

4 March 2007

**PRICE | \$2.06**

# Regional Express Holdings Ltd | REX

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Fully diluted shares  
on issue | 116.5M  
Market cap | A\$240M

1H07 results – simply spectacular!

## Key points

- REX reported a very strong interim result for FY07 on 27 February.
- The bottom line was up 31% on a lift in passenger revenue of 21%.
- EBITDA rose 29% (as did EBIT).
- Pel-Air was down 14% due to some unusual engine maintenance costs which reduced earnings by about US\$0.6M (A\$0.8M). Adding back the 50% contribution (it was a 50%-owned associate pre 31 December) and adjusting for tax, suggests a bottom line for REX of \$12.4M - 80% of total NPAT in FY06!
- Passenger numbers advanced by 20.6%, average fares fell (ex fuel surcharges) 3.1% and cost per ASK (excluding fuel) rose 3.8% (against a lift in revenue per ASK of 6.9%).
- There was no interim dividend declared as we had predicted.

## Performance & Valuation

Last Price | \$2.06  
52 wk hi/low | \$2.15 / \$0.96  
12 mth price target<sup>3</sup> | \$2.35  
Valuation | \$2.24  
Valuation methodology | DCF

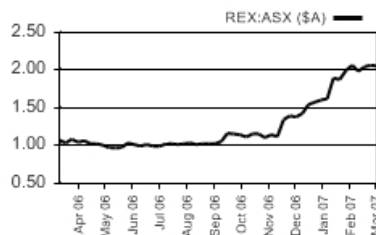
## Comment

The normal seasonal pattern of 55/45 1H/2H is currently more like 48/52 as REX enjoys strong organic growth.

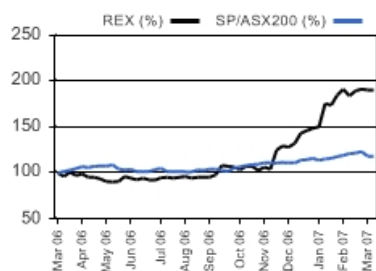
The results for 1H07 were as good as they get and the 2.2% point increase in the load factor pushed REX almost to its capacity limit. This is a nice problem to have and will be redressed through an earlier decision to acquire a further 25 Saab 340B aircraft over the three years to FY09. The company maintains load factors at or below 70% per destination and when a route reaches this limit, it adds more planes and flight schedules.

In the last six months, REX has added a number of new routes and scheduled increased flight frequency on some existing routes.

## Share price performance



## REX versus SP/ASX200



## Investment View

REX has \$20M sitting in cash and cash equivalents and gives currency to the argument of a “lazy” balance sheet. It was noted that the ideal would be net cash of \$10M and any surplus cash (that is surplus to estimated requirements) could be handed back to shareholders. This is a consideration for the future and not an initiative which is currently on the table.

No matter how we look at it, and even conceding the fact that REX is an airline, the upgraded numbers (from \$20.7M in FY07 to \$23.5M now) adds weight to our revised valuation (\$2.24) and new share price target of \$2.35.

## Earnings Summary

Y/E Jun	2006A	2007F	2008F	2009F
Revenue - A\$M	169.7	198.0	215.1	230.4
EBITDA - A\$M	20.9	33.6	40.5	43.3
NPAT (reported) A\$M	15.7	23.5	25.4	29.6
NPAT (normalised) A\$M <sup>1</sup>	13.6	23.5	25.4	29.6
EPS (diluted) - cents <sup>2</sup>	13.3	20.2	21.8	25.4
EPS (diluted) - % chg	82.1	45.6	12.9	16.4
PER (diluted) - x <sup>2</sup>	15.5	10.2	9.4	8.1
DPS - cents	5.0	10.0	11.0	12.5
Dividend Yield - %	2.4	4.9	5.3	6.1
Franking - %	0	100	100	100

Notes:

