2 July 2025

By email: submissions@airways.co.nz

RE: Airways New Zealand FY26-FY28 – Supplementary Information

The Qantas Group welcomes the opportunity to provide further comments regarding Airways New Zealand's (Airways) FY26-FY28 pricing proposal supplementary information. We appreciate the information presented in the consultation document and the provision of the additional materials requested.

Our primary concern remains New Zealand's escalating cost environment, which has become one of the world's most expensive for aviation operations. This trend has broader ramifications for passenger demand, particularly affecting budget-sensitive travellers, and impacts on New Zealand's economy more broadly.

Qantas supports sustainable investment and acknowledges that Airways must balance innovation and investment with customer and operational outcomes for New Zealand. However, Airways needs to also consider the cumulative impact of increasing costs more holistically.

We appreciate that Airways has been responsive to stakeholder recommendations, particularly regarding WACC inputs and providing additional information on capitalised leases. We have incorporated this supplementary information into our revised estimates. However, we remain concerned in relation to two key areas:

1. **BBM Analysis**: Our assessment of Building Block Model (BBM) inconsistencies remains unchanged, with calculations updated to reflect the capitalisation of leasing costs and their inappropriate inclusion in regulated returns.
2. **WACC Assessment**: Our opposition to inappropriate WACC inputs continues, with analysis updated to reflect changes to the risk-free rate and reinforced rejection of the unjustified 65th percentile uplift.

Despite Airways' provision of supplementary information, the documentation fails to provide a meaningful update on the pricing path following our 4 April 2025 submission. This makes it difficult to ascertain the specific adjustments Airways has implemented since the original pricing proposal, limiting the value of this consultation round. Consequently, all substantive comments and recommendations from our 4 April 2025 submission remain unchanged

We have, however, amended our BBM and related impact assessments to reflect the additional leasing information provided and updated WACC inputs and consider there should be no more than a cumulative 0.9% increase in the target revenue over the three-year period.

Additionally, we would like to propose suggestions to support more effective pricing discussions in future consultation rounds **(see Attachment A)**.

If you have any questions or clarifications, please do not hesitate to contact Andre Neilson at andre.neilson@qantas.com.au.

Yours sincerely

Karyn Pile

Head of Fuel Supply Chain

ATTACHMENT A

1.0 Pricing Analysis of FY26-28 Pricing Proposal

Qantas maintains its position that there are material inconsistencies in Airways' BBM with continued misalignment to industry standards.

We have incorporated capitalised lease information and amended WACC inputs into our models used in our 4 April 2025 submission. With these revisions (see Figure 1 below), we consider there should be no more than a cumulative 0.9% increase in the target revenue over the three-year period.

The key areas of concern identified in our 4 April 2025 submission remain as follows:

1. **[Amended with new information]** BBM inconsistencies identified still hold, with the calculations amended to reflect capitalisation of leasing costs;
2. [Unadjusted] Operational expenditure (OPEX) overestimation;
3. [Unadjusted] Capital expenditure (CAPEX) and misalignment of RAB roll-forward;
3. **[Adjusted]** Opposition to inappropriate WACC inputs continues, with analysis updated to reflect changes to the risk-free rate and reinforced rejection of the unjustified 65th percentile uplift; and
4. [Unadjusted] Smoothed pricing path.

