the preparation of this report. This fee is not contingent on the outcome of the APA Offer. Grant Samuel's out of pocket expenses in relation to the preparation of the report will be reimbursed. Grant Samuel will receive no other benefit for the preparation of this report.

Grant Samuel considers itself to be independent in terms of Practice Note 42 issued by the ASIC (previously known as Australian Securities Commission) on 8 December 1993.

8.4 Declarations

Qantas has agreed that it will indemnify Grant Samuel and its employees and officers in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity will not apply in respect of the proportion of any liability found by a court to be primarily caused by any conduct involving negligence, recklessness, wilful misconduct or default by Grant Samuel. Qantas has also agreed to indemnify Grant Samuel and its employees and officers for time spent and reasonable legal costs and expenses incurred in relation to any inquiry or proceeding initiated by any person. Where Grant Samuel or its employees and officers are found to have been negligent, reckless or engaged in wilful misconduct or default Grant Samuel shall bear the proportion of such costs caused by its action. Any claims by Qantas are limited to an amount equal to the fees paid to Grant Samuel except to the extent of that proportion of any loss that is primarily caused by gross negligence, recklessness, wilful misconduct or default of Grant Samuel.

Advance drafts of this report were provided to Qantas and its advisers. Certain changes were made to the drafting of the report as a result of the circulation of the draft report. There was no alteration to the methodology, evaluation or conclusions as a result of issuing the drafts.

8.5 Consents

Grant Samuel consents to the issuing of this report in the form and context in which it is to be included in the Target's Statement to be sent to shareholders of Qantas. Neither the whole nor any part of this report nor any reference thereto may be included in any other document without the prior written consent of Grant Samuel as to the form and context in which it appears.

8.6 Other

The accompanying letter dated 9 February 2007 and the Appendices form part of this report.

Grant Samuel has prepared a Financial Services Guide as required by the Corporations Act. The Financial Services Guide is set out at the beginning of this report.

GRANT SAMUEL & ASSOCIATES PTY LIMITED
9 February 2007

Grant Samuel & Associates

Appendix 1

Selection of Discount Rate

1 Overview

A discount rate in the range of 9.0-9.5% has been selected as appropriate to apply to the forecast nominal ungeared after tax cash flows of Qantas' business operations. While Qantas operates a number of discrete businesses (e.g. Jetstar), the reality is that Qantas operates an integrated airline business (e.g. Jetstar is not fully stand alone as routes are co-ordinated with Qantas) and Grant Samuel believes it is appropriate to value Qantas as a single business.

Selection of the appropriate discount rate to apply to the forecast cash flows of any business enterprise is fundamentally a matter of judgement. The valuation of an asset or business involves judgements about the discount rates that may be utilised by potential acquirers of that asset. There is a body of theory which can be used to support that judgement. However, a mechanistic application of formulae derived from that theory can obscure the reality that there is no "correct" discount rate. Despite the growing acceptance and application of various theoretical models, it is Grant Samuel's experience that many companies rely on less sophisticated approaches. Many businesses use relatively arbitrary "hurdle rates" which do not vary significantly from investment to investment or change significantly over time despite interest rate movements. Valuation is an estimate of what real world buyers and sellers of assets would pay and must therefore reflect criteria that will be applied in practice even if they are not theoretically correct. Grant Samuel considers the rates adopted to be reasonable discount rates that acquirers would use irrespective of the outcome or shortcomings of applying any particular theoretical model.

The discount rate that Grant Samuel has adopted is reasonable relative to the rates derived from theoretical models. The discount rate represents an estimate of the weighted average cost of capital ("WACC") appropriate for these assets. Grant Samuel has calculated a WACC based on a weighted average of the cost of equity and the cost of debt. This is the relevant rate to apply to ungeared cash flows. There are three main elements to the determination of an appropriate WACC. These are:

- cost of equity;
- cost of debt; and
- debt/equity mix.

WACC is a commonly used basis but it should be recognised that it has shortcomings in that it:

- represents a simplification of what are usually much more complex financial structures; and
- assumes a constant degree of leverage which is seldom correct.

The cost of equity has been derived from application of the Capital Asset Pricing Model ("CAPM") methodology. The CAPM is probably the most widely accepted and used methodology for determining the cost of equity capital. There are more sophisticated multivariate models which utilise additional risk factors but these models have not achieved any significant degree of usage or acceptance in practice. However, while the theory underlying the CAPM is rigorous the practical application is subject to shortcomings and limitations and the results of applying the CAPM model should only be regarded as providing a general guide. There is a tendency to regard the rates calculated using CAPM as inviolate. To do so is to misunderstand the limitations of the model. For example:

- the CAPM theory is based on expectations but uses historical data as a proxy. The future is not necessarily the same as the past;
- the measurement of historical data such as risk premia and beta factors is subject to very high levels of statistical error. Measurements vary widely depending on factors such as source, time period and sampling frequency;

- the measurement of beta is often based on comparisons with other companies. None of these companies is likely to be directly comparable to the entity for which the discount rate is being calculated and may operate in widely varying markets;

- parameters such as the debt/equity ratio and risk premium are based on subjective judgements; and

- there is not unanimous agreement as to how the model should adjust for factors such as taxation. The CAPM was developed in the context of a "classical" tax system. Australia's system of dividend imputation has a significant impact on the measurement of net returns to investors.

The cost of debt has been determined by reference to the pricing implied by the debt markets in Australia. The cost of debt represents an estimate of the expected future returns required by debt providers. In determining the appropriate cost of debt over this forecast period, regard was had to debt ratings of comparable companies.

Selection of an appropriate debt/equity mix is a matter of judgement. The debt/equity mix represents an appropriate level of gearing, stated in market value terms, for the business over the forecast period. The relevant proportions of debt and equity have been determined having regard to the financial gearing of the industry in general and comparable companies, and judgements as to the appropriate level of gearing considering the nature and quality of the cash flow stream.

The following sections set out the basis for Grant Samuel's determination of the discount rates for Qantas and the factors which limit the accuracy and reliability of the estimates.

2 Definition and Limitations of the CAPM and WACC

The CAPM provides a theoretical basis for determining a discount rate that reflects the returns required by diversified investors in equities. The rate of return required by equity investors represents the cost of equity of a company and is therefore the relevant measure for estimating a company's weighted average cost of capital. CAPM is based on the assumption that investors require a premium for investing in equities rather than in risk free investments (such as Australian government bonds). The premium is commonly known as the market risk premium and notionally represents the premium required to compensate for investment in the equity market in general.

The risks relating to a company or business may be divided into specific risks and systematic risks. Specific risks are risks that are specific to a particular company or business and are unrelated to movements in equity markets generally. While specific risks will result in actual returns varying from expected returns, it is assumed that diversified investors require no additional returns to compensate for specific risk, because the net effect of specific risks across a diversified portfolio will, on average, be zero. Portfolio investors can diversify away all specific risk.

However, investors cannot diversify away the systematic risk of a particular investment or business operation. Systematic risk is the risk that the return from an investment or business operation will vary with the market return in general. If the return on an investment was expected to be completely correlated with the return from the market in general, then the return required on the investment would be equal to the return required from the market in general (i.e. the risk free rate plus the market risk premium).

Systematic risk is affected by the following factors:

- financial leverage: additional debt will increase the impact of changes in returns on underlying assets and therefore increase systematic risk;

- cyclicality of revenue: projects and companies with cyclical revenues will generally be subject to greater systematic risk than those with non-cyclical revenues; and

- operating leverage: projects and companies with greater proportions of fixed costs in their cost structure will generally be subject to more systematic risk than those with lesser proportions of fixed costs.

CAPM postulates that the return required on an investment or asset can be estimated by applying to the market risk premium a measure of systematic risk described as the beta factor. The beta for an investment reflects the covariance of the return from that investment with the return from the market as a whole. Covariance is a measure of relative volatility and correlation. The beta of an investment represents its systematic risk only. It is not a measure of the total risk of a particular investment. An investment with a beta of more than one is riskier than the market and an investment with a beta of less than one is less risky. The discount rate appropriate for an investment which involves zero systematic risk would be equal to the risk free rate.

The formula for deriving the cost of equity using CAPM is as follows:

$$Re = Rf + Beta\,(Rm - Rf)$$

Where:

Re	=	the cost of equity capital;
Rf	=	the risk free rate;
Beta	=	the beta factor;
Rm	=	the expected market return; and
Rm - Rf	=	the market risk premium.

The beta for a company or business operation is normally estimated by observing the historical relationship between returns from the company or comparable companies and returns from the market in general. The market risk premium is estimated by reference to the actual long run premium earned on equity investments by comparison with the return on risk free investments.

The formula conventionally used to calculate a WACC under a classical tax system is as follows:

$$WACC = (Re \times E/V) + (Rd \times (1-t) \times D/V)$$

Where:

E/V	=	the proportion of equity to total value (where V = D + E);
D/V	=	the proportion of debt to total value;
Re	=	the cost of equity capital;
Rd	=	the cost of debt capital; and
t	=	the corporate tax rate

The models, while simple, are based on a sophisticated and rigorous theoretical analysis. Nevertheless, application of the theory is not straightforward and the discount rate calculated should be treated as no more than a general guide. The reliability of any estimate derived from the model is limited. Some of the issues are discussed below:

- **Risk Free Rate**

  Theoretically, the risk free rate used should be an estimate of the risk free rate in each future period (i.e. the one year spot rate in that year if annual cash flows are used). There is no official "risk free" rate but rates on government securities are typically used as an acceptable substitute. More importantly, forecast rates for each future period are not readily available. In practice, the long term Commonwealth Government Bond rate is used as a substitute in Australia and medium to long term Treasury Bond rates are used in the United States. It should be recognised that the yield to maturity of a long term bond is only an average rate and where the yield curve is strongly positive (i.e. longer term rates are significantly above short term rates) the adoption of a single long term bond rate has the effect of reducing the net present value where the major positive cash flows are in the initial years. The long term bond rate is therefore only an approximation.

  The ten year bond rate is a widely used and accepted benchmark for the risk free rate. Where the forecast period exceeds ten years, an issue arises as to the appropriate bond to use. While longer term bond rates are available, the ten year bond market is the deepest long term bond market in Australia and is a widely used and recognised benchmark. There is a very limited market for bonds of more than ten years. In the United States, there are deeper markets for longer term bonds. The

30 year bond rate is a widely used benchmark. However, long term rates accentuate the distortions of the yield curve on cash flows in early years. In any event, a single long term bond rate matching the term of the cash flows is no more theoretically correct than using a ten year rate. More importantly, the ten year rate is the standard benchmark used in practice.

- **Market Risk Premium**

  The market risk premium *(Rm - Rf)* represents the "extra" return that investors require to invest in equity securities as a whole over risk free investments. This is an "ex-ante" concept. It is the expected premium and as such it is not an observable phenomenon. The historical premium is therefore used as a proxy measure. The premium earned historically by equity investments is calculated over a time period of many years, typically at least 30 years. This long time frame is used on the basis that short term numbers are highly volatile and that a long term average return would be a fair indication of what most investors would expect to earn in the future from an investment in equities with a 5-10 year time frame.

  In the United States it is generally believed that the premium is in the range of 5-6% but there are widely varying assessments (from 3% to 9%). Australian studies have been more limited but indicate that the long run average premium has been in the order of 6% using a geometric average (and is in the order of 8% using an arithmetic average) measured over more than 100 years of data[1]. Even an estimate based over a very long period such as 100 years is subject to significant statistical error. Given the volatility of equity market returns it is only possible to state that the "true" figure lies within a range of approximately 2-10% at a 95% confidence level (using the geometric average).

  In addition, the market risk premium is not constant and changes over time. At various stages of the market cycle investors perceive that equities are more risky than at other times and will increase or decrease their expected premium. Indeed, there are arguments being put forward at the present time that the risk premium is now lower than it has been historically. This view is reflected in the recent update of the Officer Study[2] which indicates that (based on the addition of 17 years of data to 2004) the long term arithmetic average has declined from 7.94% to 7.17%.

  In practice, market risk premiums of 5-7% are typically adopted in Australia.

- **Beta Factor**

  The beta factor is a measure of the expected covariance (i.e. volatility and correlation of returns) between the return on an investment and the return from the market as a whole. The expected beta factor cannot be observed. The conventional practice is to calculate an historical beta from past share price data and use it as a proxy for the future but it must be recognised that the expected beta is not necessarily the same as the historical beta. A company's relative risk does change over time.

  The appropriate beta is the beta of the company being acquired rather than the beta of the acquirer (which may be in a different business with different risks). Betas for the particular subject company may be utilised. However, it is also appropriate (and may be necessary if the investment is not listed) to utilise betas for comparable companies and sector averages (particularly as those may be more reliable).

  However, there are very significant measurement issues even with historical betas which mean that only limited reliance can be placed on such statistics. There is no "correct" beta. For example:

  - over the last three years the historical Qantas beta as measured by the Australian Graduate School of Management ("AGSM") has varied between 1.0 and 1.4 and, in fact, in March 2003 was measured at 0.61; and

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1 See, for example, R.R. Officer in Ball, R., Brown, P., Finn, F. J. & Officer, R. R., "Share Market and Portfolio Theory: Readings and Australian Evidence" (second edition), University of Queensland Press, 1989 ("Officer Study") which was based on data for the period 1883 to 1987 and therefore was undertaken prior to the introduction of dividend imputation in Australia.

2 Gray, S. and Officer, R.R., "A Review of the Market Risk Premium and Commentary on Two Recent Papers: A Report prepared for the Energy Networks Association", August 2005.

- the standard error of the AGSM's estimate of the historical Qantas beta has generally been in the order of 0.5 to 0.7 meaning that for a beta of, say, 1.1 there is only a 67% confidence level that it falls somewhere in a range of roughly 0.5 to 1.7.

- **Debt/Equity Mix**

  The tax deductibility of the cost of debt means that the higher the proportion of debt the lower the WACC, although this would be offset, at least in part, by an increase in the beta factor as leverage increases.

  The debt/equity mix assumed in calculating the discount rate should be consistent with the level implicit in the measurement of the beta factor. Typically, the debt/equity mix changes over time and there is significant diversity in the levels of leverage across companies in a sector. There is a tendency to calculate leverage at a point in time whereas the leverage should represent the average over the period the beta was measured. This can be difficult to assess with a meaningful degree of accuracy.

  The measured beta factors for listed companies are "equity" betas and reflect the financial leverage of the individual companies. It is possible to unleverage beta factors to derive asset betas and releverage betas to reflect a more appropriate or comparable financial structure. In Grant Samuel's view this technique is subject to considerable estimation error. Deleveraging and releveraging betas exacerbates the estimation errors in the original beta calculation and gives a misleading impression as to the precision of the methodology. Deleveraging and releveraging is also incorrectly calculated if it is based on debt levels at a single point in time.

  In addition, the actual debt and equity structures of most companies are typically relatively complex. It is necessary to simplify this for practical purposes in this kind of analysis.

  Finally, it should be noted that, for this purpose, the relevant measure of the debt/equity mix is based on market values not book values.

- **Specific Risk**

  The WACC is designed to be applied to "expected cash flows" which are effectively a weighted average of the likely scenarios. To the extent that a business is perceived as being particularly risky, this specific risk should be dealt with by adjusting the cash flow scenarios. This avoids the need to make arbitrary adjustments to the discount rate which can dramatically affect estimated values, particularly when the cash flows are of extended duration or much of the business value reflects future growth in cash flows. In addition, risk adjusting the cash flows requires a more disciplined analysis of the risks that the valuer is trying to reflect in the valuation.

  However, it is also common in practice to allow for certain classes of specific risk (particularly sovereign and other country specific risks) in a different way by adjusting the discount rate applied to forecast cash flows.

3 Calculation of WACC for Qantas

3.1 Cost of Equity Capital

The cost of equity capital for Qantas has been estimated by reference to the CAPM formula (*Re = Rf + Beta (Rm-Rf))*. Grant Samuel has calculated a cost of equity capital of 12.4% using the following estimates for each variable:

- **Risk-Free Rate**

  Grant Samuel has adopted a risk free rate of 5.8%. The risk free rate approximates the current yield to maturity on ten year Australian Government bonds.

- **Market Risk Premium**

  Grant Samuel has consistently adopted a market risk premium for Australia of 6% and believes that, particularly in view of the general uncertainty about statistical reliability, this continues to be a reasonable estimate. It is:

  - not statistically significantly different to the premium suggested by the historical data;
  - similar to that used by a wide variety of analysts and practitioners; and
  - the same as that adopted by most regulatory authorities in Australia.

- **Beta Factor**

  Grant Samuel has adopted a beta factor of 1.1 for the purposes of valuing Qantas' business operations.

  Grant Samuel has considered the beta factors for a wide range of airline companies in determining an appropriate beta for Qantas' business operations. The betas have been calculated on two bases, relative to each company's home or local exchange index and relative to the Morgan Stanley Capital International Developed World Index ("MSCI"), an international equities market index that is widely used as a proxy for the global stockmarket as a whole. Where a company is extensively traded by global investors it can be argued that the regression against the MSCI is more relevant but:

  - this depends on who the "price setting" investors are; and
  - it raises a related issue as to whether a global risk premium is also appropriate and, if so, what that global premium is.

  Put alternatively, there is no simple, universal answer.

  A summary of betas for selected comparable listed companies is set out in the table below:

Equity Beta Factors for Selected Listed Airlines						
Company	Market Capital-isation[3] (millions)	Monthly Observations over four years			Weekly Observations over two years	
		AGSM/ Ibbotson/ LSE[4]	Bloomberg[5]		Bloomberg	
			Local Index	MSCI[6]	Local Index	MSCI
Qantas	**A$8,644**	**1.31**	**1.09**	**1.04**	**0.76**	**0.83**
Full Service Carriers						
Singapore Airlines	S$22,697	na	1.13	1.30	1.00	0.93
Cathay Pacific	HK$81,199	na	1.01	1.01	0.88	0.66
ANA	¥857,982	na	0.83	0.45	0.82	0.72
JAL	¥691,293	na	0.86	0.57	0.59	0.57
Korean Air	KRW2,522,783	na	1.15	1.62	1.22	1.13
Thai Airways	BHT73,269	na	0.62	1.00	0.70	1.23
Air New Zealand	NZ$2,013	0.31	1.13	0.59	0.83	0.80
Lufthansa	€9,671	na	1.00	1.54	0.84	0.97
British Airways	£6,163	1.79	1.42	1.99	0.91	1.04
Air France-KLM	€8,794	na	1.28	1.83	0.88	1.05
Iberia	€2,878	na	1.36	1.67	0.85	0.87
SAS	SEK21,550	na	1.21	1.81	0.84	0.62
American Airlines	US$9,375	3.85	4.72	4.54	1.65	1.57
United Airlines	US$4,870	na	na	na	na	na
ACE Aviation	C$3,639	na	na	na	na	na
Air Canada	C$1,809	na	na	na	na	na
Minimum			*0.62*	*0.45*	*0.59*	*0.57*
Maximum			*4.72*	*4.54*	*1.65*	*1.57*
Median			*1.13*	*1.54*	*0.85*	*0.93*
Weighted average[7]			*1.47*	*1.68*	*0.95*	*0.96*
Low Cost Carriers						
Virgin Blue	A$2,729	1.47	1.13	1.35	0.96	0.91
Ryanair	€8,641	1.03	1.18	1.04	0.72	0.73
easyJet	£2,855	1.16	0.66	0.93	1.04	0.86
Southwest	US$13,399	1.08	0.73	0.63	0.93	0.92
Minimum			*0.66*	*0.63*	*0.72*	*0.73*
Maximum			*1.18*	*1.35*	*1.04*	*0.92*
Median			*0.93*	*0.99*	*0.95*	*0.89*
Weighted average			*0.90*	*0.87*	*0.88*	*0.84*

Source: AGSM, Ibbotson, London Business School, Bloomberg

3 Based on share prices as at 26 January 2007, except Qantas which is based on its share price as at 21 November 2006 (being the day prior to Qantas' announcement of the approach by Airline Partners Australia).