1. Normalised earnings is pre goodwill, amortization and after adding back non-recurring items.

2. Based on normalized earnings.

3. Price target is calculated by moving current valuation one year forward.

# Final results analysis & outlook

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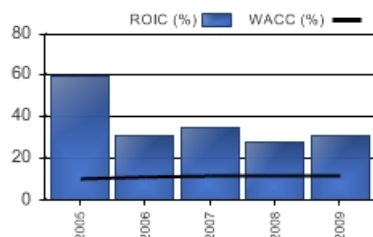


## Valuation

Methodology: DCF<sup>1</sup>

Key assumptions	
Beta	1.3
WACC %	11.2
Forecast period years	10.0
Risk premium %	5.5
PV cash flows \$M	233.2
less net debt/(add cash) \$M	(20.0)
add equity adjustments <sup>2</sup>	7.5
Total	260.7
Fully diluted shares on issue M <sup>2</sup>	116.5
Value per share \$	2.24

## Return on invested capital



## Ratio analysis

Year end Jun	06A	07F	08F
Revenue growth %	19.5	16.7	8.7
EBITDA growth %	107.7	60.7	20.5
EBITDA margin %	12.3	17.0	18.8
EBIT margin %	9.9	14.1	14.0
Tax rate %	35.5	30.1	30.0
ROA %	20.6	26.1	24.1
ROE %	24.6	29.7	26.6
Net debt/equity %	(34.3)	2.3	(8.9)
Net interest cover x	n/a	n/a	n/a
Capex to deprec'n %	172.7	84.2	62.5
NTA per share \$	0.59	0.73	0.84

## Multiple analysis

Year end Jun	06A	07F	08F
Market cap \$M	232		
Net debt (cash) \$M	(20.0)		
Options \$M	0.0		
Enterprise value \$M	204.8		
EV/EBITDA x	9.8	6.1	5.1
EPS c	13.3	20.2	21.8
P/E x	15.5	10.2	9.4
Cashflow / Share c	26.4	20.3	27.6
Price / NTA x	3.5	2.8	2.5

## Shares outstanding

Year end Jun	06A	07F	08F
Basic M	115.0	116.5	116.5
Other M	0.0	0.0	0.0
Fully diluted M	115.0	116.5	116.5

## Notes:

1. Discounted cash flow. 2. Equity adjustments and shares on issue include all notes and options on issue (if in the money or deemed appropriate).

Year end Jun	2006A	2007F	2008F	2009F
<b>Profit &amp; Loss Summary   A\$M</b>				
Operating revenue	169.7	198.0	215.1	230.4
Invest & other income	1.4	2.6	0.0	0.0
EBITDA	20.9	33.6	40.5	43.3
Depreciation/Amort	(4.2)	(5.7)	(10.3)	(10.0)
EBIT	16.7	27.9	30.2	33.3
Net Interest	0.9	0.9	0.3	1.0
Pre-tax profit	17.6	28.8	30.5	34.3
Tax expense	(6.3)	(8.0)	(9.2)	(10.3)
Minorities/Assoc./Prefs	2.2	2.5	4.0	5.6
NPAT	13.6	22.7	25.4	29.6
Non recurring items	2.1	0.0	0.0	0.0
Reported profit	15.7	23.5	25.4	29.6
add goodwill/non recurring	(2.1)	0.0	0.0	0.0
Adjusted profit	13.6	23.5	25.4	29.6
<b>Cashflow Summary   A\$M</b>				
EBITDA	20.9	33.6	40.5	43.3
Working capital changes	3.7	0.1	0.0	0.0
Interest and tax	0.9	(5.3)	(8.3)	(8.7)
Other operating items	1.4	(4.5)	(0.2)	0.0
Operating cashflow	27.0	23.9	32.1	34.6
Required capex	(7.3)	(4.8)	(6.5)	(6.9)
Maintainable cashflow	19.7	19.0	25.6	27.7
Dividends/Other	0.0	(4.5)	(12.8)	(14.6)
Acq/Disp	(23.8)	(42.6)	(2.0)	0.0
Other investing items	(4.8)	3.5	0.0	0.0
Free cashflow	(8.9)	(24.7)	10.8	13.1
Equity	35.0	0.4	0.0	0.0
Debt inc/(red'n)	(7.0)	20.6	(10.8)	(13.1)
<b>Balance Sheet   A\$M</b>				
Cash & deposits	23.6	0.0	8.8	22.0
Inventories	4.1	4.1	4.1	4.1
Trade debtors	8.6	8.5	8.5	8.5
Other curr assets	0.0	0.0	0.0	0.0
Total current assets	36.3	12.6	21.4	34.6
Prop., plant & equip.	45.6	86.1	84.2	81.1
Non-curr intangibles	0.8	0.8	0.8	0.8
Non-curr investments	14.3	15.6	19.7	25.2
Other non-curr assets	3.3	3.3	3.3	3.3
Total assets	100.3	118.4	129.4	145.0
Trade creditors	23.5	23.5	23.5	23.5
Curr borrowings	0.0	0.0	0.0	0.0
Other curr liabilities	6.5	5.4	5.8	6.4
Total current liab.	30.0	28.9	29.3	29.9
Borrowings	0.0	2.0	0.0	0.0
Other non-curr liabilities	1.5	1.4	1.4	1.4
Total liabilities	31.5	32.3	30.7	31.3
Minorities/Convertibles	0.0	0.0	0.0	0.0
Shareholders equity	68.8	86.1	98.7	113.7