Figure 1: Qantas' adjustments to Airways' modelling

BBM Review		FY26	FY27	FY28	Total
Airways Target Revenue	$m	293.5	316.8	332.7	943.0
Airways Proposed Pricing Adjustment	%	14.9%	5.6%	1.7%	22.2%
PV Neutral Flat Pricing	%	*7.2%*	*7.2%*	*7.2%*	
1. Adjust for modelling inconsistencies:					
1A. Cost of Capital Calculation	$m	-7.3	-2.1	-4.1	-13.5
1B. Asset Base for return calculation	$m	-7.9	-4.1	-3.0	-15.0
Revised Target Revenue - Errors	$m	278.3	310.6	325.6	914.5
Revised Pricing Adjustment - Errors	%	**11.6%**	**5.8%**	**2.8%**	**20.2%**
PV Neutral Flat Pricing	%	*6.6%*	*6.6%*	*6.6%*	
2. Qantas' Adjustments to Inputs:					
2A. Opex	$m	-6.5	-13.6	-16.9	-37.0
2B. PAR Roll-forward	$m	-1.6	-4.0	-4.7	-10.3
2C. WACC	$m	-2.6	-3.2	-3.5	-9.3
Revised Target Revenue - Inputs	$m	267.5	289.8	300.6	857.9
Revised Pricing Adjustment - Inputs	%	**7.3%**	**-1.3%**	**-5.1%**	**0.9%**
PV Neutral Flat Pricing	%	*0.1%*	*0.1%*	*0.1%*	

The following sections discuss each of these key areas in more detail.

Adjustments 1A and 1B (Amended to include capitalised leases): Inconsistent BBM methodology, including issues with Cost of Capital and RAB Calculations

Qantas has incorporated the capitalised lease liabilities provided by Airways in the addendum to the supplementary information, shared on 27th June 2025. While this reduces the initial $42m impact of the BBM inconsistencies that Qantas' identified in its previous submission (Adjustment 1A and 1B), a gap of $29m remains (see Figure 1) to a standard BBM approach.

Regarding Qantas' adjustment 1A, the inclusion of capitalised leases in the RAB resulted in a calculated return approximately equal to the published post-tax WACC of 8.08% for FY26-28. However, Figure 2 demonstrates that this methodology relies on Airways earning a 8.08% return on capitalised leases as well as the RAB. Qantas' view is that this approach is flawed for the following reasons:

- **Lease costs do not represent genuine capital provision.** Unlike debt or equity providers, lessors retain ownership and associated risks, merely providing temporary access to assets.
- **Leases do not justify inclusion in the RAB.** The regulatory asset base is meant to protect genuine capital investments by debt and equity providers. Lease arrangements do not create equity stakes in assets nor do they represent at-risk investments deserving regulatory returns.
- **Limited recourse differentiates leases from traditional financing.** Lessors can only claim the specific leased asset, unlike debt and equity providers who have broader claims on the business and its assets. This limited recourse highlights the differences in risk between leasing and traditional financing.
- **Regulatory precedent supports treating lease costs as operational expenses.** Under the building block methodology, the regulatory framework appropriately distinguishes between return on capital, which applies to genuine invested capital in the RAB, and operating expenditure. Lease costs are primarily operational and do not reflect genuine at-risk capital investment for the purposes of evaluating reasonable return.

Given the above, Qantas' Adjustment 1A removes the WACC component from capitalised leases and applies coverage for interest as a more appropriate indicator of the level of risk borne by the lessor. The interest rate is estimated as 4.03%, which represents the average borrowing costs used to calculate lease liabilities by Airways in their audited 2024 financials. This approach ensures that regulated returns are only applied to genuine at-risk capital investment, maintaining the integrity of the regulatory framework while appropriately treating lease costs as the operational expenses they economically represent.

Figure 2: Revised Cost of Capital reconciliation[1]

Cost of Capital	FY25	FY26	FY27	FY28
Closing RAB Book Value *(Additional information Q4; Mar25)*	215.6	273.2	307.1	321.4
Capitalised Lease Assets and Other Assets	58	62.3	59.1	56.6
Closing RAB (incl. Leases)	**273.6**	**335.5**	**366.2**	**378.0**
Cost of Capital *(Table 15 Consultation Document; Mar25)*	25.6	25.7	30.0	31.9
WACC% (Cost of Capital/ RAB, incl. leases)	9.36%	7.66%	8.19%	8.44%
Published WACC%	8.03%	8.08%	8.08%	8.08%
Variance/ over-recovery	*1.33%*	*-0.42%*	*0.11%*	*0.36%*

Qantas recommends no revision to Adjustment 1B. Qantas has calculated the return on both the RAB and capitalised leases (at borrowing rate) based on the average RAB for each year, rather than the closing RAB.