4 The Australian beta factors calculated by AGSM as at 30 September 2006 over a period of 48 months using ordinary least squares regression or the Scholes-Williams technique where the stock is thinly traded. United States beta factors calculated by Ibbotson Associates ("Ibbotson") as at 30 September 2006 over a period of 60 months using ordinary least squares regression or the Scholes-Williams technique (including lag) where the stock is thinly traded. United Kingdom beta factors calculated by the London Business School as at 30 September 2006 have been calculated over a period of 60 months using ordinary least squares regression.

5 Bloomberg betas have been calculated up to 31 December 2006. Grant Samuel understands that betas estimated by Bloomberg are not calculated strictly in conformity with accepted theoretical approaches to the estimation of betas (i.e. they are based on regressing total returns rather than the excess return over the risk free rate). However, in Grant Samuel's view the Bloomberg beta estimates can still provide a useful insight into the systematic risks associated with companies and industries. The figures used are the Bloomberg "adjusted" betas.

6 MSCI is calculated using local currency so that there is no impact of currency changes in the performance of the index.

7 Weighted by market capitalisation converted to Australian dollars using the following exchange rates: S$/A$0.83599, HK$/A$0.16443, ¥/A$0.01063, KRW/A$0.001386, BHT/A$0.029851, NZ$/A$0.89931, €/A$1.66473, £/A$2.52644, SEK/A$0.18343, US$/A$1.28337 and C$/A$1.08936.

The table shows outcomes that suggest it is extremely difficult to determine a reliable beta for Qantas:

- Qantas' beta varies significantly depending on the measurement source (AGSM, Bloomberg etc) and, as discussed earlier, has varied significantly over time;
- individual company betas (for the same source/period) fall in a very wide range. For example, Bloomberg Four Year MSCI, betas generally range from 0.45 (ANA) to 1.99 (British Airways) and up to 4.72 (American Airlines) although this should be treated as an outlier;
- some individual company betas vary significantly depending on which market index is utilised (Local or MSCI);
- the two year betas are all substantially lower than the four year betas. This arguably reflects the more benign operating conditions of 2005 and 2006, compared to 2003 and 2004 (Iraq War, etc.). However, the longer term measures may be more reflective of the true risks of the airline industry;
- none of the other airlines are directly comparable to Qantas, which has both a full service and a low cost airline and both international and domestic operations, giving it a different risk profile. The strong domestic business should make Qantas less risky than those exposed solely to international travel; and
- gearing levels vary significantly but this is not always consistent with beta factors.

In view of these issues, Grant Samuel also considered the betas of various airline indices, which effectively represent the sector average. Indices can be more reliable as they smooth out the vagaries of the circumstances of individual companies. This data is summarised below:

Beta Factor of Airline Indices vs MSCI

	Weekly			Monthly		
	Two years to 31 Dec 2004	Two years to 31 Dec 2006	Four years to 31 Dec 2006	Two years to 31 Dec 2004	Two years to 31 Dec 2006	Four years to 31 Dec 2006
World Airlines	1.39	0.95	1.23	1.39	1.08	1.27
Asian Airlines	0.87	0.64	0.78	0.82	1.21	0.98
European Airlines	1.84	0.99	1.52	2.24	1.29	1.86
United States Airlines	1.90	1.19	1.63	1.52	0.62	1.17

Source: Bloomberg

Arguably, the Asian Airlines index (of which Singapore, Cathay Pacific and Qantas represent approximately 60%) is the more relevant benchmark for Qantas but these betas are below one and are materially less than all other regions. It should also be noted that the sector indices reflect the same two year/four year differentials as the individual company betas.

Finally, intuitively, it would be expected that an airline would have a beta above 1.0 in view of the close relationship between demand (from both business and leisure consumers) and general economic conditions combined with the operating leverage inherent in the business.

Taking all of these factors into account, Grant Samuel believes that a beta of 1.1 is a reasonable estimate of the appropriate equity beta for Qantas (also having regard to its gearing levels).

3.2 Cost of Debt

A cost of debt of 6.8% has been adopted (a margin of 1.0% over the risk free rate). The cost of debt for Qantas is not straightforward. Credit margins or bank debt are in the order of 100 basis points but because of its foreign currency cash inflows, Qantas can borrow at rates well below Australian interest rates without any foreign currency risk. Qantas estimates its current cost of debt to be below 6%. However, the low cost of debt is a result of having foreign currency revenues and it is really a hedging benefit from the revenues. Qantas has effectively hedged most of its foreign currency such that net cash flows are largely A$ cash flows and the underlying credit margin in A$ is the relevant measure.

In addition, an important component of Qantas' overall financing structure is the use of operating leases. The implicit interest rate in such leases is well above 7% but this reflects the fact that operating leases have an equity funding component (as the lessor carries the residual asset value risk). In other words, part of the lease represents equity funding in Qantas' overall financial structure. The margins inherent in the debt elements of the leases would be more consistent with the normal bank credit margins.

Accordingly, having regard to the imprecision of the entire methodology, 6.8% is regarded as a reasonable estimate.

3.3 Debt/Equity Mix

The selection of the appropriate debt/equity ratio involves perhaps the most subjectivity of discount rate selection analysis. In determining an appropriate debt/equity mix, regard was had to gearing levels of Qantas and the peer group companies used in the beta analysis.

Gearing levels for these companies for the past five years are set out below:

Gearing Levels for Selected Listed Airlines (Excluding Operating Leases)						
Company	Net Debt/(Net Debt + Market Capitalisation)					
	As at 31 December				Current[8]	Average Last 4 Years
	2002	2003	2004	2005		
Qantas	**47.3%**	**49.9%**	**42.4%**	**30.9%**	**24.9%**	**37.0%**
Full Service Carriers						
Singapore Airlines	na	6.6%	(0.3%)	(7.6%)	(9.7%)	(2.7%)
Cathay Pacific	21.4%	18.4%	32.0%	29.5%	17.5%	24.3%
ANA	na	61.0%	53.9%	53.1%	42.2%	52.5%
JAL	na	41.3%	50.1%	53.8%	47.9%	48.3%
Korean Air	91.8%	87.4%	86.1%	65.4%	72.5%	77.8%
Thai Airways	66.2%	47.9%	49.8%	63.1%	61.0%	55.4%
Air New Zealand	27.4%	3.9%	(15.5%)	(14.0%)	13.3%	(3.1%)
Lufthansa	32.5%	10.5%	(9.5%)	0.1%	3.4%	1.1%
British Airways	78.0%	63.6%	55.7%	36.6%	11.6%	41.9%
Air France-KLM	na	50.4%	59.1%	52.8%	33.9%	49.1%
Iberia	(94.5%)	(70.6%)	(97.2%)	(125.7%)	(95.4%)	(97.2%)
SAS	70.3%	63.8%	65.4%	50.4%	28.7%	52.1%
American Airlines	91.6%	84.6%	86.6%	72.8%	45.1%	72.3%
United Airlines	na	na	na	na	55.3%	55.3%
ACE Aviation	na	na	na	39.3%	24.0%	31.6%
Air Canada	na	na	na	na	42.5%	42.5%
Minimum	*(94.5%)*	*(70.6%)*	*(97.2%)*	*(125.7%)*	*(95.4%)*	*(97.2%)*
Maximum	*91.8%*	*87.4%*	*86.6%*	*72.8%*	*72.5%*	*77.8%*
Median	*66.2%*	*47.9%*	*50.1%*	*44.9%*	*31.3%*	*45.4%*
Weighted average	*47.3%*	*36.3%*	*33.0%*	*27.0%*	*19.6%*	*29.9%*
Low Cost Carriers						
Virgin Blue	na	na	na	1.9%	7.6%	4.8%
Ryanair	(6.9%)	(3.1%)	(8.0%)	(0.6%)	(7.1%)	(4.7%)
easyJet	(54.3%)	(43.5%)	(335.3%)	(62.5%)	(19.5%)	(115.2%)
Southwest	(1.2%)	(2.6%)	4.1%	(4.2%)	(9.6%)	(3.1%)
Minimum	*(54.3%)*	*(43.5%)*	*(335.3%)*	*(62.5%)*	*(19.5%)*	*(115.2%)*
Maximum	*(1.2%)*	*(2.6%)*	*4.1%*	*1.9%*	*7.6%*	*4.8%*
Median	*(6.9%)*	*(3.1%)*	*(8.0%)*	*(2.4%)*	*(8.3%)*	*(3.9%)*
Weighted average	*(13.2%)*	*(10.4%)*	*(63.5%)*	*(12.7%)*	*(9.3%)*	*(22.6%)*

Source: Annual Reports, Quarterly Reports, IRESS, Bloomberg, Grant Samuel analysis

However, airlines also make extensive use of operating leases which, if not debt, are certainly leverage. The following table shows gearing adjusted to include capitalised aircraft operating leases (capitalised at 7 times aircraft rentals in each period).

8 Current gearing levels are based on the most recent balance sheet information and on sharemarket prices as at 26 January 2007, except Qantas which is based on its share price as at 21 November 2006 (being the day prior to Qantas' announcement of the approach by Airline Partners Australia).

Gearing Levels for Selected Listed Airlines (Including Operating Leases)						
Company	Net Debt + Operating Leases / (Net Debt + Operating Leases + Market Capitalisation)					
	As at 31 December				Current[9]	Average Last 4 Years
	2002	2003	2004	2005		
Qantas	**53.8%**	**57.1%**	**50.0%**	**40.7%**	**38.2%**	**46.5%**
Full Service Carriers						
Singapore Airlines	na	20.3%	14.9%	7.8%	1.5%	11.1%
Cathay Pacific	25.6%	24.2%	37.6%	37.8%	28.8%	32.1%
ANA	na	74.4%	70.3%	69.1%	59.0%	68.2%
JAL	na	63.6%	66.5%	70.1%	65.6%	66.5%
Korean Air	94.2%	90.4%	89.6%	75.4%	78.7%	83.5%
Thai Airways	67.5%	62.0%	60.4%	69.1%	67.6%	64.8%
Air New Zealand	70.1%	55.1%	49.8%	45.7%	50.0%	50.2%
Lufthansa	34.1%	18.3%	13.5%	14.9%	12.3%	14.8%
British Airways	81.8%	69.4%	61.9%	43.6%	20.6%	48.9%
Air France–KLM	na	73.9%	72.2%	66.6%	50.5%	65.8%
Iberia	63.5%	46.1%	39.5%	46.7%	36.6%	42.2%
SAS	84.8%	78.3%	79.1%	69.6%	60.8%	72.0%
American Airlines	94.3%	88.6%	89.9%	78.7%	56.0%	78.3%
ACE Aviation	na	na	na	62.4%	54.0%	58.2%
United Airlines	na	na	na	na	64.7%	64.7%
Air Canada	na	na	na	na	65.9%	65.9%
Minimum	*25.6%*	*18.3%*	*13.5%*	*7.8%*	*1.5%*	*11.1%*
Maximum	*94.3%*	*90.4%*	*89.9%*	*78.7%*	*78.7%*	*83.5%*
Median	*76.5%*	*63.6%*	*61.9%*	*64.5%*	*55.0%*	*64.7%*
Weighted average	*62.3%*	*52.4%*	*50.8%*	*46.2%*	*37.2%*	*47.4%*
Low Cost Carriers						
Virgin Blue	na	na	na	43.9%	29.4%	36.6%
Ryanair	(6.2%)	(3.1%)	(5.6%)	1.8%	(2.9%)	(2.4%)
easyJet	(7.5%)	27.6%	35.9%	26.3%	13.9%	25.9%
Southwest	9.8%	7.0%	12.3%	4.4%	(0.5%)	5.8%
Minimum	*(7.5%)*	*(3.1%)*	*(5.6%)*	*1.8%*	*(2.9%)*	*(2.4%)*
Maximum	*9.8%*	*27.6%*	*35.9%*	*43.9%*	*29.4%*	*36.6%*
Median	*(6.2%)*	*7.0%*	*12.3%*	*15.3%*	*6.7%*	*15.9%*
Weighted average	*0.7%*	*7.1%*	*10.0%*	*9.9%*	*3.2%*	*8.5%*

Source: Annual Reports, Quarterly Reports, IRESS, Bloomberg, Grant Samuel analysis

At the same time, as discussed above, part of the aircraft operating lease has an equity component so the ratios above arguably overstate the true level of financial gearing for each company.

The selection of gearing levels is highly judgemental. The table shows a very wide range of gearing levels. The debt levels should actually be the weighted average measured over the same period as the beta factor rather than just at the current point in time. Moreover, these do not always bear any relationship to the betas of the individual companies. In some cases lowly geared companies still have equity betas towards the higher end of the range (e.g. British Airways or Lufthansa).

Qantas' gearing has historically been higher than comparables such as Singapore Airlines and Cathay Pacific, yet it has similar beta.

Having regard to the above, the debt/equity mix has been estimated as 55-60% equity and 40-45% debt. This is regarded as being broadly consistent with a beta factor of 1.1.

9 Current gearing levels are based on the most recent balance sheet information and on sharemarket prices as at 26 January 2007, except Qantas which is based on its share price as at 21 November 2006 (being the day prior to Qantas' announcement of the approach by Airline Partners Australia).

3.4 WACC

On the basis of the parameters outlined above and assuming a corporate tax rate of 30%, the nominal WACC is calculated to be in the range 8.9% to 9.3%.

This is an after tax discount rate to be applied to nominal ungeared after tax cash flows. However, it must be recognised that this is a very crude calculation based on statistics of limited reliability and involving a multitude of assumptions.

Having regard to these matters and the calculations and data set out above, a discount rate range of 9.0-9.5% have been selected for application in the discounted cash flow analysis.

4 Dividend Imputation

The conventional WACC formula set out above was formulated under a "classical" tax system. The CAPM model is constructed to derive returns to investors after corporate taxes but before personal taxes. Under a classical tax system, interest expense is deductible to a company but dividends are not. Investors are also taxed on dividends received. Accordingly, there is a benefit to equity investors from increased gearing.

Under Australia's dividend imputation system, domestic equity investors now receive a taxation credit (franking credit) for any tax paid by a company. The franking credit attaches to any dividends paid out by a company and the franking credit offsets personal tax. To the extent the investor can utilise the franking credit to offset personal tax, then the corporate tax is not a real impost. It is best considered as a withholding tax for personal taxes. It can therefore be argued that the benefit of dividend imputation should be added into any analysis of value.

There is no generally accepted method of allowing for dividend imputation. In fact, there is considerable debate within the academic community as to the appropriate adjustment or even whether any adjustment is required at all. Some suggest that it is now appropriate to discount pre tax cash flows, with an increase in the discount rate to "gross up" the market risk premium for the benefit of franking credits that are on average received by shareholders. On this basis, the discount rate might increase by approximately 2% but it would be applied to pre tax cash flows. However, not all of the necessary conditions for this approach exist in practice:

- not all shareholders can use franking credits. In particular, foreign investors gain no benefit from franking credits. If foreign investors are the marginal price setters in the Australian market there should be no adjustment for dividend imputation. In this context, foreign investors already represent more than 40% of Qantas' share register;
- not all franking credits are distributed to shareholders; and
- capital gains tax operates on a different basis to income tax. Investors with high marginal personal tax rates will prefer cash to be retained and returns to be generated by way of a capital gain.

Other have proposed a different approach involving an adjustment to the tax rate in the discount rate by a factor reflecting the effective use or value of franking credits. If the credits can be used, the tax rate is reduced towards zero. The proponents of this approach have in the past suggested a factor of up to 50% as representing the appropriate adjustment (gamma). Alternatively, the tax charge in the forecast cash flows can be decreased to incorporate the expected value of franking credits distributed.

There is undoubtedly merit in the proposition that dividend imputation affects value. Over time dividend imputation will become factored into the determination of discount rates by corporations and investors. In Grant Samuel's view, however, the evidence gathered to date as to the value the market attributes to franking credits is insufficient to rely on for valuation purposes. More importantly, Grant Samuel does not believe that such adjustments are widely used by acquirers of assets at present. While acquirers are undoubtedly attracted by franking credits there is no clear evidence that they will actually pay extra for them or build it into values based on long term cash flows. The studies that measure the value attributed to franking credits are based on the immediate value of franking credits distributed and do not address the risk and other issues associated with the ability to utilise them over the longer term. Accordingly it is Grant Samuel's opinion that it is not appropriate to make any such adjustments in the valuation methodology. This is a conservative approach.

Appendix 2

Discounted Cash Flow Model Assumptions

1 General Assumptions

The following general assumptions have been made in the discounted cash flow model:

- inflation of 2.5% per annum;
- corporate tax rate of 31% in the medium term, consistent with Qantas' current effective tax rate. The effective rate is assumed to revert to the Australian general corporate tax rate of 30% in the long term;
- a discount rate of 9.0-9.5% is applied to nominal ungeared after tax cash flows;
- the model runs from 1 January 2007 for a nine and a half year period to 30 June 2016 with a terminal value. The terminal value at 30 June 2016 is based on forecast EBITDAR multiples of 4.0-4.5 times;
- foreign exchange rates are assumed to be constant for the forecast period such that no profit or loss is derived from foreign exchange movements; and
- no acquisitions or divestitures of business units occur.