# Final results analysis & outlook

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Year end Jun	2006A	2007F	2008F	2009F
<b>Divisional Summary A\$M</b>				
<b>Revenue</b>				
Division 1	169.7	198.0	215.1	230.4
<b>EBITDA</b>				
Division 1	19.6	31.0	40.5	43.3
<b>Margin %</b>				
Division 1	11.5	15.7	18.8	18.8

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# 1 | Result detail

## Comment

Rex produced a very solid 1H07 result and, after adjustments, was north of our optimistic forecast of \$11-12M NPAT:

Interim results (six months to 31 December 2006)

	1H06 (\$M)	1H07 (\$M)	% change
Passenger revenue	82.9	100.6	21.4%
Revenue	86.2	103.7	20.4%
<b>EBITDA</b>	<b>13.6</b>	<b>17.5</b>	<b>28.7%</b>
Depreciation and amortisation	-1.8	-2.2	23.6%
<b>EBIT</b>	<b>11.8</b>	<b>15.3</b>	<b>29.4%</b>
Finance charges	0.4	0.6	78.0%
<b>Pre tax</b>	<b>12.2</b>	<b>15.9</b>	<b>30.8%</b>
Tax	-3.9	-4.6	18.4%
<b>NPAT (pre associates)</b>	<b>8.3</b>	<b>11.3</b>	<b>36.7%</b>
Share of associate <sup>1</sup>	1.0	0.8	-13.8%
<b>NPAT</b>	<b>9.3</b>	<b>12.2</b>	<b>31.5%</b>

Source: REX and Tricom Equities.

Notes: 1. The Pel-Air result was affected by unusual maintenance costs of about \$0.8M. Adjusting the result above to account for normalisation would have dropped an NPAT of \$12.4M to REX's bottom line. It also would have allowed Pel-Air to report a lift in earnings of a nudge under 16%, rather than a decline of 14%.

The company continued with its strategy to phase out the 19 seat Metro 23 aircraft from regular passenger services. This was completed during the reporting period and permitted increased capacity and thus underpinned further passenger growth.

Service frequency was increased on Melbourne – Burnie, Adelaide – Port Lincoln and Adelaide – Kingscote, following the withdrawal of services by QantasLink on these routes in June and July 2006. Frequency was increased on Sydney – Wagga Wagga in July 2006, bringing the schedule frequency to six return flights each weekday.

Frequency and capacity was added to Adelaide – Olympic Dam services progressively over the period in response to increased demand from BHP Billiton (ASX:BHP) and the local community. Additional services were also added to increase capacity of the Sydney – Moruya – Merimbula route in response to increased demand.