[1] Implied cost of capital, based on inputs from Airways NZ. Not yet adjusted for Qantas' inputs.

Adjustment 2C (Revised): Inappropriate WACC input parameters

Gearing input assumptions

While Qantas appreciates Airways revisiting its gearing structure, it remains outside what would be deemed efficient and misaligned with regulatory consensus. Airways continues to misrepresent regulatory precedent by using gearing calculations that do not correspond to its asset beta comparable list. Qantas' position remains that gearing should reflect the characteristics of the comparable companies used in the asset beta calculation.

However, even utilising Airways' current methodology while adjusting for market value of equity, a more appropriate gearing ratio would be 27%, calculated using AIAL's P/E multiple as a proxy for Airways' market value of equity (see Figure 3). As discussed in sections 1A/1B, since leasing obligations lack full business recourse, either complete exclusion or partial adjustment of lease liabilities should be considered. This would reduce Airways' gearing ratio further to approximately 14-21%, more accurately reflecting the company's true financial risk profile.

Figure 3: Auckland Airport Vs Airways risk profile comparison

Financial comparison[2]	AIAL	Airways
Credit rating	BBB+	A+
Effective interest cost	5.79%	4.1%
Interest coverage ratio	5.7x	9.9x
P/E multiple (2012 -2019 average)[3]	19x	N/A
Book value Equity	$8.6bn	$186m
Book value Debt (including leases, exclude non-interest-bearing liabilities)	$2.7bn	$115m
Market Value Equity [4]	$18.8bn	$300m[5]
Gearing ratio (book value)	24%	38%
Gearing Ratio (market value)	13%	27%
Gearing ratio (full and partial exclusion of leases)[6]	N/A	14%-21%

WACC 65th percentile adjustment

We find no regulatory or reasonable justification for Airways to continue applying a 65th percentile WACC uplift. More concerning is Airways' attempt to align with Auckland Airport's WACC despite stark differences in business risk profile (see Figure 4). Airways maintains a 20 basis point higher cost of equity than Auckland Airport's PSE4 determination, yet it seeks additional premium uplifts.

The financial evidence overwhelmingly demonstrates Airways' lower risk profile: interest coverage ratios of nearly 10 times (versus Auckland Airport's 5.7 times), an A+ credit rating with implicit sovereign backing, and materially lower borrowing costs at 4.1% versus 5.79%. As a state-owned

[2] Information used is sourced from FY24 annual statements of Auckland Airport and Airways New Zealand
[3] Used historical average P/E values for Auckland Airport for 2012-2019 period
[4] Utilised current market capitalisation for capital stock and included cash reserves, and other equity account items
[5] Used average P/E for AIAL and applied to Airways NZ (151m shares outstanding FY24) to formulate a proxy market value of equity for Airways NZ
[6] Gearing range reflects two adjustment approaches: complete exclusion of capitalised leases (13% - lower bound) and partial inclusion of 50% of lease values to account for limited recourse characteristics (21% - upper bound)

enterprise with monopoly revenue streams and zero competitive threats, Airways exhibits lower business risk across every relevant metric.

The Qantas Group rejects Airways' application of any WACC percentile uplift. The uplift is unjustified, inconsistent with regulatory precedent for comparable infrastructure assets, and contrary to the balanced approach required by the Part 4 Commerce Act purpose statement.