2 Operational Assumptions

2.1 Scenario A

The main business assumptions underlying Scenario A of the discounted cash flow model are:

- available seat capacity across all Qantas banners is assumed to increase at an average rate of approximately 5% per annum over the forecast period. The greatest capacity growth occurs through 2009 and 2010 as the bulk of Qantas' new aircraft are delivered. Further significant capacity growth occurs in 2012 and 2013. Growth in international capacity is expected to outpace domestic capacity growth, in part due to rapid expansion of Jetstar international over the next four years;
- load factor (the percentage of available seats filled by paying passengers) for Qantas domestic, Qantas international and Jetstar domestic is expected to remain steady over the forecast period at a level near 80%, considered a practical maximum. This level is consistent with Qantas' performance in recent years. Jetstar international's load factor increases to this level by 2010, consistent with its start-up plan. A small temporary decline in international load factor is assumed to coincide with the additional capacity created by delivery of the A380s;
- yield (ticket prices (including surcharges) expressed per passenger-kilometre) for each flying banner is assumed to increase at an average rate of 0.7% per annum in nominal terms in the long term with some fluctuations in the first fours years according to the specifics of Qantas' forecasts. The reduction in fuel surcharge announced by Qantas on 16 January 2007 was taken into account. The long term growth rate of 0.7% is significantly below the rate of general inflation and reflects the assumed continuation of intense competition in the airline industry, particularly on Qantas' international routes. Qantas' aggregate yield increases at a somewhat lower rate due to the increasing proportion of (lower yield) Jetstar revenue in the total;
- Qantas' freight capacity is assumed to grow broadly in line with its available seat capacity, with freight revenue remaining at a steady proportion of passenger revenue. Other revenue, including commissions earned by Qantas Holidays and income from external engineering contracts, is assumed to grow at 3.0% per annum;

- the price of jet fuel in the short term is indexed according to expected movements in benchmark crude oil prices, taking into account Qantas' current hedging positions. For 2007/08 and 2008/09, the oil price is assumed to follow the path implied by West Texas Intermediate crude oil futures prices as at 4 February 2007, being an average of approximately US$63.50 per barrel in 2007/08 and US$65 in 2008/09. Prices are assumed to remain at US$65 in the long term;

- fuel costs are partly offset by improvements in fuel efficiency of engines and aircraft, particularly as the Airbus 380s and Boeing 787s enter the fleet. Average fuel efficiency of the fleet is expected to improve by an aggregate 3.3% per available seat-kilometre over the forecast period;

- hourly rates of pay for pilots, cabin crews, ground staff, engineers and other flight-related staff are assumed to increase at an average of 3.0% per annum, consistent with those set out in Qantas' current Enterprise Bargaining Agreements;

- personnel costs are partly offset by productivity gains derived from the increasing scale of the fleet, an increasing proportion of capacity operated by Jetstar, technology improvements and the implementation of more efficient work practices. Average productivity gains of approximately 2% per annum are assumed, with the bulk of gains occurring over 2008 – 2010;

- further cost savings are assumed over 2008 – 2009, delivered primarily by the Sustainable Future Program. These savings amount to approximately 2% of Qantas' cost base and are assumed to be maintained through the forecast period;

- air navigation charges, including airport landing fees, are assumed to increase at 4.0% per annum. These costs are levied principally by foreign airports and governments and are largely out of Qantas' control;

- other aircraft operating expenses (eg meals and externally performed maintenance) expressed per available set kilometre are assumed to increase at the rate of inflation. Some efficiency improvement is also assumed for these expenses, equating to an aggregate of approximately 7% over the forecast period;

- overhead costs (including marketing and selling expenses, communications, IT, property and head office costs) are assumed to increase at the rate of inflation;

- total capital expenditure of approximately $20 billion is assumed over the period 30 June 2006 to 30 June 2014, in line with Qantas' fleet plan. Capital expenditure of $6 billion is assumed in the final two years. Proceeds from disposals of equipment (primarily aircraft) total approximately $1 billion. The majority of capex is spent on aircraft purchases and related items such as flight simulators, spare parts and interior refits. It also includes a substantial amount of investment in IT systems and other business infrastructure. The capital expenditure schedule is consistent with Qantas' fleet plan and capacity assumptions up to 30 June 2014. For the final two years, the capital expenditure assumption was based on capacity growth, fleet value and replacement rate assumptions;

- the model assumes new aircraft are owned by Qantas and carried on its balance sheet, rather than leased. The decision whether to purchase outright or lease an aircraft is made by Qantas management in order to minimise the total cost of ownership. This decision is made around the time of delivery according to the state of financial markets at the time and thus cannot be reliably forecast. Existing operating leases are assumed to remain in place until Qantas retires the aircraft from its fleet;

- depreciation of aircraft and non-aircraft assets is calculated on a basis consistent with Qantas' existing depreciation policies, assuming an average useful life for all assets of 10 years; and

- working capital balances (receivables, payables, inventories, revenue received in advance, etc) are assumed to be a fixed proportion of their corresponding revenue and expense items. These proportions are consistent with Qantas's historical accounts.

2.2 Scenario B

Assumptions used in Scenario B are the same as those for Scenario A except that domestic yields for both Qantas and Jetstar are assumed to rise by an additional 2% per annum in each of 2007/08 and 2008/09, relative to Scenario A.

2.3 Scenario C

Assumptions used in Scenario C are the same as those for Scenario A except for the following:

- domestic yields for both Qantas and Jetstar are assumed to fall by (a cumulative) 5% over 2008/09 and 2009/10 relative to Scenario A; and

- only a quarter of fuel cost increases are assumed to be recovered through surcharges on domestic flights.

2.4 Scenario D

Assumptions used in Scenario D are the same as those for Scenario A except for the following:

- Qantas' international yields fall by (a cumulative) 5% over 2008/09 and 2009/10, relative to Scenario A;

- increases in fuel costs are not recovered; and

- further productivity improvements of 4% are assumed over the forecast period.

2.5 Scenario E

Assumptions used in Scenario E are the same as those for Scenario A except that international yields for both Qantas and Jetstar are assumed to rise by an additional 2% per annum over each of 2007/08 and 2008/09, relative to Scenario A.

2.6 Scenario F

Assumptions used in Scenario F are the same as those for Scenario A except that the crude oil price is assume to rise at 2.5% per annum from 30 June 2010.

2.7 Scenario G

Assumptions used in Scenario G are the same as those for Scenario A except for the following:

- yields across the airline fall by 4% in 2010, with recovery over the following two years;

- load factors across the airline are reduced by 8% in 2010, returning to normal levels the following year. This assumption is consistent with Qantas' experience of recent external shocks; and

- wage growth is limited to 1% in 2010, with recovery in the following two years.

Appendix 3

Valuation Evidence from Acquisitions

In recent years there have been few transactions involving acquisitions of airlines. As the Australian domestic and international airline markets have distinct regulatory, consumer and competitor features the transactions identified provide only limited evidence of the prices that acquirers would be willing to pay for airlines in Australia. It should also be noted that a number of the transactions identified took place before the 11 September 2001 terrorist attacks in the United States, when different market conditions prevailed.

The following table sets out transactions for which meaningful valuation parameters can be calculated. The selected transactions include full service, low cost and regional carriers. The transactions are presented in date order under each business category and not by geographic region.

Recent Transaction Evidence

Date	Target	Transaction	Consid-eration[1] (million)	EBITDAR Margin[2] (%)		CASK[3] (¢)		Revenue Load Factor[4] (%)		EBITDAR Multiple[5] (times)		Ungeared NTA Multiple[6] (times)
				actual	forecast	actual	forecast	actual	forecast	actual	forecast	
Full Service Carriers												
Nov 2006[7]	Delta Air Lines Inc	Offer by U.S. Airways Group Inc	US$9,558.2	10.4%	15.4%	na[8]	na	na	na	10.1	6.4	3.2
Jun 2006	Hong Kong Dragon Airlines Limited	Acquisition of 82.2% by Cathay Pacific Airways Limited	HK$10,000	16.9%	na	na	na	na	na	10.9	na	3.0
May 2005	U.S. Airways Group Inc	Merger with America West Holdings Corp	US$119.0	4.5%	7.3%	9.70¢	9.09¢	73.5%	74.8%	17.6	11.9	na
Mar 2005	Swiss International Air Lines Ltd	Acquisition by Deutsche Lufthansa AG	CHF471.9	13.2%	na	12.90¢	na	74.9%	na	4.3	na	1.4
Sep 2003	KLM Royal Dutch Airlines	Acquisition by Air France	€824.5	8.8%	10.7%	14.60¢	13.75¢	79.4%	79.5%	7.8	6.9	1.0
Jan 2001	Trans World Airlines Inc	Asset purchase by AMR Corporation	US$625.0	12.0%	na	7.76¢	na	73.1%	na	9.2	na	na
Low Cost Carriers												
Oct 2006[9]	Aer Lingus Group	Takeover offer by Ryanair Holdings plc	€1,481.2	19.5%	na	9.76¢	na	81.4%	na	6.0	na	3.9
Jan| 2005	Virgin Blue Holdings Ltd	Takeover offer by Patrick Corporation Ltd	$1,992.6	30.1%	24.1%	8.16¢	7.45¢	82.6%	75.3%	8.4	8.4	3.0
Mar 2004	Virgin Express Holdings plc	Merger with SN Brussels Airlines	€40.0	10.3%	12.2%	9.08¢	8.52¢	79.8%	75.7%	10.6	10.2	nmf[10]
Jan 2003	Buzz Airlines	Acquisition by Ryanair Holdings plc	€23.9	na	1.5%	na	na	na	na	na	114.5	nmf
May 2002	Go Fly Ltd	Acquisition by easyJet plc	£374.0	20.6%	20.7%	na	na	76.5%	78.0%	11.9	8.4	nmf

1 Implied equity value if 100% of the company or business had been acquired.

2 Represents EBITDAR divided by total revenue. EBITDAR is earnings before net interest, tax, depreciation, amortisation, significant and non-recurring items and aircraft rentals.

3 CASK is operating cost per ASK. ASK is available seat kilometres and is a measure of capacity over a given period. CASK has been calculated in local currencies and converted to Australian dollars using the following exchange rates US$/A$1.2773, €/A$1.6503, CHF/A$1.0232 and £/A$2.5065.

4 Revenue load factor is RPK divided by ASK. RPK is revenue passenger kilometres.

5 Represents gross consideration divided by EBITDAR. Gross consideration is the sum of the equity and/or cash consideration plus borrowings net of cash plus aircraft operating leases (capitalised at 7 times aircraft rentals).

6 Represents gross capitalisation divided by ungeared net tangible assets (that is, shareholders' funds less intangibles plus borrowings less cash at the latest balance sheet).

7 Withdrawn by U.S. Airways on 31 January 2007 due to a lack of support from Delta's Unsecured Creditors' Committee.

8 na = not available

9 Withdrawn by Ryanair on 21 December 2006 due to an investigation by the European Commission into competition impacts.

10 nmf = not meaningful.

Recent Transaction Evidence												
Date	Target	Transaction	Consid-eration (million)	EBITDAR Margin (%)		CASK (¢)		Revenue Load Factor (%)		EBITDAR Multiple (times)		Ungeared NTA Multiple (times)
				actual	forecast	actual	forecast	actual	forecast	actual	forecast	
Nov 1998	Reno Air Inc	Acquisition by AMR Corporation	US$126.1	17.9%	na	6.67¢	na	66.5%	na	9.2	na	9.3
Regional Carriers												
Dec 2006 (pending)	Midwest Air Group Inc	Offer by AirTran Holdings Inc	US$242.2	11.6%	14.3%	9.86¢	9.43¢	76.1%	76.0%	9.3	6.7	na
Aug 2005	ASA Holdings Inc	Acquisition by Skywest Inc	US$425.0	23.8%	na	na	na	na	na	9.6	na	1.3
Mar 2001	British Regional Air Lines Group	Acquisition by British Airways plc	£81.0	21.6%	na	35.60¢	na	60.8%	na	7.2	na	2.5
Oct 2000	Hazelton Airlines Ltd	Acquisition by Ansett Holdings Ltd	$27.2	24.9%	na	na	na	na	na	6.4	na	4.7
Oct 1999	Comair Holdings Inc	Acquisition by Delta Air Lines Inc	US$2,282.9	43.1%	40.9%	12.86¢	12.29¢	63.0%	64.1%	8.1	7.4	11.1
Feb 1999	ASA Holdings Inc	Acquisition by Delta Air Lines Inc	US$986.2	37.8%	37.9%	13.36¢	12.23¢	55.8%	54.6%	7.2	6.3	5.6

Source: Grant Samuel analysis[11]

A brief summary of each transaction is set out below:

Delta Air Lines Inc/U.S. Airways Group Inc

On 15 November 2006, U.S. Airways Group Inc ("U.S. Airways") announced it had made a merger proposal to Delta Air Lines Inc ("Delta") which is going through Chapter 11 bankruptcy proceedings. The consideration offered to Delta's unsecured creditors was US$4 billion in cash and 78.5 million shares of U.S. Airways. The offer was rejected by Delta's board of directors. On 10 January 2007, U.S. Airways made a revised proposal to Delta consisting of US$5 billion in cash and 89.5 million shares of U.S. Airways. Delta operates a fleet of more than 600 aircraft with flights to 303 destinations throughout the United States and internationally. The combined entity of U.S. Airways and Delta would be one of the world's largest airlines and the dominant carrier across the Atlantic. U.S. Airways expects that a merger would generate at least US$1.65 billion in annual synergies by the second year. Delta's actual and forecast multiples reflect expected results for the years ending 31 December 2006 and 31 December 2007. If the expected synergies are included in Delta's earnings, the historical and forecast EBITDAR multiples would be 5.3 times and 4.0 times respectively. On 31 January 2007 U.S. Airways withdrew its offer citing a lack of support from Delta's Unsecured Creditors' Committee.

Hong Kong Dragon Airlines Limited / Cathay Pacific Airways Limited

On 8 June 2006, Cathay Pacific Airways Limited ("Cathay Pacific"), Air China Limited ("Air China"), China National Aviation Company Limited, CITIC Pacific Limited and Swire Pacific Limited jointly announced a restructuring and associated transactions ("the restructuring") to rearrange the ownership structure of the major Hong Kong/China aviation companies. As part of the restructuring Cathay Pacific acquired the 82.2% of Hong Kong Dragon Airlines Limited ("Dragonair") it did not already own for HK$8.2 billion, comprising HK$0.8 billion cash and HK$7.4 billion in new shares. Associated with this acquisition was an increase (from 10% to 20%) of Cathay Pacific's interest in Air China. Dragonair operates as a high yield, high cost airline with a strong position in the Hong Kong/China market. Increased competition in the Chinese aviation market is expected to place pressure on Dragonair's business model and constrain its ability to expand regionally. Notwithstanding that, Dragonair holds a unique market position and merger synergies are expected to be significant (although, given the market in which Dragonair operates, such benefits are only expected to emerge gradually overtime). Little financial information is available for Dragonair and the data presented above reflects both the available information and market analyst's estimates. Market analysts considered the price paid for Dragonair to be high but reasonable given the benefits to Cathay Pacific of the wider restructuring, namely access to China, improvements in network reach and connectively, reduction in competition and the potential for cost savings.

11 Grant Samuel analysis based on data obtained from IRESS, company announcements, transaction documentation and, in the absence of company published financial forecasts, brokers' reports. Where company financial forecasts are not available, the median of the financial forecasts prepared by a range of brokers has generally been used to derive relevant forecast value parameters. The source, date and number of broker reports utilised for each transaction depends on analyst coverage, availability and corporate activity.

U.S. Airways Group Inc/America West Holdings Corp

On 19 May 2005, U.S. Airways and America West Holdings Corp ("America West") announced an agreement to merge and create a national low-cost hub-and-spoke network carrier operating under the U.S. Airways name. America West was the eighth largest passenger airline and the second largest low cost carrier in the United States. America West operated a fleet of 138 aircraft serving 96 destinations in the United States, Canada, Mexico and Costa Rica. U.S. Airways operated a fleet of over 300 aircraft flying to 179 destinations throughout the United States and internationally. However, U.S. Airways was going through Chapter 11 bankruptcy proceedings at the time. The US$119 million market capitalisation reflects the 14% interest that U.S. Airways would receive in the merged entity (initially capitalised at US$850 million). In addition, America West assumed all of U.S. Airways restructured debt obligations. The merged entity would be the fifth largest airline in the United States and was expected to operate a reduced fleet of 361 aircraft. The EBITDAR multiples implied by the transaction are high. Annual synergies were expected to be US$600 million which, if allowed for in full, would reduce the actual and forecast EBITDAR multiples to 6.1 times and 5.2 times respectively.

Trans World Airlines Inc/AMR Corporation

On 10 January 2001, AMR Corporation ("American Airlines") announced it would acquire all of the assets of Trans World Airlines Inc ("TWA") for US$500 million and assume all of TWA's operating leases. TWA filed for Chapter 11 bankruptcy in order to facilitate the transaction. American Airlines subsequently raised its offer to US$625 million. The TWA assets consisted of up to 190 aircraft, 175 gates and 173 landing slots. The acquisition expanded American Airlines' operations in the north eastern United States and also provided it with a hub in St. Louis.

Swiss International Air Lines Ltd/Deutsche Lufthansa AG

On 22 March 2005, Deutsche Lufthansa AG ("Lufthansa") announced it would acquire Swiss International Air Lines Ltd ("Swiss International"). The acquisition was staggered in order to maintain Swiss International's landing rights. Swiss International operated international flights out of Zurich, Geneva, Basel and Lugano to 74 destinations in Europe and around the world. The acquisition provided Lufthansa with greater access to Switzerland and additional landing rights at various international airports. Annual synergies between the two airlines were expected to reach €165 million by 2008 split approximately 50/50 between revenue and costs. Swiss International, which had a history of unprofitable operations, was undertaking a restructuring at the time of acquisition and was expected to post an operating loss in 2005.

KLM Royal Dutch Airlines NV/Air France

On 30 September 2003, Air France announced it had agreed to acquire KLM Royal Dutch Airlines NV ("KLM") for €824 million. The consideration offered was 11 shares and 10 warrants of Air France stock for every 10 shares of KLM, which valued KLM shares at €16.74. Air France would gain a 100% economic interest in KLM but only a 49% voting interest for the first three to six years in order to preserve KLM's landing rights. The merger combined Europe's second largest airline with the fourth largest to create the world's largest airline. The combined entity had a fleet of 556 aircraft serving over 600 destinations out of two major European hubs, Charles de Gaulle Airport in Paris and Amsterdam Airport. Air France expected to realise annual cost savings of €385-495 million by 2009 which would increase the combined entity's EBIT margin to 5% (from approximately 2%). KLM had been experiencing EBIT losses since 2001 with a modest improvement expected in the future absent the transaction. The savings would be achieved through a combination of network optimisation and merging sales and airport operations in common destinations. The transaction consolidated Air France's market position in Europe and effectively privatised Air France by reducing the French government's interest below 50% which significantly increased the free float of Air France's shares. Allowing for the full value of the expected synergies, the actual and forecast EBITDAR multiples would be 4.2 times and 3.9 times respectively.

Virgin Blue Holdings Limited/Patrick Corporation Limited

On 28 January 2005, Patrick Corporation Limited ("Patrick") announced an offer for the 54.6% of shares in Virgin Blue Holdings Limited ("Virgin Blue") that it did not already own. The consideration offered was $1.90 cash per share. Virgin Blue is Australia's second largest domestic airline with a market share of approximately 30% and runs a low cost carrier business model. The airline operates a fleet of Boeing 737s on routes between major cities and regional leisure locations within Australia. The company also operates as an international carrier under the Pacific Blue brand, flying between Australia, New Zealand and the Pacific Islands. Patrick was an Australian transport logistics company with operations in ports, rail and airlines. Virgin Blue was experiencing a period of uncertainty regarding its future earnings as it had an unhedged fuel position (during a period of rising jet fuel prices) and faced increased competition from Qantas' low cost subsidiary, Jetstar. The offer closed with Patrick increasing its interest in Virgin Blue to 62.4%.

Reno Air Inc/AMR Corporation

On 19 November 1998, AMR Corporation ("American Airlines"), the owner of American Airlines, agreed to acquire Reno Air Inc ("Reno Air") for US$126 million. The consideration offered was US$7.75 cash per share. Reno Air was an American low cost, low fare airline that operated a fleet of MD-80s and MD-90s primarily in the western United States from its hubs in Reno, Las Vegas and San Jose. American Airlines intended to drop Reno Air's low fare approach and operate it as a normal part of the American Airlines network. The acquisition expanded American Airlines' presence on the West Coast which was expected to generate more east-west traffic for the airline.