Operations in Portland (Victoria) were ceased on 31 December 2007.

The increased demand for services, in concert with the withdrawal of the Metro 23 aircraft, resulted in three additional Saab 340 aircraft being added to the fleet. The company now has 29 Saab aircraft in its fleet.

The withdrawal of QantasLink from the routes noted above resulted in Rex competing with QantasLink on only four routes – Sydney – Albury, Dubbo and Wagga Wagga and Melbourne – Mildura.

## FY06 Key Operating Statistics

Six months to 31 December 2006	1H06 (\$M)	1H07 (\$M)	% change
Passengers	583,615	703,915	20.6%
ASKs (M)	338	384	13.6%
Average Fare (\$)	142.10	143.00	0.6%
Average Fare (excl. fuel levy) (\$)	123.10	119.30	-3.1%
Load Factor	66.6%	68.8%	2.2% pts
Revenue/ASK (cents)	24.50	26.20	6.9%
Total cost/ASK (cents)	22.00	23.20	5.5%
Total cost/ASK (excl fuel) (cents)	18.20	18.90	3.8%

Source: REX and Tricom Equities

The highlights of the result were:

### Revenue and associates

#### Revenue

- Passenger revenue contributed 97%, or \$100.6M of total revenue.
- There was a 20.6% (11% in pcp) increase in passenger numbers, from 583k in 1H06 to 703k in 1H07, with load factors increasing to 68.8% from 66.6% pcp.
- Fares rose 0.6%, however, ignoring the fuel price surcharge, average fares in fact declined by 3.1% (5% down in the six months to December 2005). The average fare was \$119.30 after removing the fuel price surcharge.
- Revenue per ASK (average seat kilometres – an estimate of total capacity) rose 6.9%, while costs (excluding the fuel price surcharge) rose just 3.8%.

#### Pel-Air

The 50% owned associate, Pel-Air, acquired 1 July 2005, delivered a lower result in 1H07 by almost 14%. This was in spite of increased activity and higher revenue. The company lamented that Pel-Air has some unusual engine maintenance issues which cost it about US\$0.6M (A\$0.8M). By adding this back and adjusting for tax (assuming 30%), suggests the Pel-Air result should have shown c16% lift in its 1H07 results rather than a 14% decline. Moreover, this also implies that REX would have reported an adjusted NPAT for that period of \$12.4M.

#### Costs

- Improved productivity and cost containment measures contributed to a 17.7% increase in (non fuel) costs against a lift in passenger revenue of 21.3%.
- Fuel costs remain a primary expense at \$16.8M and up 30% pcp. REX does not hedge its fuel costs. Fuel made up 18.8% of total costs in this half, c/f 17.4% in the previous period.
- Part of the increase in costs reported in this six months related to the full consolidation of Air Link, which operates smaller plains and has generally higher costs per ASK. Significantly, total cost per ASK for REX rose 3.5% (1.8% ex fuel) and 5.5% (3.8%) for the (consolidated) REX group. Air Link was also only consolidated for one month in the six months to December 2005 (six months for the current period).

## 2 | Outlook

### **The way forward**

The company re-iterated its earlier guidance of 20% upside this year over the pcp. It also re-iterated the growth cycle at the moment is skewing the normal seasonal pattern (55/45) 1H/2H and it is more likely 52/48 at the moment.

If we assume that the extraordinary engine expense that hit Pel-Air's 1H results aren't repeated in 2H07, the \$12.4M NPAT in 1H07 suggests (on a 52/48 split) \$11.4M in 2H07. That is, \$23.8M NPAT for FY07.

We have applied a lot more science to our analysis and on the basis of some revisions to our core forecast assumptions, our new estimate for FY07 is \$23.5M NPAT (c/f \$20.7M) and \$25.4M in FY09 (\$23.9M).

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As at the time of writing this report, the authors held shares in Regional Express Limited (REX), which were acquired as part of the REX IPO, in November 2005.

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