Figure 4: WACC inputs, calculations and comparison analysis

	Airways 2025	NZCC 2023 IM	AIA PSE4 2025[7]	ENAV[8]	NATs[9]	Qantas recommendation
Risk free rate	3.70%	3.70%	3.70%	3.70%	3.70%	3.70%
Tax -Adj. Market Risk Premium (TAMRP)	*7.00%*	7.00%	7.00%	7.00%	7.00%	7.00%
Asset beta (β)	0.60	0.67	0.71	0.39	0.61	0.60
Gearing (D/V)	36%	23.00%	23%	8.00%	30.00%	19%
Equity Beta[10]	0.94	0.87	0.92	0.42	0.87	0.74
Credit rating	A+	*BBB+*	*BBB+*	A-	A-	A+
Return of Debt (Pre-tax)	5.13%	5.13%	5.13%	5.13%	5.13%	5.13%
Return on Debt (Post tax)	3.69%	3.69%	3.69%	3.69%	3.69%	3.69%
Return on Equity (Post tax nominal)	9.23%	8.75%	10.33%	5.63%	8.76%	*7.8%*
Nominal Vanilla WACC	7.75%	7.92%	8.20%	5.59%	7.67%	7.33%
Post tax WACC	*7.90%*[11]	7.59%	7.87%	5.48%	7.24%	7.06%

Note: *For the purposes of this analysis, we have excluded the recent Airservices FY24-FY26 pricing WACC, as pricing was not set through the Building Block Model (BBM), but through a predetermined price escalation. Qantas was not supportive of the WACC inputs Airservices proposed, and the regulator (ACCC) did not comment as part of its consultation process. This exclusion ensures our comparative analysis focuses only on properly established regulatory benchmarks.*

[7] AIA stands for Auckland International Airport; gearing and asset beta derived from NZCC PSE4 decision

[8] ENAV stands for Ente Nazionale Assistenza al Volo a Italian listed business that operates navigation services; asset beta and gearing is calculated using Bloomberg data.

[9] NATs is short for NATS Enroute limited which operates in the UK. NATS' asset beta and gearing are determined by the Civil Aviation Authority CAA.

[10] Equity beta has been re-levered using Brealey Myers formula from stated asset beta data.

[11] Post tax WACC includes Airways proposed 65th percentile increase based on NZCC 2023 IM methodology.

2.0 Qantas consultation suggestions to be included

Qantas would like to take this opportunity to provide feedback on establishing a 'best practice' pricing consultation process. This will ensure key customer concerns are considered in a timely and efficient manner while providing adequate time to implement pricing changes and mitigate financial impacts on airlines.

Key Features for Effective Regulatory Pricing Consultation:

1. **Implementation Timeline:** Ensure **at least four months** between final pricing determination and implementation, consistent with IATA standards. This provides airlines with reasonable time to manage ticket pricing without bearing undue financial burden from sudden cost changes.
2. **Comprehensive Economic Modelling Transparency** Provide detailed Building Block Model (BBM) or Economic Value Added (EVA) modelling to support the pricing path, including:
    a. Opening and closing regulatory asset bases (RAB);
    b. CAPEX investment programme including existing capital items with respective useful lives and depreciation schedules;
    c. WACC inputs breakdown and internal rate of return validation
    d. OPEX analysis by key expense categories, including detailed breakdown of employee numbers and costs by major workforce classifications;
    e. Taxation components separately identified; and
    f. Volume forecasts, including underpinning demand assumptions.

3. **Period-to-Period Reconciliation** Provide comprehensive reconciliation between past and current pricing models, including opening RAB reconciliation and any underspend/ over-recovery from prior regulatory periods carried forward to new pricing determinations.

4. **Pricing Path Methodology** A smoothed pricing path based on present value neutral methodology, consistent with approaches adopted by other major infrastructure regulators.

5. **Consultation and engagement sessions** on the above inputs should be undertaken at least six months prior to pricing implementation, in advance of seeking formal written responses.

These measures would significantly enhance consultation effectiveness and regulatory certainty for all stakeholders.

3.0 CAPEX considerations

We appreciate that Airways NZ has provided more information on key CAPEX items in the supplementary information, however we require further information on revised CAPEX re-prioritisation and re-profiling to provide meaningful feedback. As it stands, all our substantive CAPEX concerns and recommendations from our 4 April submission remain. As it stands, all of our substantive CAPEX concerns and recommendations from our 4 April submission remain.