Aer Lingus Group plc/Ryanair Holdings plc

On 5 October 2006, Ryanair Holdings plc ("Ryanair") announced it had acquired 16% of the shares in Aer Lingus Group plc ("Aer Lingus") and would make an offer for the remaining 84%. The consideration offered was €2.80 cash per share. Aer Lingus was founded by the Irish Government in 1936 and was listed on the Irish and London Stock Exchanges on 2 October 2006. Initially Aer Lingus operated as a full service carrier, however, in order to counter the downturn in the global aviation industry, it commenced implementation of a restructuring plan and a change in its business model in October 2001. Today, Aer Lingus is a low cost carrier that offers short haul and long haul airline services out of Ireland. It operates a fleet of 35 aircraft on routes from Ireland to the United Kingdom, the United States, Europe and the Middle East. Ryanair is based in Ireland and operates a low cost European carrier that provides short haul, point to point services from bases throughout Europe. Ryanair operates a fleet of 120 aircraft serving 125 locations in Europe. An acquisition of Aer Lingus would position the combined entity as the only airline group based in Ireland and would provide Ryanair with complementary short haul and long haul routes as well as slots at Heathrow. There is little overlap between the two airlines which compete on only 17 of more than 500 combined routes. Ryanair would continue the cost rationalisation plans already being undertaken by Aer Lingus and would seek to further reduce Aer Lingus' costs through improved efficiencies and greater purchasing power. On 21 December 2006, Ryanair announced it was withdrawing its offer for Aer Lingus after the European Commission launched an investigation into the proposed transaction. The European Commission was concerned about the potential anticompetitive effects of the transaction. Ryanair announced it would only make another offer if the European Commission approved the proposed takeover. As at 31 December 2006, Ryanair had accumulated a 25% shareholding in Aer Lingus.

SN Brussels Airlines/Virgin Express Holdings plc

On 15 March 2004, the majority shareholders of Virgin Express Holdings plc ("Virgin Express") and SN Brussels Airlines ("SN Brussels") signed a non-binding letter of intent to merge their respective airlines. On 6 October 2004, a binding agreement was approved to initially operate the airlines as an alliance and, subject to satisfying certain performance criteria, ultimately combine the airlines into a new holding company called SN Airholding. As part of the transaction, Virgin Express' majority shareholder, the Virgin Group, offered €1 per share to acquire the remaining shares in Virgin Express from minority shareholders subject to the merger proceeding. Virgin Express is a low cost, no-frills carrier with a fleet of Boeing 737s that operates out of Brussels and flies to major European cities. It also has a second hub in Amsterdam which connects to Rome and Milan. SN Brussels was founded in 2001 following the bankruptcy of Sabena, Belgium's national airline. It is Sabena's former regional airline subsidiary and operates a fleet of Airbus A319s and Avro RJ/BAe 146 regiona-l jets. SN Brussels is a private company which caters mainly to Brussels-based business passengers on routes to Europe, Africa and the United States. The merger consolidated the airlines' positions in the Brussels market, which has experienced increased competition from foreign airlines since Sabena's collapse. The multiples reflect the offer made to the minority shareholders of Virgin Express.

Buzz Airlines/Ryanair Holdings plc

On 31 January 2003, Ryanair announced it would acquire low cost carrier Buzz Airlines ("Buzz") from KLM for €23.9 million. Buzz operated a network of 21 routes from London's Stansted airport to Germany, Holland, France and Spain in addition to two domestic French routes. Buzz's aircraft fleet consisted of six Boeing 737s and six BAe 146s. The acquisition gave Ryanair additional capacity at Stansted, its main United Kingdom base. Ryanair expected to switch Buzz's operations over to its own low cost, low fare model by closing down unprofitable routes to congested primary airports and replacing the BAe 146s with more fuel-efficient Boeing

737s. Buzz's forecast multiple reflects expected poor results for the year ending 31 March 2003. However, forecasts for the year to 31 March 2004 give an EBITDAR multiple of 6.5 times and an EBITDAR margin of 18.9%.

Go Fly Limited/easyJet plc

On 16 May 2002, easyJet announced it would acquire Go Fly Limited ("Go") for £374 million. Go was a point-to-point low cost carrier that operated out of London's Stansted airport. The company was originally set up by British Airways in 1997 to be its low cost subsidiary to compete with Ryanair and easyJet. However, Go instead ended up cannibalising British Airway's core business. In June 2001, British Airways sold Go to private equity firm 3i. Go operated a fleet of 27 Boeing 737s on 36 routes to 22 airports throughout Europe. The acquisition allowed easyJet to overtake Ryanair as Europe's largest low fare airline in terms of passengers carried. The acquisition was complementary as both airlines operated Boeing 737s providing intra-European low fare point-to-point services with bases in the south east of England which offered the potential for cost savings. In addition, the acquisition expanded easyJet's network as there were few destination overlaps and consolidated easyJet's market position in the United Kingdom.

Hazelton Airlines Limited/Ansett Holdings Limited

On 10 October 2000, after acquiring an initial 20% shareholding, Ansett Holdings Limited ("Ansett") announced an offer to acquire Hazelton Airlines Limited ("Hazelton") for $0.90 per share which valued Hazelton at $15.3 million. Hazelton was an Australian regional carrier based in New South Wales that transported over 400,000 passengers per year. Hazelton operated a fleet of four Fairchild Metro 23 turboprops and nine Saab 340 turboprops to 20 airports throughout the east coast of Australia. Ansett and Hazelton had been code-share partners since March 1993. An Independent Expert Report found the offer to be fair and reasonable, however Hazelton's directors considered it inappropriate to make a recommendation as the offer was conditional on a 90% minimum acceptance and two major shareholders, representing 35% of the outstanding shares, did not intend to accept. On 24 November 2000, after acquiring a 20% interest from one of the two major shareholders, Qantas announced a $1.20 per share off-market takeover bid for a minimum of 51% of Hazelton's shares on issue. On 5 December 2000, Ansett responded by raising its offer to $1.35 per share and lowering its minimum acceptance to 50.1%. On 2 January 2001, Qantas raised its offer to $1.50 per share which was countered by Ansett on 4 January 2001 when it raised its offer to $1.60 per share. Qantas withdrew from the transaction on 22 January 2001 following concern from the Australian Competition and Consumer Commission ("ACCC") in relation to the potential impact on competition the acquisition would have on regional markets. Ansett extended its offer and on 9 March 2001 the ACCC accepted an undertaking from Ansett.

Midwest Air Group Inc/AirTran Holdings Inc

On 13 December 2006, AirTran Holdings Inc ("AirTran") announced a takeover offer for Midwest Air Group Inc ("Midwest"). The consideration offered is US$11.25 per share in cash and AirTran shares. Midwest is a regional airline that flies to destinations throughout the United States from Milwaukee and Kansas City. Midwest operates a fleet of 38 aircraft under the Midwest Airlines and Midwest Connect brands. Airtran is a United States low cost carrier with hubs in Atlanta, Orlando, Baltimore, Philadelphia and Chicago. Airtran flies to 50 cities in the United States and Bahamas with a fleet of 120 aircraft. The acquisition would strengthen AirTran's position in its key markets and offer the potential for significant cost savings. There is limited overlap between the two companies' route networks and Midwest's upper midwest hub complements Air Tran's presence in the eastern states. Midwest's actual and forecast multiples reflect expected results for the years ending 31 December 2006 and 31 December 2007 respectively. The transaction is pending.

ASA Holdings Inc/Skywest Inc

On 15 August 2005, Skywest Inc ("Skywest") announced it would acquire ASA Holdings Inc ("ASA") from Delta Air Lines Inc ("Delta") for US$425 million. ASA was a Delta Connection regional carrier which flew customers primarily from cities in the Southeast United States and Texas to Delta's hubs in Atlanta and Dallas/Fort Worth. ASA's fleet consisted of 12 ATR-72 Turboprops, 59 Embraer Brasilia Turboprops and 19 Canadair Regional Jet-200s. Skywest was one of the largest regional airlines in the United States operating under code sharing agreements with both Delta and United Airlines. At the time of acquisition, Skywest operated 221 aircraft and provided passenger and freight services to 110 cities primarily in the western United States. The acquisition created the largest regional airline in the United States with a fleet of 372 aircraft and expanded Skywest's operations into the eastern United States. The combined companies are expected to approach $3 billion in revenue by 2006 from a base of $2.1 billion in 2004.

Comair Holdings Inc/Delta Air Lines Inc

On 18 October 1999, Delta Air Lines Inc ("Delta") announced it would acquire the 78% of Comair Holdings Inc ("Comair") it did not already own. The consideration offered was US$23.50 cash per share. Comair was a Delta Connection regional carrier which, through a codeshare agreement, flew customers primarily from cities in the Midwest and Florida to Delta's hubs in Cincinnati, Ohio, and Orlando, Florida. It operated a fleet of 82 50-seat regional jets. Delta was pursuing a strategy of increasing the number of planes that fed passengers from small to midsize cities to Delta's hub airports in Atlanta and Cincinnati. The acquisition gave it an 85% market share in Cincinnati and was expected to be accretive to earnings.

ASA Holdings Inc/Delta Air Lines Inc

On 16 February 1999, Delta announced it would acquire the 72% of ASA it did not already own. The consideration offered was US$34 cash per share. Delta expected the acquisition to increase revenue through more efficient operations, better use of both airlines' fleets and market share growth. The acquisition gave Delta control of more than 80% of air traffic in Atlanta.

British Regional Air Lines Group plc/British Airways plc

On 8 March 2001, British Airways agreed to buy British Regional Air Lines Group plc ("British Regional") for £81.0 million. The consideration offered was £1.20 cash per share. British Regional was British Airway's largest franchise operator, operating over 190 daily flights under the British Airways brand to regional and hub airports throughout the United Kingdom and Europe. British Regional had a fleet of 50 turboprop and jet aircraft, with seat capacities of up to 111 seats. The acquisition allowed British Airways to consolidate its regional operations.

Appendix 4

Valuation Evidence from Comparable Listed Companies

The valuation of Qantas has been considered in the context of the sharemarket ratings and operating statistics of selected comparable listed airlines. The following table sets out multiples of the selected airlines, which includes Qantas' key competitors as well as a range of other airlines. The selected carriers have been segmented between full service and low cost carriers (Qantas has both types of operations). The airlines have also been arranged based on major operating region (i.e. Asia/Pacific, Europe and North America). The table on the following page summarises key operating statistics for these airlines and Qantas.

Sharemarket Ratings of Selected Airlines

	Market Capitalisation[1] (million)	EBITDAR Multiple[2] (times)			EBIT Multiple[3] (times)			Price Earnings Multiple[4] (times)			Ungeared NTA Multiple (times)[5]
		2006	2007	2008	2006	2007	2008	2006	2007	2008	
Full Service Carriers											
Singapore Airlines	S$22,697	7.0	6.8	6.1	14.6	14.0	11.1	19.3	18.1	15.1	1.4
Cathay Pacific	HK$81,199	10.2	8.5	7.2	19.4	15.7	12.8	22.9	18.4	14.9	1.6
ANA	¥857,982	8.1	7.9	7.5	16.0	16.6	15.4	22.7	21.1	17.6	1.5
JAL	¥691,293	10.7	8.8	7.9	na[6]	141.4	50.5	na	na	126.2	1.5
Korean Air	KRW2,522,783	7.2	6.6	6.0	17.9	14.6	11.9	27.3	15.7	9.1	0.7
Thai Airways	BHT73,269	8.0	6.1	5.6	25.0	14.3	12.4	14.7	9.0	7.4	1.1
Air New Zealand	NZ$2,013	6.1	5.2	4.8	15.4	10.6	9.2	16.0	13.6	11.1	1.2
Lufthansa	€9,671	6.5	5.7	5.1	16.2	12.0	10.1	21.9	15.5	12.5	2.7
British Airways	£6,162	5.7	5.6	5.3	11.2	10.9	9.8	14.3	11.9	10.8	2.4
Air France-KLM	€8,794	4.8	4.2	4.0	11.8	9.1	8.6	15.5	11.8	10.1	0.9
Iberia	€2,878	6.7	6.0	5.2	15.4	11.0	7.2	17.8	21.5	14.0	6.4
SAS	SEK21,550	9.2	7.5	6.3	37.5	15.4	9.5	116.8	13.0	7.2	1.7
American Airlines	US$9,375	10.8	7.6	6.5	36.1	13.6	9.9	na	10.9	6.6	3.1
United Airlines	US$4,870	11.0	6.7	5.2	109.2	12.6	7.7	na	20.1	6.8	5.4
ACE Aviation	C$3,639	6.9	5.8	5.2	13.9	10.5	8.7	18.2	12.9	12.7	8.8
Air Canada	C$1,809	6.0	5.4	4.3	15.7	11.0	7.7	41.8	9.8	7.5	2.1
Low Cost Carriers											
Virgin Blue	A$2,729	nmf[7]	9.0	7.8	nmf	13.8	10.8	nmf	20.1	15.3	3.8
Ryanair	€8,641	15.0	13.1	9.7	21.0	18.3	13.2	27.7	24.0	16.5	4.4
easyJet	£2,855	11.9	9.5	8.0	20.3	13.5	10.2	29.4	20.0	15.2	8.2
Southwest	US$13,399	8.8	7.5	6.5	14.0	11.4	9.4	23.3	18.5	15.5	1.9

Source: Grant Samuel analysis[8]

1 Market capitalisation based on sharemarket prices as at 26 January 2007.

2 Represents gross capitalisation (that is, the sum of the market capitalisation adjusted for minorities, plus borrowings less cash as at the latest balance date plus aircraft operating leases (capitalised at 7 times forecast aircraft rentals)) divided by EBITDAR. EBITDAR is earnings before net interest, tax, depreciation, amortisation, significant and non-recurring items and aircraft rentals.

3 Represents gross capitalisation divided by EBIT. EBIT is earnings before net interest, tax, goodwill amortisation and significant and non-recurring items.

4 Represents market capitalisation divided by net profit after tax (before goodwill amortisation and significant and non-recurring items).

5 Represents the gross capitalisation divided by ungeared net tangible assets (that is, shareholders' funds less intangibles plus borrowings less cash at the latest balance sheet). Comparatively high ungeared NTA multiples for certain of the selected companies reflect instances where book gearing is low or substantial net cash balances held (e.g. Iberia, easyJet) or where shareholders' funds are low or negative (e.g. American Airlines, United Airlines and ACE Aviation).

6 na = not available.

7 nmf = not meaningful.

8 Grant Samuel analysis based on data obtained from IRESS, company announcements and, in the absence of company published financial forecasts, brokers' reports. Where company financial forecasts are not available, the median of the financial forecasts prepared by a range of brokers has generally been used to derive relevant forecast value parameters. The source, date and number of broker reports utilised for each company depends on analyst coverage, availability and recent corporate activity.

Operating Statistics of Selected Airlines									
	EBITDAR Margin[9] (%)			CASK[10] (¢)			Revenue Load Factor[11] (%)		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
Qantas	17.8%	17.2%	19.3%	10.79¢	11.29¢	11.31¢	77.0%	77.9%	78.0%
Full Service Carriers									
Singapore Airlines	21.3%	20.5%	22.4%	9.26¢	9.59¢	9.48¢	75.6%	78.1%	78.3%
Cathay Pacific	18.4%	18.4%	18.8%	9.44¢	9.77¢	9.84¢	78.8%	78.3%	77.7%
ANA	18.4%	17.6%	17.8%	15.76¢	16.55¢	16.57¢	67.8%	67.9%	68.4%
JAL	8.9%	10.4%	11.4%	15.92¢	17.38¢	18.42¢	67.5%	70.3%	72.5%
Korean Air	19.2%	19.9%	21.1%	14.57¢	14.51¢	14.11¢	72.0%	72.8%	73.0%
Thai Airways	16.0%	19.7%	20.7%	7.13¢	6.80¢	6.75¢	75.4%	74.9%	75.6%
Air New Zealand	17.1%	18.6%	19.5%	9.66¢	9.93¢	9.81¢	75.0%	72.9%	73.5%
Lufthansa	10.2%	10.7%	11.5%	21.10¢	21.80¢	19.78¢	75.0%	75.0%	75.4%
British Airways	18.0%	17.2%	17.7%	13.34¢	13.66¢	13.85¢	75.6%	77.5%	78.1%
Air France-KLM	15.1%	16.0%	15.9%	14.55¢	14.91¢	14.91¢	80.6%	82.2%	82.7%
Iberia	14.1%	15.0%	17.1%	na	na	na	na	na	na
SAS	10.2%	12.4%	15.2%	na	na	na	na	na	na
American Airlines	10.8%	14.5%	16.8%	8.92¢	9.06¢	8.94¢	78.8%	79.9%	80.1%
United Airlines	7.6%	11.7%	14.3%	9.28¢	9.33¢	na	81.3%	81.5%	na
ACE Aviation	14.1%	15.6%	16.9%	10.98¢	11.21¢	11.03¢	79.7%	79.5%	78.5%
Air Canada	11.2%	11.9%	14.0%	10.81¢	10.95¢	10.83¢	79.9%	80.2%	79.4%
Low Cost Carriers									
Virgin Blue	21.1%	21.4%	23.0%	8.00¢	8.27¢	8.26¢	77.0%	78.9%	78.5%
Ryanair	32.3%	29.1%	32.5%	5.61¢	na	na	77.6%	na	na
easyJet	17.2%	18.9%	19.5%	10.23¢	10.02¢	10.19¢	85.3%	86.2%	86.6%
Southwest	18.4%	18.6%	19.2%	6.69¢	7.07¢	7.23¢	71.9%	73.5%	74.2%

Source: Grant Samuel analysis

The multiples shown are based on sharemarket prices as at 26 January 2007 and do not reflect a premium for control.

In considering relative earnings valuation parameters, differences in growth trajectories and aircraft fleet ownership structures need to be taken into consideration. In this regard, the use of off balance sheet operating leases to finance all or part of aircraft fleets needs to be allowed for and this is done by using EBITDAR multiples. In doing so, the enterprise value of the entity needs to include the notional off balance sheet debt represented by future aircraft rental payments - this is done by capitalising (or grossing up) aircraft rental payments. Industry convention is to capitalise aircraft rental payments by a multiple in the range of 6-9 times. For the purposes of calculating gross capitalisation for the above analysis, Grant Samuel has capitalised aircraft operating leases at 7 times.

The airlines selected have a variety of year ends. The majority of the selected airlines have a 31 December year end with the exception of Singapore Airlines Limited ("Singapore Airlines"), All Nippon Airways Co Ltd ("ANA"), Japan Airlines Corporation ("JAL"), British Airways Plc ("British Airways"), Air France-KLM and Ryanair Holdings plc ("Ryanair") which have a 31 March year end, Air New Zealand Limited ("Air New Zealand") and Virgin Blue Holdings Limited ("Virgin Blue") which have a 30 June year end and easyJet plc ("easyJet") and Thai Airways International Public Company Limited ("Thai Airways") which have a 30 September year end.

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9 Represents EBITDAR divided by total revenue.

10 CASK is operating cost per ASK. Operating cost is total revenue less EBIT. ASK is available seat kilometres and is a measure of capacity over a given period. CASK has been calculated in local currencies and converted to Australian dollars using the following exchange rates: S$/A$0.83599, HK$/A$0.16443, ¥/A$0.01063, KRW/A$0.001386, BHT/A$0.029851, NZ$/A$0.89931, €/A$1.66473, £/A$2.52644, SEK/A$0.18343, US$/A$1.28337 and C$/A$1.08936.

11 Revenue load factor is RPK divided by ASK. RPK is revenue passenger kilometres.

The data analysed for each company included the last two years annual historical result plus the subsequent two forecast years. However, the data presented above represents an alignment of the financial data to allow direct comparison to Qantas' financial information which is on a 30 June year end. Under this alignment, the earnings for 31 December year end companies have been averaged (e.g. the 2007 earnings are an average of the 31 December 2006 and 31 December 2007 years). While this is a relatively crude adjustment it is arguably more useful than leaving the data unadjusted.

A brief description for each company is set out below.

Singapore Airlines Limited

Singapore Airlines is an international full service passenger airline of which 56% is owned by Temasek Holdings (Pte) Ltd, the Singapore Government's investment company. Singapore Airlines flies passengers to 62 cities in 34 countries, and operates 85 weekly flights to Australia. It operates a fleet of 90 wide body aircrafts comprising 27 Boeing 747s, 58 Boeing 777s and five Airbus A340s, with an average passenger fleet age of just over five years. Singapore Airlines' regional subsidiary, SilkAir, flies 13 Airbus A319s and A320s to 26 destinations in Asia. Singapore Airlines is a member of Star Alliance, which currently has 18 members and a network spanning 157 countries, with access to 841 airports. In December 1999, Singapore Airlines acquired a 49% stake in Virgin Atlantic, a London-based international carrier. Singapore Airlines also holds a 49% interest in Tiger Air, a low cost carrier serving the Asia Pacific Region. Singapore Aircraft Leasing Enterprise ("SALE"), of which Singapore Airlines held a 35.5% stake, was sold to the Bank of China Limited for US$965 million in cash on 15 December 2006. SALE owns 63 aircraft and manages another 14 on behalf of third parties. Singapore Airlines is expected to be the first airline to operate the world's largest commercial airliner, the Airbus A380, with delivery of the first A380 scheduled for October 2007. The average age of Singapore Airlines' fleet is approximately 5.5 years.

Cathay Pacific Airways Limited

Cathay Pacific Airways Limited ("Cathay Pacific") is an international full service passenger airline based in Hong Kong. It flies to 102 destinations in 35 countries and operates a fleet of 101 aircraft comprising Boeing 747s and 777s and Airbus A330s and A340s. Cathay Pacific is one of eight members of the **one**world alliance. Swire Pacific Limited, a Hong Kong investment company, owns 40% of Cathay Pacific and entities associated with the Peoples Republic of China hold a further 35% (i.e. it only has a 25% free float). In September 2006 Cathay Pacific acquired the 82.2% of Hong Kong Dragon Airlines Limited ("Dragonair"), a Hong Kong-based regional airline, which it did not already own for HK$8.2 billion and a further 10% (to 20%) of Air China Limited for HK$4.1 billion. As a consequence, the historical multiples calculated for Cathay Pacific are not meaningful (i.e. they include only 3 months contribution for these acquisitions). In addition, very little financial information is available for Dragonair and no profit guidance has been provided by Cathay Pacific for the merged group. Therefore, the broker forecasts used to calculate forecast multiples for Cathay Pacific contain greater uncertainty than usual. Further, the forecast multiples for Cathay Pacific are high as the earnings forecasts used do not make any allowance for the significant merger synergies that are expected to emerge.

All Nippon Airways Co Ltd

ANA consists of air transport, travel, hotel operations and other businesses. The company was founded in Japan in 1952 and listed on the Tokyo Stock Exchange and Osaka Stock Exchange in 1961, on the Frankfurt Stock Exchange in 1978 and on the London Stock Exchange in 1991. ANA, through Air Nippon and Air Japan, operates 913 domestic flights a day on 138 routes and 494 international flights a week on 35 routes. As of 31 March 2006, ANA operated a fleet of 172 aircraft comprising 53 Boeing wide-body aircraft, 54 Boeing B767-300s, 7 A321s, 28 A320s and 30 B737s. ANA became a member of Star Alliance in October 1999. ANA began serving the Central Japan International Airport in February 2006.

Japan Airlines Corporation

Japan Airlines Corporation ("JAL") was formed in October 2002 from the merger between Japan Airlines Co and Japan Systems Co. JAL operates in air transportation, airline-related businesses, travel services, and finance (credit card and leasing businesses). Over 65% of JAL's revenue is from the air transportation segment (i.e. passenger, cargo and mail service operations) however in 2006 this segment incurred an operating loss due to the sharp rise in fuel costs. The JAL air transportation segment flies to 216 airports in 35 countries via 279 international routes and 166 domestic routes. As of September 2006 JAL operated a fleet of 275 aircraft with an average age of 11.6 years of which they owned 179. JAL plans to become a member of the **one**world alliance in

2007. JAL's EBITDAR multiples are comparatively high due to the operating losses incurred in 2006 and the expected gradual recovery in profitability over the forecast period. Further, where forecast EBIT multiples and price earnings multiples can be calculated for JAL they are high and not meaningful for the purposes of this analysis.

Korean Air Lines Co Ltd

Korean Air Lines Co Ltd ("Korean Air") started as a national carrier of South Korea and was privatised in March 1969. It flies to 14 domestic cities and 87 international cities in 32 countries. Korean Air currently operates a fleet of 121 aircraft comprising 26 Boeing 747s, 16 Boeing 777s, 19 A330s, 31 Boeing 737s, 19 Boeing 747-400Fs and 1 A300-600F. Korean Air is a founding member of the SkyTeam global alliance which formed in 2000. SkyTeam has 10 member airlines offering 14,615 daily flights to 728 destinations in 149 countries. Korean Air is the largest cargo airline operator in the world (with a fleet of 19 dedicated freighters) with approximately 30% of revenue derived from cargo operations. During 2005 and 2006 Korean Air has experienced difficult trading conditions as a result of internal restructuring, aircraft reconfiguration, increasing fuel prices, industrial disputation and a stagnant export market (as a result of an appreciating currency). Brokers are expecting Korean Air's profitability to improve over the forecast period.

Thai Airways International Public Company Limited

Thai Airways was founded in 1960 as a joint venture and became fully owned by the Thai Government in 1977. It was listed in 1999 and is currently 54% owned by the Thai Government. Thai Airways operates domestic, regional and international flights from its hub in Bangkok with a fleet of 91 aircraft. It is a member of Star Alliance. Thai Airways' operating profit declined in the year ended 30 June 2006 primarily as a result of increased fuel prices, staff bonuses and the impact of appreciation of the Thai Baht. Analysts are forecasting significant growth in profitability over the next three years although there is some concern regarding the recent political instability in Thailand and teething problems being experienced at the newly opened Bangkok airport. Thai Airway's multiples may also be distorted by a substantial level of investments.

Air New Zealand Limited

Air New Zealand is New Zealand's largest domestic and international airline. Air New Zealand has over 470 daily flights to 26 domestic destinations in New Zealand and also runs three New Zealand regional airlines; Mount Cook Airline, Eagle Air and Air Nelson. It also operates a low cost carrier, Freedom Air, which flies on Trans-Tasman and Pacific routes. Air New Zealand operates a fleet of 94 aircraft comprising Boeing 747, 767, 777 and 737 jets and Airbus A320 jets, while its regional carriers operate ATR72, Q300, SAAB 340 and Beech 1900 aircraft. In 2001 it was recapitalised by the New Zealand Government, which is now the majority shareholder (80%). Air New Zealand became a member of Star Alliance in March 1999.

Deutsche Lufthansa AG

Deutsche Lufthansa AG ("Lufthansa") is an aviation group based in Germany. Lufthansa's core business is passenger transportation, which accounted for 64% of the revenue and 43% of segment earnings in the year ended 31 December 2005. Its other businesses are logistics, maintenance repair overhaul, catering, leisure travel and IT services. Lufthansa was fully privatised in 1997, and became a founding member of Star Alliance in that year. It operates a worldwide network with flights to 185 cities and is equipped with 255 jets comprising Airbus 300/310/319/320/321/330/340s and Boeing 737s and 747s. Lufthansa also established a regional network of five partner airlines under the "Lufthansa Regional" banner. The airlines involved are Air Dolomiti (100% owned by Lufthansa), Lufthansa CityLine (100%), Eurowings, Augsburg Airways and Contact Air. Lufthansa acquired Swiss International Air Lines Ltd in 2005. Lufthansa's operating margins are lower than its peer group but market analysts expect them to increase over time as the benefits of integrating Swiss International Air Lines emerge and management strategies (including the divestment of non-core activities and cost management) are implemented. In this regard, in December 2006 Lufthansa announced the sale of its 50% interest in Thomas Cook AG.

British Airways plc

British Airways is the United Kingdom's largest international passenger airline. It operates from London's two main airports, Heathrow (the world's biggest international airport) and Gatwick, both of which service a high volume of international point-to-point traffic. British Airways' worldwide route network comprised 148 destinations in 75 countries as at March 31, 2006. It has a fleet of 289 aircraft comprised of 57 Boeing 747s, 43 Boeing 777s, 21 Boeing 767s, 13 Boeing 757s, 67 Airbus A319/320/321s, 33 Boeing 737s and 55 smaller aircraft used in the company's regional business. In September 2004, British Airways sold its 18.25% interest in Qantas via a bookbuild to international and Australian investors. In February 2005, the Australian Competition and Consumer Commission ("ACCC") gave approval to the continuation of a joint service agreement between British Airways and Qantas on the Kangaroo route (between Australia and the United Kingdom) for a further five years. British Airways was one of the founding partners of the **one**world alliance. The EBITDAR and EBIT multiples for British Airways are flat reflecting expectations of pressure on profit margins as the airline introduces substantial premium service capacity into a highly competitive premium traffic market. However, the price earnings multiples imply growth over the forecast period due to a decrease in interest as debt is paid down. In January 2007 British Airways announced that it had agreed a resolution to a material employee pension deficit.

Air France- KLM

Air France-KLM was created via a merger of Air France and KLM in 2004. It operates under two brands coordinated around its Paris Charles de Gaulle and Amsterdam Schiphol hubs. The French Government owns 19% and employees own 15%. Air France has 380 aircraft in operation, comprising Boeing 747/777/737s, Airbus A330/340/318/319/320/321s and 127 aircraft belonging to the regional subsidiaries. KLM has 190 aircraft in operation. Air France-KLM flies to 225 destinations in 109 countries with a fleet of 570 aircraft. Air France's subsidiaries include Regional, Brit Air, City Jet, Sodexi (cargo), Servair (catering) and CRMA (repairs). KLM has interests in KLM UK/Cithopper (100%), transavia.com (100%), Martinair Holland (50%) and Kenya Airways (26%). Air France-KLM is a member of the SkyTeam Alliance. Synergy benefits from the 2003 merger are beginning to emerge and are expected to reach €1.0 billion by March 2011. In addition, cost cutting programmes are being implemented across the business.

Iberia Lineas Aer De Espana

Iberia Lineas Aer De Espana ("Iberia") was founded in Spain in 1927 becoming Spain's first airline, and listed in April 2001 (it currently has a 46% free float). Iberia flies to 101 destinations in 39 countries, and is a founding member of the **one**world alliance. It is the market leader for air travel between Europe and Latin America. As of September 2006, Iberia had an operating fleet of 150 aircraft of which they owned 45. It is the fourth largest European airline. British Airways owns a 10% interest in Iberia. The multiples calculated for Iberia in 2006 and 2007 are high reflecting difficult trading years. Profitability is expected to improve in the forecast period notwithstanding recent industrial disputes with pilots and ground handling staff and the expectation for increased competition from low cost carriers - Ryanair and EasyJet and a domestic operator Vueling.

SAS Group

SAS Group ("SAS") is the Nordic region's largest listed airline and travel group. It was formed in 1946 from Det Danske Luftfartselskab A/S, Det Norske Luftfartselskap A/S and Svensk Interkontinetal Lufttrafik AB and is 50% privately owned and 50% state owned. Denmark and Norway both hold 14.3% interests and Sweden holds a 21.4% interest. In 2001 a single SAS share was established and on 6 July 2001, SAS listed on the stock exchanges in Stockholm, Copenhagen and Oslo. SAS has a fleet of 305 aircraft of which Scandinavian Airlines operates 183, Spanair operates 61, Wideroe operates 29, Blue1 operates 17 and airBaltic operates 15. The group runs approximately 1,520 daily flights to 147 destinations. SAS was one of the founders of the Star Alliance.

Following operating losses in 2001 and 2002 a cost reduction and business model redirection program was implemented in 2003 (although operating losses continued in 2004 and 2005). In 2006 SAS has experienced favourable economic conditions in its markets resulting in growth in passenger traffic, notwithstanding increased fuel prices. SAS has returned to profitability in 2006 as the benefits of the internal restructuring began to emerge. Market sentiment has generally been positive with the trend of improving profitability expected to continue in the forecast period. In December 2006 SAS floated its hotel operations Rezidor (it has retained 6.7% interest) raising gross proceeds of SEK5.1 billion and it will book a SEK4.12 billion gain on the transaction. The data presented in the table allows for the Rezidor initial public offering ("IPO"). However, as a result of the IPO and low profitability the 2006 earnings multiples for SAS are high and not meaningful. The forecast price earnings multiples for SAS are low as minimal income tax expense has been allowed for due to carried forward losses. If the corporate tax rate of 28% is applied the forecast 2007 and 2008 price earnings multiples would increase to around 16 and 9 times respectively.

AMR Corporation

AMR Corporation ("American Airlines") was formed in 1982 and its operations primarily relate to the aviation activities of American Airlines and AMR Eagle. American Airlines provides scheduled jet service to destinations throughout North America, the Caribbean, Latin America, Europe and the Pacific, serving 172 cities and is a founding member of the **one**world alliance. As at 30 September 2006, American Airlines operated a fleet of 699 aircraft comprising Airbus A300s, Boeing 737s, Boeing 757s, Boeing 767s, Boeing 777s and McDonnell Douglas MD-80s with an average aircraft age of 13.7 years. AMR Eagle owns two regional airlines, American Eagle Airlines and Executive Airlines. American Eagle Airlines was established in 1984 by America Airlines as its regional airline affiliate. As at 30 September 2006, American Eagle Airlines fleet consisted of 309 aircraft and served 161 cities throughout the United States, Canada, The Bahamas and the Caribbean.

In the year ended 31 December 2006 American Airlines produced its first full year profit since 2000 and, notwithstanding the current fuel price uncertainty and security challenges, the market expects American Airlines' profitability to continue to improve. However, the 2006 earnings multiples for American Airlines are high and not meaningful due to the low level of profitability. The forecast price earnings multiples for American Airlines are low as no income tax expense has been forecast due to carried forward tax losses. If the corporate tax rate of 35% is applied the forecast 2007 and 2008 price earnings multiples would increase to around 15 and 9 times respectively.

UAL Corporation

UAL Corporation ("United Airlines") is the United States holding company for United Airlines, one of the largest passenger airlines in the world. United Airlines was founded in 1926 and operates more than 3,700 daily flights to more than 210 domestic and international destinations from hubs in Los Angeles, San Francisco, Denver, Chicago and Washington DC. Its passenger airline operations include United (a full service carrier), United Express (a group of United States regional affiliates contracted to United Airlines) and Ted (a low fare service). It operates a fleet of 460 aircraft, half of which are owned. United Airlines holds a unique portfolio of international route authorisations and 40% of its capacity is deployed in international markets. Approximately 62% of revenue is derived from the United States market, 18% from Pacific routes and 12% from transatlantic routes. United Airlines also provides cargo and engineering services. It is a founding member of Star Alliance.

United Airlines sought Chapter 11 bankruptcy protection in December 2002 and emerged from protection on 1 February 2006 following a restructuring of its operations which reduced costs by US$7 billion. Brokers generally consider that, although the cost reductions have been material and the balance sheet de-levered, there is a need for United Airlines to continue to reduce costs and to diversify its product offering. The 2006 multiples are high and not meaningful due to the low level of profitability as United Airlines emerged from bankruptcy and the forecast multiples are distorted by the low profitability and the expectation of significant earnings growth over the period. In addition, caution is needed in reviewing United Airlines' multiples due to limited broker coverage, particularly for the 2008 year.

ACE Aviation Holdings Inc

ACE Aviation Holdings Inc. ("ACE Aviation") was incorporated in June 2004 and is the holding company of various transportation and other service companies and partnerships including: Air Canada, Aeroplan, Air Canada Jazz ("Jazz"), Air Canada Technical Services and Air Canada Vacations. Air Canada is Canada's largest domestic and international full-service airline and Jazz is Canada's largest regional carrier. Aeroplan owns Air Canada's frequent flyer program. Air Canada was founded in 1937 by the Canadian Government and was privatised in 1988/89. The early 2000's were a difficult period for Air Canada due to excess debt, the impact of September 2001 terrorist attacks and the SARS crisis and an economic slowdown. As a result it filed for bankruptcy in April 2003. In September 2004 ACE Aviation emerged from bankruptcy as a holding company for the various Air Canada businesses and commenced a strategy to spin out part or all of these operations in order to realise value for shareholders. Currently, Aeroplan (June 2005), Jazz (February 2006) and Air Canada (November 2006) have been listed with ACE Aviation retaining between 50-79% of securities on issue. However, on a consolidated basis ACE Aviation's businesses comprise the operations of a legacy airline business (similar to Qantas).

There is some uncertainty associated with the multiples calculated for ACE Aviation. In recent months ACE Aviation has completed the IPO of Air Canada and announced an "in-specie" distribution of a further 25% (approximately) interest in Aeroplan to ACE Aviation shareholders. Market analysts have therefore revised their financial forecasts for ACE Aviation but do not appear to have restructured the latest ACE Aviation balance sheet (30 September 2006) to reflect these announcements (in part because ACE Aviation will report its 31 December balance sheet in February 2007). In addition, ACE Aviation has also announced its intention to realise the 100% owned engineering and maintenance business) Air Canada Technical Services during 2007.

Air Canada Inc

Air Canada today has 60% domestic market share in Canada, approximately 38% of Canada/US travel and more than 43% of international travel to and from Canada. It operates hubs in Toronto, Montreal and Vancouver. It is the world's 14th largest airline in terms of capacity and is a founding member of the Star Alliance. Air Canada and Jazz have a combined fleet of 335 aircraft of which Air Canada has 200 aircraft. Recent low profitability means that the 2006 price earnings multiples for Air Canada are high and not meaningful for the purpose of this analysis. Air Canada's current business strategy revolves around improving yields and reducing costs and profitability is expected to improve over time. Air Canada was listed at C$21 per share representing forecast multiples of 4-5 times and price earnings multiples of 8.5-9 times. These multiples are low but were considered appropriate as Air Canada does not own its frequent flyer program and in-house maintenance operations. Air Canada is currently trading at a 15% discount to IPO price. Market analysts consider that this discount reflects non-operational matters such as the recent IPO, the potential stock overhang (due to ACE Aviation's 75% interest and the relatively short 90 day lock-up period to mid February) and arbitrage trading around ACE Aviation's component entities (ACE Aviation, Aeroplan, Jazz and Air Canada).

Virgin Blue Holdings Limited

Virgin Blue is a low cost, low fare, single class Australian domestic carrier. It was established in November 1999 and listed on the Australian Stock Exchange on 8 December 2003. Virgin Blue currently operates a fleet of 53 Boeing 737s, and flies to 15 regional ports. In September 2003, Virgin Blue launched Pacific Blue, an international airline subsidiary to be based in Christchurch, New Zealand. Pacific Blue is a low cost, single class carrier, flying between Australia, New Zealand and the Pacific Islands. Polynesian Blue is a joint venture airline formed by Virgin Blue and the Government of Samoa in October 2005 providing non-stop services from Australia and New Zealand to Samoa. Together, these three airlines provide domestic air services to 22 Australian cities and centres and eight international destinations including New Zealand, Vanuatu, the Cook Islands, Fiji, Tonga and Samoa. On 28 January 2005, Patrick Corporation Limited ("Patrick") announced a takeover offer for all of the ordinary shares in Virgin Blue that it did not already own. The offer closed with Patrick increasing its interest in Virgin Blue to 62.4%. Following Patrick's takeover offer Virgin Blue changed its financial year end to 30 June and as its 2006 results are only for a nine month period they are not meaningful for this analysis.

Ryanair Holdings plc

Ryanair is a low cost carrier and currently has 18 bases across Europe, flying to 24 European countries via 437 routes. It is based in Dublin, Ireland and listed in May 1997. Its predominantly point-to-point network services secondary airports in Ireland, the United Kingdom and continental Europe. Ryanair operates a fleet of 120 Boeing 737s, with another 161 on firm order. Its subsidiaries include Ryanair.com credit cards, Ryanair Express Loans, Ryanair Hostels and Ryanair Hotels. In late 2006 Ryanair acquired 25.2% of Aer Lingus and made a cash takeover offer of €2.80 per share for the remaining shares on issue. This offer was withdrawn on 21 December 2006 following the launch of an investigation into the competition impacts of the transaction by the European Commission although Ryanair remains interested in acquiring Aer Lingus. Ryanair is the leading proponent of the deep discount low cost carrier business model and is highly profitable even in comparison to its low cost carrier peers. As a consequence, it is highly rated by the stockmarket which is reflected in its earnings multiples.

easyJet plc

easyJet commenced operations in 1995 as a low cost carrier and listed on the London Stock Exchange in October 2000. Based in the United Kingdom easyJet focuses on intra-European short haul routes flying to 74 destinations via 262 routes. It currently manages a fleet of 122 aircraft, comprising 87 Airbus A319 and 35 Boeing 737s and has recently placed firm orders for Airbus A319 aircraft which will see its fleet grow to more than 170 aircraft by the end of 2008. easyJet was a pioneer of internet distribution and sells approximately 95% of all seats via the Internet. Following the acquisition of Go Fly Limited from British Airways in 2002 and with increased low cost competition, easyJet's earnings came under pressure. A new management team was appointed in December 2005 and profitability has improved following the focus on both revenue sources and cost control.

Southwest Airlines Co

Southwest Airlines Co ("Southwest") is a value based domestic airline in the United States that provides predominantly short-haul, point-to-point services. Southwest operates 479 Boeing 737s and flies to 63 cities in 32 states. The company's fleet has an average age of about nine years. Southwest is widely regarded as the first low cost airline, with many airlines trying to copy its model. Southwest has been consistently profitable for 34 years. It has continued to grow in recent years notwithstanding the impact of higher fuel prices and security challenges. Market analysts believe Southwest's balance sheet strength positions it to continue to grow both organically and from participation in industry consolidation.

Appendix 5

Broker Consensus Forecasts

Set out below is a summary of forecasts prepared by brokers that follow Qantas in the Australian stockmarket:

Qantas – Broker Forecasts for the Year Ending 30 June 2007 ($ millions)

Broker	Date	EBITDAR[1]		Net Profit after Tax	
		Reported	Adjusted[2]	Reported	Adjusted[2]
Broker 1	8 Feb 07	2,795.0	2,967.6	642.9	763.7
Broker 2	8 Feb 07	2,912.0	3,090.6	649.0	774.0
Broker 3	8 Feb 07	2,617.1	2,817.1	697.1	837.1
Broker 4	9 Feb 07	2,580.9	2,668.0	633.0	694.0
Broker 5	8 Feb 07	2,823.5	2,900.6	686.0	740.0
Broker 6	8 Feb 07	2,619.0	2,797.6	662.0	787.0
Broker 7	8 Feb 07	2,750.0	2,928.6	682.0	807.0
Broker 8	8 Feb 07	2,774.0	2,994.0	636.0	790.0
Broker 9	9 Feb 07	2,770.4	3,017.5	644.0	817.0
Minimum		*2,580.9*	*2,668.0*	*633.0*	*694.0*
Maximum		*2,912.0*	*3,090.6*	*697.1*	*837.1*
Median		***2,770.4***	***2,928.6***	***649.0***	***787.0***
Average		*2,738.0*	*2,909.1*	*659.1*	*778.9*

Source: Broker's reports, Grant Samuel analysis

When reviewing this data the following should be noted:

- the forecasts presented above represent the latest available broker forecasts for Qantas;
- the brokers presented are those who have published research on Qantas following Qantas' announcement of its half year results for the six months ended 31 December 2007 on 8 February 2007;
- Grant Samuel is aware of only three other brokers that follow Qantas. These brokers have not released any research on Qantas that includes earnings forecasts subsequent to Qantas' announcement of its half year results for the six months ended 31 December 2007 on 8 February 2007;
- only two of the nine brokers present EBITDAR forecasts. EBITDAR is the metric most commonly used in valuing airlines. Where EBITDAR has not been presented, Grant Samuel has added Qantas' forecast non-cancellable operating lease payments to the broker forecast EBITDA to arrive at an estimate of forecast EBITDAR; and
- the broker forecasts are not prepared on a consistent basis, particularly in relation to the treatment of share of net profit after tax from associates and significant and non recurring items. Some brokers show these items separately and some do not. As Grant Samuel has valued Qantas' interests in associates separately, net profit after tax from associates should be excluded from the earnings parameters (except for net profit after tax). In the table above, Grant Samuel has attempted to present the broker earnings forecasts on a common basis by making the following adjustments:
  - in the three cases where share of net profit after tax from associates was not separately presented, the median share of forecast net profit after tax from associates has been subtracted from the presented EBITDAR; and
  - in the two cases where significant and non recurring items was not separately presented, the median forecast significant and non recurring items has been added back to net profit after tax and the equivalent pre tax amount has been added back to EBITDAR.

[1] EBITDAR is earnings before net interest, tax, depreciation, amortisation and non cancellable operating lease payments.

[2] The adjusted multiples have been calculated before significant and non recurring items.

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ANNEXURE B. QANTAS FINANCIAL RESULTS FOR THE HALF YEAR TO 31 DECEMBER 2006

QANTAS

Media Release

QANTAS RESULTS

FOR THE HALF-YEAR ENDED 31 DECEMBER 2006

HIGHLIGHTS

- Profit before tax of $523 million
- Net profit after tax of $359 million
- Revenue of $7.7 billion
- Earnings per share of 18.2 cents
- Operating cashflow over $1.0 billion
- Special dividend of 15.0 cents per share fully franked

Media Release

QANTAS REPORTS HALF-YEAR PROFIT OF $523 MILLION

SYDNEY, 8 February 2007: Qantas today announced a profit before tax (PBT) of $523 million for the half-year ended 31 December 2006, an 8.3 per cent increase on the prior comparative half-year to 31 December 2005.

Net profit after tax increased only 1.7 per cent to $359 million as a result of a favourable tax charge in the prior corresponding half.

The Chairman of Qantas, Ms Margaret Jackson, said that in December 2006, under the terms of the Airline Partners Australia (APA) takeover offer for Qantas, it was stated that the interim dividend that would otherwise have been payable in April 2007 would not be available. It was further stated that the Board would evaluate whether a fully franked Special Dividend could be paid during the bid period and, if this were possible, the offer consideration would be reduced by the dividend amount.

“We have established that a fully franked dividend can be paid and, accordingly, the Directors have today declared a fully franked Special Dividend of 15 cents per share, payable whether the APA offer succeeds or not. This Special Dividend will fully utilise all Qantas available franking credits,” Ms Jackson said.

The Special Dividend will be paid to all Qantas shareholders who are recorded on the register at 5.00 pm (Sydney time) on 19 February 2007. Payment will be made on the earlier of 19 March 2007 and 10 business days after the APA offer is unconditional.

Ms Jackson said that in accordance with the APA offer terms, if the APA offer succeeded, Qantas shareholders would receive a total of $5.60, comprising the fully franked Special Dividend of 15 cents per share and the balance of the $5.60 offer price by way of cash payment from APA.

She said Qantas had also decided to suspend the Dividend Reinvestment Plan (DRP), a decision that had been contemplated prior to the takeover offer from APA.

“This move is in line with the continued strength of the company’s balance sheet.”

Ms Jackson said Qantas Directors believed the APA offer was the best opportunity for shareholders to realise significant value for their investment in Qantas.

She said the half-year result reflected buoyant consumer demand and efficiency improvements throughout the airline over the past three-and-a-half years.

“Like other Australian companies, we have benefited from the continued strength in the Australian economy,” Ms Jackson said.

The Chief Executive Officer of Qantas, Mr Geoff Dixon, said crude oil prices had remained volatile during the six months – peaking at US$77 a barrel in July 2006.

“This has resulted in a total fuel bill $388 million higher than the comparative half year, after hedging.

Mr Dixon said the volatility in price remained, with prices only a few weeks ago reaching US$50 a barrel, before moving up to the current price of around US$60.

“On current forecasts, we expect our full year fuel costs to be around $3.5 billion, over $660 million higher than the prior full year.

“At these levels it is imperative we continue to seek efficiencies across all sections of our business.”

Mr Dixon said Qantas’ Sustainable Future Program had achieved benefits of $319 million during the half-year.

“Business transformation under the Program enabled an underlying improvement in unit costs of 0.9 per cent.

“We need to accelerate this unit cost reduction in the second half of the year if we are to achieve our target of $750 million.”

Mr Dixon said other contributing factors to the half-year result were:

- capacity growth of 3.7 per cent, particularly within the leisure market segments as Jetstar consolidated its position domestically following delivery of its A320 fleet in the prior year and commenced long haul international operations in November 2006;

- a four-fold improvement in Jetstar’s profit for the half year from $10 million to $51 million (excluding start-up costs for Jetstar International’s operations);

- an improvement in yield of 7.2 per cent (including the favourable impact of foreign exchange rate movements) and a 2.8 percentage point improvement in seat factor to 80.3 per cent, principally in Qantas Airlines where there had been an improvement in international operations;

- cashflow from operations of over $1.0 billion which, after capital investments and other financing costs, saw the airline’s cash position improve by $151 million to over $3.0 billion.

Mr Dixon said Qantas needed to continue to adjust its business to meet ongoing intense international competition, potential new costs from changed environmental regulations, and an expected new low cost airline in the Australian domestic market.

"However, despite these challenges we have and will continue to expand and invest in existing and growing markets.

"To this end, Jetstar International operations will expand to six A330-200 aircraft and Qantas will acquire four A330-200s over the next two years.

"Also, in late 2008 the Qantas Group will commence the introduction of the world's newest aircraft, the Airbus A380 and the Boeing 787."

He said Qantas had:

- increased Qantaslink capacity by over 20 per cent as it expanded regional flying with new Q400 aircraft;
- successfully launched Jetstar international operations in November 2006, which had added six new destinations to the Qantas Group network and created 500 new jobs;
- opened a new QantasLink pilot and cabin crew base in Canberra in September 2006, creating 30 jobs;
- announced increased services to San Francisco from March 2007;
- increased trans-continental capacity with the addition of wide body aircraft to these routes; and
- launched a range of product enhancements, including online check-in, with refreshed international menus and amenities on board from next month and state-of-the-art international First lounges opening in Melbourne and Sydney in April 2007.

Mr Dixon said the Qantas Group intended to build on its track record of growth and service excellence.

"I would like to take this opportunity to thank our staff for their unwavering professionalism during a period of difficult operating conditions and – more recently – relentless public speculation about the future of Qantas."

Outlook

We believe that the full year result will be around 30 to 40 per cent higher than last year's result subject to fuel costs not increasing significantly, demand continuing to grow and cost reductions not achieved in the first half being realised in the second half.

Group Revenue

Total revenue for the half-year was $7.7 billion, an increase of $870 million or 12.7 per cent on the prior half-year compared to capacity growth, measured in Available Seat Kilometres (ASK), of 3.7 per cent. Excluding the favourable impact of foreign exchange rate movements, total revenue increased by 12.5 per cent.

Net passenger revenue including fuel surcharge recoveries increased $717 million or 13.6 per cent to $6.0 billion. Traffic, measured in Revenue Passenger Kilometres (RPK), increased by 7.4 per cent while yield improved by 7.2 per cent. Excluding favourable foreign exchange rate movements, net passenger revenue was up 13.4 per cent, with yield improving 7.0 per cent.

Other revenue categories increased by $153 million or 9.7 per cent including a 6.7 per cent improvement in freight revenue from additional wet-leased freighter capacity and stronger yields.

Expenditure

Total operating expenditure increased by 10.7 per cent or $684 million to $7.1 billion, excluding borrowing costs and future ineffectiveness on open hedge instruments.

Total fuel costs increased by $388 million to $1.7 billion. The increase included $379 million due to fuel price rises after hedging, reflecting an average into-plane fuel price rise of 27.1 per cent. A 2.0 per cent increase in consumption from activity growth increased costs by $17 million while favourable foreign exchange rate movements reduced fuel costs by $8 million.

Manpower and staff related costs increased by $22 million or 1.3 per cent. Capacity growth, Enterprise Bargaining Agreement (EBA) wages and salary increases were offset by cost saving initiatives and productivity improvements of $114 million. Business restructuring costs increased by $61 million to a total of $111 million, including $100 million in redundancy costs with a total of 986 managed redundancies effected or announced during the period. Full-time equivalent employees (FTEs) decreased by 4.1 per cent on the prior comparative period.

Aircraft operating variable costs increased $16 million or 1.2 per cent to $1.3 billion, reflecting activity and price related increases, particularly domestic airport charges, offset by cost saving initiatives and capitalised maintenance costs as required under Australian International Financial Reporting Standards (A-IFRS).

Financing charges including depreciation, non-cancellable operating lease rentals and net interest increased by 19.7 per cent or $155 million. Depreciation expense included $19 million on new aircraft deliveries, $14 million from a change in aircraft modification depreciation policy and $41 million in depreciation on capitalised maintenance costs as required under A-IFRS. The increase in operating lease charges largely reflects the full-period effect of Jetstar's A320 aircraft. Net interest costs decreased $3 million due to higher average cash balances.

Total expenditure also included an unfavourable impact of $99 million from the accounting recognition of open hedging instruments (hedge ineffectiveness) as required under A-IFRS. This compares to a favourable impact of $49 million in the comparative results.

Net Impact of Foreign Exchange Rate Movements

The net effect of foreign exchange rate movements on overall profit before tax was an unfavourable impact of $8 million.

Sustainable Future Program

Benefits delivered across the Group under the Sustainable Future Program totalled $319 million in the half-year. Savings comprised labour savings of $111 million, distribution savings of $61 million and $147 million in fleet, product and overhead initiatives.

Restructuring costs associated with the Sustainable Future Program totalled $132 million, including $100 million in redundancy payments and provisions.

Group Unit Costs

Net expenditure cost per ASK increased by 11.6 per cent, driven by fuel cost movements, restructuring expenses and ineffectiveness from open hedge positions. After adjusting for those factors, unit costs decreased by 0.9 per cent despite wages and inflationary price increases.

Qantas Mainline

PBT for Qantas Mainline operations (including QantasLink and Australian Airlines) totalled $424 million, an increase of $9 million or 2.2 per cent on the comparative half-year.

Passenger revenue increased by 12.3 per cent, including fuel surcharge recoveries, reflecting an 8.3 per cent improvement in yield (excluding favourable foreign exchange rate movements) and a 2.8 point increase in seat factor to 80.4 per cent.

Constant capacity reflected the conversion of some Pacific Islands codeshare operations from block-space to free-sale, the transfer of some domestic flying to Jetstar and the new Q400 turboprop aircraft within QantasLink.

Net expenditure increased by 13.3 per cent, predominantly due to the impact of fuel price increases. Mainline net expenditure also includes the $132 million in restructuring costs and the $99 million from the accounting recognition of open hedging instruments.

Jetstar

Jetstar A320 operations, which include domestic Australia, Trans-Tasman and short-haul international, achieved a PBT of $51 million or a four-fold increase on the comparative half-year of $10 million.

Passenger revenue increased by $161 million or 55.2 per cent on a 50.7 per cent increase in capacity reflecting the expansion of the Jetstar domestic network, a full six months of Trans-Tasman flying and the transition to an all A320 fleet.

Net operating expenditure increased by $92 million or 39.0 per cent which was significantly below the capacity increase of 50.7 per cent and includes the impact of higher fuel prices.

Total expenditure per ASK was 7.75 cents, a reduction of 5.8 per cent on the comparative half-year and industry leading in Australia.

Jetstar International commenced operations with an interim fleet of A330-200s on 23 November 2006 with the inaugural flight from Melbourne to Bangkok followed by services to Phuket commencing on 24 November 2006 and Sydney - Ho Chi Minh City operations from 30 November. In December 2006, Jetstar International commenced flying to Bali and Honolulu and achieved a break-even operating result for its first full month of operations. Start-up costs expensed in the period prior to commencement of operations totalled $26 million.

Market Share

Total Qantas Group international market share was 31.3 per cent based on the latest Bureau of Transport and Regional Economics (BTRE) statistics for the four months ended October 2006, a 0.2 point increase on the comparative period.

Total Qantas Group domestic market-share for the five months to November 2006 as reported by the BTRE was 67.5 per cent, a 1.5 point increase on the comparative period.

Qantas Holidays

Qantas Holidays reported a half-year PBT of $26 million, which was in line with the comparative half-year. The continued trend of consumers to unbundle domestic and point-to-point international travel resulted in lower passenger volumes, although these were offset by improved margin management and stronger inbound and reseller activity.

As an outbound destination, Bali continues to be impacted by the October 2005 bombings, with bookings down 46 per cent on the former level of activity, although this has been partially offset by substantial growth to Thailand.

Bookings through the Ready Rooms on-line channel have also seen substantial growth, increasing over 60 per cent on the comparative period.

Qantas Flight Catering Group

Qantas Flight Catering (QFC) achieved a PBT of $15 million, 5.1 per cent down on the comparative half-year. This reflected lower client volumes, including the cessation of services on behalf of Malaysian Airlines, and lower Qantas volumes from the transfer of some domestic services to Jetstar. The decline in revenue was largely offset by lower material costs and labour savings.

QFC has begun a change management program at its Sydney facilities, which is expected to take up to two years, that will see the establishment of a ‘client only’ facility at Caterair Sydney with ‘Qantas only’ volumes being delivered from the existing QFCL facility.

Cash Flow and Balance Sheet

Net cash held at 31 December 2006 was over $3.0 billion, an increase of $151 million compared to 30 June 2006.

Cash flow from operations totalled $1,050 million, an increase of $65 million or 6.6 per cent compared to the profit after tax improvement of 1.7 per cent.

Net capital expenditure totalled $661 million and included the purchase of three new Q400 aircraft, progress payments on A380, A330, B738 and B787 aircraft, modifications, spares and related equipment.

Net cash outflows from financing activities totalled $238 million, and included $116 million in dividend payments net of reinvestment under the DRP and net debt repayments of $122 million.

The book debt to equity ratio (including off Balance Sheet debt) at 31 December 2006 was 42:58 compared to 45:55 at 30 June 2006.

Earnings per share (EPS) was 18.2 cents per share.

Special Dividend

The Special Dividend of 15 cents per share is a fully franked Special Dividend payable on the earlier of 19 March 2007 and 10 business days after the APA offer is unconditional, with a record date (books close) of Monday, 19 February 2007.

Issued by Corporate Communication (Q3526)
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QANTAS AIRWAYS LIMITED AND CONTROLLED ENTITIES

CONSOLIDATED INTERIM FINANCIAL REPORT
FOR THE HALF-YEAR ENDED
31 DECEMBER 2006

ABN 16 009 661 901

ASX CODE: QAN

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RESULTS FOR ANNOUNCEMENT TO THE MARKET

	December 2006 $m	December 2005 $m	Change $m	Change %
Sales and other income	7,726.9	6,857.2	869.7	up 12.7%
Profit for the half-year attributable to members	358.7	352.8	5.9	up 1.7%

DIVIDENDS

31 December 2006 special dividend	
Amount per security (cents)	15.0
Franked amount per security at 30% tax	15.0
Record date for determining entitlements to the dividend	19 February 2007
Date the dividend is payable	The earlier of 19 March 2007 and 10 business days after the APA Offer becomes unconditional
Total dividend declared ($m)	297.6

The Qantas Board has decided to suspend the Dividend Reinvestment Plan (DRP). The suspension has been effected pursuant to Rule 12(a) of the DRP, which entitles the Qantas Directors to terminate or suspend the DRP at any time on giving notice to DRP participants of the termination of suspension (and this paragraph is deemed to constitute such notification). This means that the Special Dividend cannot be applied to acquire further Qantas shares under the DRP.

EXPLANATION OF RESULTS

Please refer to the attached Press Release for an explanation of the results.

This information should be read in conjunction with the Qantas Airways Limited 2006 Annual Report.

The information provided in this report contains all the information required by ASX Listing Rule 4.2A.

OTHER INFORMATION

	December 2006 $	December 2005 $
Net Tangible Assets per ordinary share	**2.90**	**2.98**

Entities over which control was gained or lost during the half-year:

Qantas gained control of Jet Turbine Services Pty Limited on 15 December 2006 when it acquired the remaining 50% equity in the company. Accordingly, the results of Jet Turbine Services Pty Limited are included in the Qantas Group's consolidated results from this date.

Details of associates and jointly controlled entities

Equity accounted associates and jointly controlled entities	Percentage of ownership interest held at end of half-year or date of disposal		Contribution to net profit	
	December 2006 %	December 2005 %	December 2006 $m	December 2005 $m
Air Pacific Limited	46.3	46.3	0.1	2.4
Australian air Express Pty Limited	50.0	50.0	8.7	5.6
Hallmark Aviation Services LP	49.0	49.0	0.7	0.1
Harvey Holidays Pty Limited	50.0	50.0	0.5	0.6
HT & T Travel (Phillipines) Inc.	28.1	28.1	-	-
Holidays Tours and Travel (Thailand) Ltd.	36.8	36.8	-	-
Holidays Tours and Travel Vietnam Joint Venture Company	36.8	36.8	-	-
Jet Turbine Services Pty Limited [1]	100.0	50.0	(1.9)	(2.3)
Jupiter Air Oceania Limited	47.6	47.6	-	-
Orangestar Investment Holdings Pte Limited [2]	45.0	44.5	(4.4)	(12.2)
Star Track Express Holdings Pty Limited	50.0	50.0	9.6	9.7
Tour East (TET) Ltd.	36.8	36.8	0.1	-
Thai Air Cargo Company Limited [3]	-	49.0	-	0.7
Travel Software Solutions Pty Limited	50.0	50.0	0.1	2.2
Total			**13.5**	**6.8**

1 Qantas acquired the remaining 50% equity in Jet Turbine Services Pty Limited on 15 December 2006. Qantas ceased to equity account the results of Jet Turbine Services Pty Limited from this date.

2 On 29 December 2006, the Board of Orangestar Investment Holdings Pte Limited approved the issuing of an optional convertible note to shareholders. This convertible note had not been issued at 31 December 2006.

3 On 21 August 2006, Qantas sold its share of Thai Air Cargo Company Limited to the other joint venture partner. Losses from the venture had previously been equity accounted and no further losses were recognised on disposal of the investment.

DIRECTORS' REPORT

The Directors present their report together with the Consolidated Interim Financial Report for the half-year ended 31 December 2006 and the Independent Auditors' Review Report thereon.

DIRECTORS

The Directors of Qantas Airways Limited at any time during or since the end of the half-year are as follows:

Name	Period of Directorship
Margaret Jackson, AC *Chairman*	*Director since July 1992 - appointed Chairman August 2000*
Geoff Dixon *Chief Executive Officer*	*Director since August 2000 - appointed CEO in March 2001*
Peter Gregg *Chief Financial Officer*	*Director since September 2000*
Paul Anderson	*Director since September 2002*
Mike Codd, AC	*Director since January 1992*
Peter Cosgrove, AC, MC	*Director since July 2005*
Patricia Cross	*Director since January 2004*
Garry Hounsell	*Director since January 2005*
James Packer	*Director since March 2004*
John Schubert	*Director since October 2000*
James Strong, AO	*Director since 1 July 2006*

REVIEW OF OPERATIONS

The Qantas Group achieved a profit before related income tax expense (PBT) for the half-year of $523.4 million, representing an increase of $39.9 million or 8.3% on the comparative half-year.

Total sales and other income for the half-year increased by $869.7 million or 12.7% to $7.7 billion. Revenue Passenger Kilometres (RPKs) increased by 7.4% on increased capacity of 3.7%, leading to an increase in passenger load factor of 2.8 percentage points, while yields increased by 7.2%.

Total expenditure increased by $829.8 million or 13.0% to $7.2 billion.

Qantas flying brands (including QantasLink) contributed PBT of $423.6m, an increase of $9.2 million or 2.2% over the comparative half-year. RPKs increased by 3.5% on decreased capacity of 0.1%, leading to an increase in passenger load factor of 2.8 percentage points.

Jetstar contributed PBT of $23.3 million, an increase of $13.7 million over the comparative half-year. RPKs increased by 63.8% on increased capacity of 57.5%, leading to an increase in passenger load factor of 3.0 percentage points.

PBT for other subsidiary operations increased by $17.0 million or 28.6% to $76.5 million.

DIRECTORS' REPORT (continued)

LEAD AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

The Directors have received the Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001.

The Lead Auditor's Independence Declaration is set out on page 15 and forms part of the Directors' Report for the half-year ended 31 December 2006.

ROUNDING

The Qantas Group is of the kind referred to in Australian Securities Investment Commission (ASIC) Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and in accordance with the Class Order, amounts in the Financial Report and Directors' Report have been rounded to the nearest hundred thousand dollars, unless otherwise stated.

Signed pursuant to a Resolution of the Directors:

MARGARET JACKSON
Chairman

GEOFF DIXON
Chief Executive Officer

Sydney, 7 February 2007

CONSOLIDATED INCOME STATEMENT
for the half-year ended 31 December 2006

	December 2006 $m	December 2005 $m
Sales and other income		
Net passenger revenue	5,996.4	5,279.2
Net freight revenue	493.8	462.8
Tours and travel revenue	409.5	381.9
Contract work revenue	214.5	240.8
Other [1,2,3]	612.7	492.5
	7,726.9	**6,857.2**
Expenditure		
Manpower and staff related [4]	1,687.3	1,664.9
Selling and marketing	241.7	228.9
Aircraft operating - variable	1,305.2	1,289.2
Fuel	1,735.3	1,347.5
Property	165.1	163.1
Computer and communication	259.1	239.9
Tours and travel	342.7	312.6
Capacity hire	160.1	192.8
Other [2]	246.4	173.8
Ineffective hedging - closed derivative positions	33.5	30.6
Depreciation and amortisation [5]	707.2	601.0
Non-cancellable operating lease rentals	209.9	158.1
Share of net profit of associates and jointly controlled entities	(13.5)	(6.8)
	7,080.0	**6,395.6**
Operating result	**646.9**	**461.6**
Ineffective hedging - open derivative positions	(99.4)	49.4
Profit before related income tax expense and net finance costs	**547.5**	**511.0**
Finance income	106.9	69.0
Finance costs	(131.0)	(96.5)
Net finance costs	(24.1)	(27.5)
Profit before related income tax expense	**523.4**	**483.5**
Income tax expense	(164.9)	(130.9)
Profit for the half-year	**358.5**	**352.6**
Attributable to:		
Members of Qantas	358.7	352.8
Minority interest	(0.2)	(0.2)
Profit for the half-year	**358.5**	**352.6**
Earnings per share (EPS) attributable to members of Qantas		
Basic earnings per share (cents)	18.2	18.4
Diluted earnings per share (cents)	18.2	18.4

1 Compensation for the late delivery of aircraft has resulted in the recognition of $97.5 million, representing the present value of future receipts.
2 Prior year gain on sale of non-current assets of $10.4 million has been reclassified from Other Expenses to Other Income.
3 Change in the estimate of points not expected to be redeemed resulted in the recognition of $51.6 million in Frequent Flyer revenue.
4 Redundancy costs incurred during the half-year were $100.1 million (2005: $45.2 million).
5 Change in the estimated useful life of aircraft modifications resulted in additional depreciation of $35.9 million.

The Consolidated Income Statement is to be read in conjunction with the Condensed Notes to the Consolidated Interim Financial Statements set out on pages 10 to 14.

CONSOLIDATED BALANCE SHEET
as at 31 December 2006

	December 2006 $m	June 2006 $m
Current assets		
Cash and cash equivalents	3,053.3	2,902.0
Receivables	1,089.6	1,124.3
Other financial assets	286.7	476.7
Inventories	188.3	334.8
Assets classified as held for sale	9.6	24.2
Other	57.8	86.4
Total current assets	**4,685.3**	**4,948.4**
Non-current assets		
Receivables	378.0	342.0
Other financial assets	702.4	766.8
Investments accounted for using the equity method	360.4	372.9
Other investments	78.2	53.7
Property, plant and equipment	12,398.3	12,375.0
Intangible assets	329.2	311.7
Deferred tax assets	0.3	2.9
Other	32.0	9.9
Total non-current assets	**14,278.8**	**14,234.9**
Total assets	**18,964.1**	**19,183.3**
Current liabilities		
Payables	1,893.3	1,988.0
Interest bearing liabilities	735.9	440.8
Other financial liabilities	295.7	139.2
Provisions	458.8	469.0
Current tax liabilities	63.6	72.4
Revenue received in advance	2,213.2	2,282.8
Deferred lease benefits/income	37.6	37.5
Total current liabilities	**5,698.1**	**5,429.7**
Non-current liabilities		
Interest bearing liabilities	4,781.1	5,334.8
Other financial liabilities	479.6	352.2
Provisions	472.3	477.0
Deferred tax liabilities	674.4	701.2
Revenue received in advance	700.9	708.5
Deferred lease benefits/income	79.2	98.8
Total non-current liabilities	**7,187.5**	**7,672.5**
Total liabilities	**12,885.6**	**13,102.2**
Net assets	**6,078.5**	**6,081.1**
Equity		
Issued capital	4,481.2	4,382.2
Treasury shares	(38.9)	(23.8)
Reserves	89.8	329.3
Retained profits	1,541.7	1,388.5
Equity attributable to members of Qantas	**6,073.8**	**6,076.2**
Minority interests in controlled entities	4.7	4.9
Total equity	**6,078.5**	**6,081.1**

The Consolidated Balance Sheet is to be read in conjunction with the Condensed Notes to the Consolidated Interim Financial Statements set out on pages 10 to 14.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the half-year ended 31 December 2006

	Issued Capital $m	Treasury Stock $m	Employee Compensation Reserve $m	Hedge Reserve $m	Fair Value Reserve $m	Asset Revaluation Reserve $m	Foreign Currency Reserve $m	Retained Earnings $m	Minority Interest $m	Total Equity $m
Balance at 1 July 2005	4,181.5	(17.8)	13.7	-	-	4.4	(3.5)	1,347.4	4.2	5,529.9
Impact of initial adoption of AASB 132 and AASB 139	10.8	-	-	379.0	(28.8)	-	-	(36.0)	-	325.0
Restated balance	4,192.3	(17.8)	13.7	379.0	(28.8)	4.4	(3.5)	1,311.4	4.2	5,854.9
Profit for the half-year	-	-	-	-	-	-	-	352.8	(0.2)	352.6
Dividends to members	97.4	-	-	-	-	-	-	(190.0)	-	(92.6)
Own shares acquired	-	(9.9)	-	-	-	-	-	-	-	(9.9)
Shares vested to employees	-	1.7	(1.7)	-	-	-	-	-	-	-
Share-Based payments	-	-	5.7	-	-	-	-	-	-	5.7
Transfer of Hedge Reserve to Income Statement	-	-	-	(149.5)	-	-	-	-	-	(149.5)
Recognition of effective cash flow hedges on capitalised assets	-	-	-	18.3	-	-	-	-	-	18.3
Effective portion of changes in fair value of cash flow hedges	-	-	-	101.1	-	-	-	-	-	101.1
Share of movement in jointly controlled entity's hedge reserve	-	-	-	(1.1)	-	-	-	-	-	(1.1)
Change in fair value of assets available for sale	-	-	-	-	(7.2)	-	-	-	-	(7.2)
Recognition of deferred tax liability on revalued assets	-	-	-	-	-	(0.4)	-	-	-	(0.4)
Balance at 31 December 2005	**4,289.7**	**(26.0)**	**17.7**	**347.8**	**(36.0)**	**4.0**	**(3.5)**	**1,474.2**	**4.0**	**6,071.9**

The Consolidated Statement of Changes in Equity is to be read in conjunction with the Condensed Notes to the Consolidated Interim Financial Statements set out on pages 10 to 14.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)
for the half-year ended 31 December 2006

	Issued Capital $m	Treasury Stock $m	Employee Compensation Reserve $m	Hedge Reserve $m	Fair Value Reserve $m	Asset Revaluation Reserve $m	Foreign Currency Reserve $m	Retained Earnings $m	Minority Interest $m	Total Equity $m
Balance at 1 July 2006	4,382.2	(23.8)	23.7	332.2	(35.4)	4.0	4.8	1,388.5	4.9	6,081.1
Profit for the half-year	-	-	-	-	-	-	-	358.7	(0.2)	358.5
Dividends to members	99.0	-	-	-	-	-	-	(215.3)	-	(116.3)
Own shares acquired	-	(24.5)	-	-	-	-	-	-	-	(24.5)
Shares vested to employees	-	9.4	(7.2)	-	-	-	-	(2.2)	-	-
Share-Based payments	-	-	6.0	-	-	-	-	-	-	6.0
Transfer of Hedge Reserve to Income Statement	-	-	-	(40.2)	-	-	-	-	-	(40.2)
Recognition of effective cash flow hedges on capitalised assets	-	-	-	13.0	-	-	-	-	-	13.0
Effective portion of changes in fair value of cash flow hedges	-	-	-	(241.4)	-	-	-	-	-	(241.4)
Change in fair value of assets available for sale	-	-	-	-	26.6	-	-	-	-	26.6
Impairment charge against assets previously measured at fair value	-	-	-	-	10.1	-	-	-	-	10.1
Foreign exchange impact of Fair Value Reserve transferred to Foreign Currency Reserve	-	-	-	-	(1.3)	-	1.3	-	-	-
Translation of foreign currency subsidiaries	-	-	-	-	-	-	(6.4)	-	-	(6.4)
Pre-acquistion retained profits acquired on acquisition	-	-	-	-	-	-	-	12.0	-	12.0
Balance at 31 December 2006	**4,481.2**	**(38.9)**	**22.5**	**63.6**	**0.0**	**4.0**	**(0.3)**	**1,541.7**	**4.7**	**6,078.5**

The Consolidated Statement of Changes in Equity is to be read in conjunction with the Condensed Notes to the Consolidated Interim Financial Statements set out on pages 10 to 14.

CONSOLIDATED STATEMENT OF CASH FLOWS

for the half-year ended 31 December 2006

	December 2006 $m	December 2005 $m
Cash flows from operating activities		
Cash receipts in the course of operations	7,893.4	6,958.4
Cash payments in the course of operations	(6,687.8)	(5,828.3)
Interest received	102.7	69.6
Interest paid	(184.0)	(132.5)
Dividends received	8.7	18.5
Income taxes paid	(82.6)	(100.2)
Net cash from operating activities	**1,050.4**	**985.5**
Cash flows from investing activities		
Payments for property, plant and equipment [1]	(660.8)	(820.0)
Proceeds from sale of property, plant and equipment	8.1	20.4
Proceeds from financing of non-current assets	-	383.3
Payments for investments, net of cash acquired	(11.6)	(25.2)
Proceeds from sale of investments	3.4	-
Advances of investment loans	-	(3.0)
Net cash used in investing activities	**(660.9)**	**(444.5)**
Cash flows from financing activities		
Repayment of borrowings	(180.0)	(191.7)
Proceeds from swaps	56.1	43.1
Receipts from aircraft security deposits	1.8	-
Dividends paid [2]	(116.1)	(92.2)
Net cash used in financing activities	**(238.2)**	**(240.8)**
Net increase in cash and cash equivalents held	**151.3**	**300.2**
Cash and cash equivalents at the beginning of the half-year	2,902.0	1,903.8
Cash and cash equivalents at the end of the half-year	**3,053.3**	**2,204.0**

1 As a consequence of the assignment of purchase rights prior to aircraft delivery, contractual payments to manufacturers of $nil (2005: $279.2 million) were settled by aircraft lessors.

2 During the half-year 28,991,867 (2005: 31,024,893) shares were issued under the Dividend Reinvestment Plan. Dividends settled in shares rather than cash during the half-year totalled $99.0 million (2005: $97.4 million).

The Consolidated Statement of Cash Flows is to be read in conjunction with the Condensed Notes to the Consolidated Interim Financial Statements set out on pages 10 to 14.

CONDENSED NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS
for the half-year ended 31 December 2006

Note 1. Statement of Significant Accounting Policies

(a) Reporting entity

Qantas Airways Limited (Qantas) is a company domiciled in Australia. The Consolidated Interim Financial Report (Financial Report) of Qantas as at and for the six months ended 31 December 2006 comprises Qantas and its subsidiaries (Qantas Group) and the Qantas Group's interest in associates and jointly controlled entities.

The consolidated annual financial report of the Qantas Group as at and for the year ended 30 June 2006 is available upon request from the registered office of Qantas at Qantas Centre, Level 9 Building A, 203 Coward Street, Mascot NSW 2020, Australia or at www.qantas.com.au.

(b) Statement of compliance

The Financial Report is presented in Australian dollars and is a general purpose Financial Report which has been prepared in accordance with *AASB 134: Interim Financial Reporting* and the *Corporations Act 2001*. International Financial Reporting Standards (IFRSs) form the basis of Australian Accounting Standards (AASBs) adopted by the Australian Accounting Standards Board (AASB). The Financial Report of the Qantas Group also complies with IAS 34 *Interim Financial Reporting*.

The Financial Report does not include all of the information required for a full annual financial report and should be read in conjunction with the consolidated annual financial report of the Qantas Group as at and for the year ended 30 June 2006. This report must also be read in conjunction with any public announcements made by Qantas during the half-year in accordance with the continuous disclosure requirements arising under the *Corporations Act 2001* and ASX Listing Rules.

This Financial Report was approved by the Board of Directors on 7 February 2007.

The Qantas Group is of the kind referred to in Australian Securities Investment Commission (ASIC) Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) and in accordance with the Class Order, amounts in the Financial Report and Directors' Report have been rounded to the nearest hundred thousand dollars, unless otherwise stated.

(c) Significant accounting policies

The accounting policies applied by the Qantas Group in this Financial Report are the same as those applied by the Qantas Group in the consolidated Financial Report as at and for the year ended 30 June 2006.

CONDENSED NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS
for the half-year ended 31 December 2006

Note 1. Statement of Significant Accounting Policies (continued)

(c) Significant accounting policies (continued)

In the prior financial year the Qantas Group adopted *AASB 132: Financial Instruments: Disclosure and Presentation* and *AASB 139: Financial Instruments: Recognition and Measurement* in accordance with the transitional rules of *AASB 1: First-time Adoption of Australian Equivalents to International Financial Reporting Standards*. This change has been accounted for by adjusting the opening balance of retained earnings and reserves at 1 July 2005, as disclosed in the Consolidated Statement of Changes in Equity.

The Qantas Group adopted *AASB 2005-9 Amendments to Australian Accounting Standards (September 2005)* as of 1 July 2006. The amendment requires liabilities to be recognised for certain financial guarantee contracts. The initial application of AASB 2005-9 has had no material impact on the Qantas Group.

(d) Estimates

The preparation of the Financial Report requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

In preparing this Financial Report, the significant judgements made by management in applying the Qantas Group's accounting policies and the key sources of uncertainty in estimation were the same as those that applied to the Financial Report as at and for the year ended 30 June 2006, with the following exceptions:

1 Changes in breakage assumptions for Frequent Flyer have resulted in a $51.6 million reduction in the Frequent Flyer liability during the half-year.

2 A reduction in the estimated useful life of aircraft modifications resulted in additional depreciation of $35.9 million during the half-year.

Note 2. Tax Reconciliation

The prima facie income tax on profit before related income tax expense differs from the income tax charged in the Income Statement and is calculated as follows:

	December 2006 $m	December 2005 $m
Profit before related income tax expense	523.4	483.5
Prima facie income tax expense @ 30%	157.0	145.1
Less: utilisation of carry forward tax losses	(1.5)	(21.4)
Add: other items	9.4	7.2
Income tax expense	164.9	130.9

CONDENSED NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

for the half-year ended 31 December 2006

Note 3. Capital Expenditure Commitments

	December 2006 $m	June 2006 $m
Capital expenditure commitments contracted but not provided for in the Financial Statements, payable:		
Not later than June 2007	628.2	1,349.4
Not later than June 2008	621.9	4,753.1
Later than June 2008 but not later than June 2012	9,009.1	3,898.8
Later than June 2012	2,569.9	-
	12,829.1	10,001.3

Note 4. Dividends

A fully franked final dividend of 11 cents (2005: 10 cents fully franked) per ordinary share was paid on 4 October 2006 in relation to the financial year ended 30 June 2006. The total amount of the dividend declared was $215.1 million (2005: $189.9 million).

A fully franked special dividend of 15 cents per share has been declared. This will have the effect of distributing accumulated franking credits to shareholders.

Note 5. Contingent Liabilities

The contingent liabilities disclosed in the 30 June 2006 Annual Report remain unresolved. While the construction dispute referred to in the Annual Report is ongoing, the proceedings in respect of one aspect of the claim against Qantas have been summarily dismissed on appeal by the plaintiff.

A new class action claim was made during the half-year by a number of travel agents against IATA, Qantas and other airlines as a result of travel agents not being paid commission on fuel surcharge. The claim amount has not yet been determined and Qantas is investigating the claim.

As disclosed in the 2006 Annual Report, Qantas is being investigated by a number of regulators in relation to alleged price fixing in the air cargo market. In late January 2007, Qantas was made aware of representative proceedings filed in the Federal Court of Australia against Qantas and other airlines in relation to alleged price fixing in the air cargo market. On 1 February 2007 Qantas was served with representative proceedings filed in the Federal Court of Australia against Qantas and other airlines in relation to alleged price fixing in the air cargo market. No estimate of quantum is provided in the pleadings. Qantas expects that it will take at least 12 months before it is possible to quantify any direct or indirect liability associated with this matter.

Qantas, along with other major airlines, has undertaken to provide financial support to a number of airports should they enter into financial difficulty. This situation is considered to be very remote.

CONDENSED NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS
for the half-year ended 31 December 2006

Note 5. Contingent Liabilities (continued)

On 14 December 2006 Airline Partners Australia Limited (APA) announced an intention to make a conditional takeover offer for all the ordinary shares in Qantas Airways Limited for $5.60 per share. Qantas entered into an Implementation Deed dated 14 December 2006 in regard to the transaction and the independent Directors unanimously recommended the offer in the absence of a superior proposal and subject to receipt of an independent expert's report.

As a consequence of these agreements, Qantas has a number of contingent liabilities which may crystalise if the APA bid is successful, as noted below:

1 Qantas has a number of Performance Equity Plans (Plans), tranches of which have not yet satisfied their vesting and performance criteria. If the APA bid is successful, the existing rules governing the operation of these Plans permits the Board to waive these conditions and vest all shares and rights (as is market practice in such transactions). This will result in an expense of $28.1 million being recognised to accelerate the vesting of these Plans. In addition, Qantas will be required to fair value the Plans before and after the vesting conditions are removed by the Board and further expense the differential. This additional amount can not be estimated at this time, as it is contingent upon future market valuations.

2 Qantas has entered into a number of contingent fee agreements with its advisors and valuers as a result of the bid made by APA to acquire Qantas. Should the bid be successful, Qantas will be required to pay contingent fees of approximately $98 million.

Note 6. Post Balance Date Events

There has not arisen in the interval between 31 December 2006 and the date of this report, any event that would have had a material effect on the interim financial statements at 31 December 2006.

Note 7. Segment Reporting

Business Segments

The segmentation of the Qantas Group into business segments supported by a corporate centre is progressively being implemented to deliver a broad range of benefits to the business.

Financial reporting system changes to transition Qantas to a segmented model are currently under development. Disclosure of segment information is provided as follows:

1. Qantas and Jetstar as the Qantas Group's flying segments, which are supported by Qantas Engineering, Airports and Qantas Freight;
2. Qantas Holidays, which forms part of the Associated Businesses segment; and
3. Qantas Catering, which forms part of the Associated Businesses segment.

CONDENSED NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS
for the half-year ended 31 December 2006

Note 7. Segment Reporting (continued)

Analysis by Business Segments	Qantas and other entities $m		Jetstar $m		Qantas Holidays $m		Qantas Flight Catering $m		Eliminations $m		Consolidated $m	
	Dec-06	Dec-05	Dec-06	Dec-05	Dec-06	Dec-05	Dec-06	Dec-05	Dec-06	Dec-05	Dec-06	Dec-05
Sales and other income												
External segment revenue	6,759.7	6,086.3	479.2	301.9	409.5	381.9	78.5	87.1	-	-	7,726.9	6,857.2
Inter-segment revenue	95.1	41.1	33.2	22.5	92.6	104.9	183.4	190.6	(404.3)	(359.1)	-	-
Total segment sales and other income	**6,854.8**	**6,127.4**	**512.4**	**324.4**	**502.1**	**486.8**	**261.9**	**277.7**	**(404.3)**	**(359.1)**	**7,726.9**	**6,857.2**
Share of net profit of associates and jointly controlled entities	13.4	6.8	-	-	0.1	-	-	-	-	-	13.5	6.8
Profit before related income tax expense and net finance costs	490.8	466.9	23.3	9.6	18.1	18.4	15.3	16.1	-	-	547.5	511.0
Net finance (costs)/revenue	(31.8)	(35.1)	-	-	7.7	7.6	-	-	-	-	(24.1)	(27.5)
Profit before related income tax expense	**459.0**	**431.8**	**23.3**	**9.6**	**25.8**	**26.0**	**15.3**	**16.1**	-	-	**523.4**	**483.5**
Income tax expense											(164.9)	(130.9)
Profit for the half-year											**358.5**	**352.6**

KPMG

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001 to the Directors of Qantas Airways Limited.

I declare that, to the best of my knowledge and belief, in relation to the review for the financial period ended 31 December 2006 there have been:

- no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and
- no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

Martin Sheppard
Partner

Sydney

7 February 2007

KPMG, an Australian partnership, is part of the KPMG International network. KPMG International is a Swiss cooperative.

DIRECTORS' DECLARATION

In the opinion of the Directors of Qantas Airways Limited:

(a) the financial statements and notes set out on pages 5 to 14, are in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the financial position of the Qantas Group as at 31 December 2006 and of its performance, as represented by the results of its operations and cash flows for the half-year ended on that date; and

(ii) complying with Australian Accounting Standard *AASB 134: Interim Financial Reporting* and the *Corporations Regulations 2001*; and

(b) there are reasonable grounds to believe that Qantas Airways Limited and its controlled entities will be able to pay its debts as and when they become due and payable.

Signed pursuant to a Resolution of the Directors:

MARGARET JACKSON
Chairman

GEOFF DIXON
Chief Executive Officer

Sydney, 7 February 2007

KPMG

Independent auditor's review report to the members of Qantas Airways Limited

We have reviewed the accompanying consolidated interim financial report ("financial report") of Qantas Airways Limited, which comprises the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, statement of changes in equity and statement of cash flows for the half year ended on that date, a statement of accounting policies, other explanatory notes 1 to 7, and the directors' declaration of the Qantas Airways Limited consolidated entity ("the Consolidated Entity"). The Consolidated Entity comprises Qantas Airways Limited ("the Company") and the entities it controlled at the half-year's end or from time to time during the half-year period.

Directors' Responsibility for the Financial Report

The directors of the Company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of an Interim Financial Report Performed by the Independent Auditor of the Entity,* in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2006 and its performance for the interim period ended on that date; and complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of Qantas Airways Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the financial report of Qantas Airways Limited, is not in accordance with the *Corporations Act 2001*, including:

(a) giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2006 and of its performance for the half-year period ended on that date; and

(b) complying with Australian Accounting AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001.

KPMG

Martin Sheppard
Partner

Sydney

7 February 2007

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QANTAS AIRWAYS LIMITED
ABN 16 009 661 901

OPERATIONAL STATISTICS
for the half-year ended 31 December 2006

(Unaudited)		Half-Year Ended December 2006	Half-Year Ended December 2005	Percentage Increase/ (Decrease)	
QANTAS INTERNATIONAL - SCHEDULED SERVICES[1]					
TRAFFIC AND CAPACITY					
Passengers carried	000	4,464	4,776	(6.5)	
Revenue passenger kilometres (RPK)	m	30,996	30,219	2.6	
Available seat kilometres (ASK)	m	38,361	39,319	(2.4)	
Revenue seat factor	%	80.8	76.9	3.9	pts
Revenue freight tonne kilometres (RFTK)	m	1,415	1,382	2.4	
QANTAS DOMESTIC - SCHEDULED SERVICES					
TRAFFIC AND CAPACITY					
Passengers carried	000	8,344	8,133	2.6	
Revenue passenger kilometres (RPK)	m	12,142	11,664	4.1	
Available seat kilometres (ASK)	m	15,101	14,474	4.3	
Revenue seat factor	%	80.4	80.6	(0.2)	pts
QANTASLINK - SCHEDULED SERVICES					
TRAFFIC AND CAPACITY					
Passengers carried	000	1,949	1,629	19.6	
Revenue passenger kilometres (RPK)	m	1,281	1,016	26.1	
Available seat kilometres (ASK)	m	1,761	1,458	20.8	
Revenue seat factor	%	72.8	69.7	3.1	pts
JETSTAR - SCHEDULED SERVICES					
TRAFFIC AND CAPACITY					
Passengers carried	000	3,781	2,722	38.9	
Revenue passenger kilometres (RPK)	m	4,741	2,895	63.8	
Available seat kilometres (ASK)	m	6,023	3,823	57.5	
Revenue seat factor	%	78.7	75.7	3.0	pts
QANTAS GROUP OPERATIONS					
TRAFFIC AND CAPACITY					
Passengers carried	000	18,538	17,260	7.4	
Revenue passenger kilometres (RPK)	m	49,160	45,794	7.4	
Available seat kilometres (ASK)	m	61,245	59,074	3.7	
Revenue seat factor	%	80.3	77.5	2.8	pts
Aircraft in service at year end[2]	#	211	205	6	units
FINANCIAL					
Yield (passenger revenue per RPK)	¢	11.65	10.87	7.2	
PRODUCTIVITY					
Average full-time equivalent employees	#	33,725	35,158	(4.1)	
RPK per employee	000	2,892	2,584	11.9	
ASK per employee	000	3,602	3,333	8.1	

1 Includes prior year statistics for Australian Airlines which, effective 1 July 2006, provides wet lease services to Qantas mainline.
2 Excludes six temporarily grounded B717-200 aircraft.

QANTAS AIRWAYS LIMITED
ABN 16 009 661 901

CONSOLIDATED PROFIT BEFORE RELATED INCOME TAX EXPENSE
for the half-year ended 31 December 2006

(Unaudited)	Half-Year Ended December 2006 $m	% of Group Total	Half-Year Ended December 2005 $m	% of Group Total
Qantas	423.6	80.9	414.4	85.7
Jetstar [1]	23.3	4.5	9.6	2.0
Total Flying Operations	446.9	85.4	424.0	87.7
Other Subsidiaries: [2]				
Qantas Holidays Group	25.8	4.9	26.0	5.4
Qantas Flight Catering Group	15.3	2.9	16.1	3.3
Qantas Defence Services	10.6	2.0	4.1	0.8
Equity Accounting	13.5	2.6	6.8	1.4
Other Subsidiaries	11.3	2.2	6.5	1.4
Total Other Subsidiaries	76.5	14.6	59.5	12.3
Group Profit Before Related Income Tax Expense	**523.4**	**100.0**	**483.5**	**100.0**

Notes

1 The current year Result for Jetstar includes $26.0 million of start-up costs incurred in establishing Jetstar International.

2 Subsidiary operations profit before related income tax expense includes profit earned on services provided to Qantas Airways Limited.

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QANTAS AIRWAYS LIMITED
ABN 16 009 661 901

CONSOLIDATED DEBT, GEARING AND CAPITALISATION OF NON-CANCELLABLE OPERATING LEASES
as at 31 December 2006

(Unaudited)	As at December 2006 $m	As at June 2006 $m
Balance Sheet Equity	6,078.5	6,081.1
Hedge Reserve	63.6	332.2
Equity excluding Hedge Reserve	6,014.9	5,748.9
On Balance Sheet Debt [1]		
Current Debt	735.9	440.8
Non-current Debt [2]	4,781.1	5,334.8
Cash and Cash Equivalents [3]	(3,180.1)	(3,031.6)
Fair value of hedges relating to debt [4]	(376.1)	(453.3)
Net On Balance Sheet Debt	1,960.8	2,290.7
Off Balance Sheet Debt		
Non-Cancellable Operating Leases [5]	2,548.7	2,670.8
Net Debt including Off Balance Sheet Debt	4,509.5	4,961.5
Balance Sheet including Off Balance Sheet Debt		
Total Assets [6]	21,632.8	21,932.0
Total Liabilities	15,443.5	15,780.2
Total Equity including Hedge Reserve	6,189.3	6,151.8
Less: Hedge Reserve	63.6	332.2
Total Equity excluding Hedge Reserve	6,125.7	5,819.6
Net Debt to Net Debt and Equity	24 : 76	27 : 73
Net Debt to Net Debt and Equity (including Off Balance Sheet Debt and Hedge Reserve)	42 : 58	45 : 55
Net Debt to Net Debt and Equity (including Off Balance Sheet Debt and excluding Hedge Reserve)	42 : 58	46 : 54
Working Capital Ratio	45 : 55	48 : 52

Notes

1. On balance sheet debt includes bank and other loans and lease liabilities.
2. Non-current debt excludes debt available to be set-off against non-current assets.
3. Cash and cash equivalents includes bills of exchange and promissory notes, negotiable securities and security and term deposits. The non-current aircraft security deposits have been pledged as security to providers of aircraft finance.
4. Fair value of hedges relating to debt represents the fair value of derivatives hedging debt in accordance with AASB 139: *Financial Instruments: Recognition and Measurement.*
5. Non-cancellable operating leases has been calculated assuming the assets are owned and debt funded and is not consistent with the disclosure requirements of *AASB 117: Leases* .
6. Total assets including assets related to off balance sheet debt has been calculated as the sum of total assets on the balance sheet and operating lease assets capitalised.

QANTAS AIRWAYS LIMITED
ABN 16 009 661 901

CONSOLIDATED NET INTEREST AS A PERCENTAGE OF AVERAGE NET DEBT

as at 31 December 2006

(Unaudited)	Half-Year Ended December 2006 $m	Half-Year Ended December 2005 $m
Borrowing Costs		
Net Borrowing Costs	24.1	27.5
Unwind of discount on non-current provisions	(17.4)	(11.8)
Unwind of discount on non-current receivables	5.7	-
Capitalised Interest	36.5	35.5
Interest on Non-cancellable Operating Leases	121.5	84.8
Adjusted Net Borrowing Costs	**170.4**	**136.0**
Interest Cover	22.7	18.6
Average Net Debt *		
Average Net Debt Including Off Balance Sheet Debt	4,735.5	4,896.7
Adjusted Net Borrowing Costs as a Percentage of:		
Average Net Debt Including Off Balance Sheet Debt	3.6	2.8

* Average Net Debt balances are calculated on a weighted average basis.

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QANTAS AIRWAYS LIMITED
ABN 16 009 661 901
DERIVATIVE INEFFECTIVENESS (Unaudited)

Qantas is subject to foreign currency, interest rate, fuel price and credit risks. Derivative financial instruments are used to hedge these risks. It is Qantas policy not to enter into, issue or hold derivative financial instruments for speculative trading purposes.

Accounting standard *AASB 139: Financial Instruments: Recognition and Measurement* (AASB 139) contains a strict definition of hedge effectiveness for accounting purposes and requires that all derivatives be held at current market values. Each derivative transaction used to hedge identified risks must be documented and proven to be effective in offsetting changes in the value of the underlying risk within a range of 80%-125%. This measure of effectiveness may result in economically appropriate hedging transactions being deemed ineffective for accounting purposes.

Accounting ineffectiveness for derivative transactions has been split into two lines within the Consolidated Income Statement, as shown in the table below. The table shows the foreign exchange, interest rate and fuel hedging transactions that fail the accounting effectiveness measure in the half-year ended 31 December 2006.

	December 2006 $m	December 2005 $m
Ineffective hedging - closed derivative positions	33.5	30.6
Ineffective hedging - open derivative positions	99.4	(49.4)
Total Ineffectiveness	132.9	(18.8)

Two hedging strategies in particular drive ineffectiveness in Qantas accounting results. Crude oil prices and jet fuel prices do not always correlate within the 80% to 125% range required by AASB 139 and can result in changes in fair value of the derivative being deemed ineffective for accounting purposes from time to time. Also, ineffectiveness results from the treatment of options used as hedging instruments under AASB 139.

AASB 139 will only permit the intrinsic component of an option value to be deemed an effective hedge. As a result, all other aspects of the option value must be marked to market through the Consolidated Income Statement as ineffective. Changes in the non-intrinsic value do not necessarily reflect the original premium paid or potential losses if the option is held to maturity.

A total loss of $132.9m has been recognised as Derivative Ineffectiveness during the half-year. This includes a loss of $33.5m recognised as “Ineffectiveness hedging - closed derivative positions”. This has been included in Operating Results in the Consolidated Income statement as it relates to derivative hedging instruments deemed ineffective for accounting purposes that matured during the half-year.

The remaining loss of $99.4m has been recognised as “Ineffectiveness hedging - open derivative positions”. This has been excluded from Operating Results as it relates to derivative hedging instruments deemed ineffective for accounting purposes that are to hedge underlying risks in future reporting periods.

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Qantas Shareholder Information Line

If you have any queries in relation to Airline Partners Australia's Offer, please call the Qantas Shareholder Information Line on the following numbers:

1300 658 942 (if in Australia)
+61 3 9415 4285 (if outside Australia)

The Qantas Shareholder Information Line is open Monday to Friday between 9.00am and 5.00pm (Sydney time).

As required by the Corporations Act, calls to the Qantas Shareholder Information Line will be recorded, indexed and stored.

Qantas website address

www.qantas.com

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