

16 November 2006

PRICE | \$1.30

Regional Express Holdings Ltd | REX

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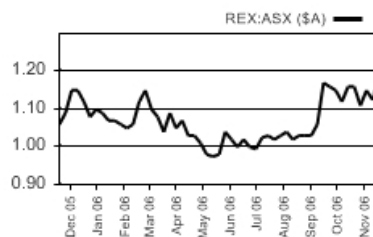
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Fully diluted shares
on issue | 115M
Market cap | A\$133M

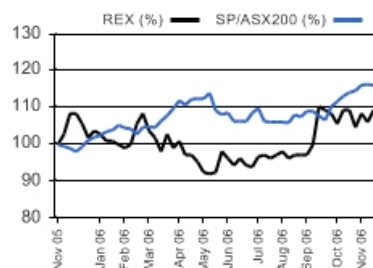
Performance & Valuation

Last Price | \$1.30
52 wk hi/low | \$1.21 / \$0.96
12 mth price target³ | \$1.83
Valuation | \$1.89
Valuation methodology | DCF

Share price performance



REX versus SP/ASX200



1Q07 Result – flying start leads to FY07 profit upgrade

Key points

- REX announced a very strong 1Q07 result today.
- NPAT lifted 46% YoY from \$3.9M in 1Q06 to \$5.7M in 1Q07. We note 1Q06 did not include Air Link.
- Load factors over the period increased from 65% to 68% with passenger volumes increasing 20% pcp to 345k in the quarter.
- Fuel costs accelerated 43% YoY to \$9M but overall costs appreciated by 8.5% in 1Q07.
- The company upgraded its FY07 NPAT expectations by 20% (c/f FY06).
- No dividend was declared for the quarter.

Comment

There is little doubt that REX has proved the doomsayers wrong and in spite of drought, significantly higher fuel costs and a competitive market, REX achieves operating statistics and balance sheet ratios that make most businesses blush. Lets start with a load factor a nudge under 70%, organic revenue up 22.3% (QoQ), ROE and ROA of 28% and 24% respectively (FY07 forecast and only slightly lower after adjusting for lease commitments) and a company forecast of 20% lift in FY07 NPAT.

Yes airlines are difficult businesses but with the disciplines in place and management skill inherent in this company's performance over the last three years, as well as cold hard statistics, this should provide some investor comfort and thus share price traction.

Investment View

We have lifted our FY07 NPAT forecast by 18% to \$20.5M. We have done so on the basis of our assessment of recent performance, the very strong operating environment that this company continues to enjoy, as well disciplined approach to cost management.

Our valuation has risen to \$1.89 and we have increased our dividend assumption to 9.5cps (ff) in FY07.

Earnings Summary

Y/E Jun	2005A	2006A	2007F	2008F
Revenue - A\$M	142.0	169.7	203.8	224.7
EBITDA - A\$M	10.1	20.9	29.9	35.2
NPAT (reported) A\$M	6.5	15.7	20.5	22.4
NPAT (normalised) A\$M ¹	4.3	13.6	20.5	22.4
EPS (diluted) - cents ²	7.3	13.3	17.8	19.5
EPS (diluted) - % chg	n/a	82.1	34.3	9.1
PER (diluted) - x ²	17.8	9.8	7.3	6.7
DPS - cents	0.0	5.0	9.5	10.0
Dividend Yield - %	0.0	3.8	7.3	7.7
Franking - %	0	0	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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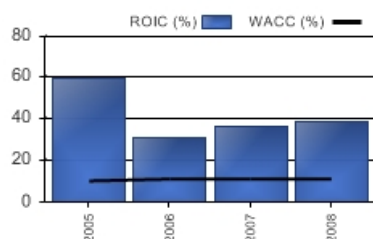


Valuation

Methodology: DCF¹

Key assumptions	
Beta	1.3
WACC %	11.2
Forecast period years	10.0
Risk premium %	5.5
PV cash flows \$M	181.9
less net debt/(add cash) \$M	(20.0)
add equity adjustments ²	15.0
Total	216.9
Fully diluted shares on issue M ²	115.0
Value per share \$	1.89

Return on invested capital



Ratio analysis

Year end Jun	06A	07F	08F
Revenue growth %	19.5	20.1	10.3
EBITDA growth %	107.7	42.9	17.7
EBITDA margin %	12.3	14.7	15.7
EBIT margin %	9.9	11.9	12.1
Tax rate %	35.5	30.0	30.0
ROA %	20.6	24.0	24.0
ROE %	24.6	27.9	26.7
Net debt/equity %	(34.3)	(6.5)	(14.9)
Net interest cover x	n/a	n/a	n/a
Capex to deprec'n %	172.7	72.1	83.3
NTA per share \$	0.59	0.67	0.77

Multiple analysis

Year end Jun	06A	07F	08F
Market cap \$M	133		
Net debt (cash) \$M	(20.0)		
Options \$M	0.0		
Enterprise value \$M	98.4		
EV/EBITDA x	4.7	3.3	2.8
EPS c	13.3	17.8	19.5
P/E x	9.8	7.3	6.7
Cashflow / Share c	26.4	19.7	24.2
Price / NTA x	2.2	1.9	1.7

Shares outstanding

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

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	2005A	2006A	2007F	2008F
Profit & Loss Summary A\$M				
Operating revenue	142.0	169.7	203.8	224.7
Invest & other income	0.2	1.4	0.0	0.0
EBITDA	10.1	20.9	29.9	35.2
Depreciation/Amort	(2.6)	(4.2)	(5.6)	(8.1)
EBIT	7.5	16.7	24.3	27.1
Net Interest	(0.6)	0.9	0.9	0.5
Pre-tax profit	6.9	17.6	25.2	27.6
Tax expense	(2.6)	(6.3)	(7.6)	(8.3)
Minorities/Assoc./Prefs	0.0	2.2	2.9	3.1
NPAT	4.3	13.6	20.5	22.4
Non recurring items	2.2	2.1	0.0	0.0
Reported profit	6.5	15.7	20.5	22.4
add goodwill/non recurring	(2.2)	(2.1)	0.0	0.0
Adjusted profit	4.3	13.6	20.5	22.4
Cashflow Summary A\$M				
EBITDA	10.1	20.9	29.9	35.2
Working capital changes	7.1	3.7	0.1	0.0
Interest and tax	(0.6)	0.9	(5.3)	(7.3)
Other operating items	(13.6)	1.4	(2.0)	0.0
Operating cashflow	2.9	27.0	22.7	27.9
Required capex	(5.9)	(7.3)	(4.1)	(6.7)
Maintainable cashflow	(3.0)	19.7	18.6	21.1
Dividends/Other	0.0	0.0	(11.5)	(10.9)
Acq/Disp	(2.7)	(23.8)	(25.6)	(2.0)
Other investing items	0.2	(4.8)	0.0	0.0
Free cashflow	(5.6)	(8.9)	(18.5)	8.2
Equity	0.2	35.0	0.0	0.0
Debt inc/(red'n)	8.6	(7.0)	18.5	(8.2)
Balance Sheet A\$M				
Cash & deposits	4.5	23.6	5.1	13.3
Inventories	3.1	4.1	4.1	4.1
Trade debtors	11.7	8.6	8.5	8.5
Other curr assets	0.0	0.0	0.0	0.0
Total current assets	19.4	36.3	17.7	25.9
Prop., plant & equip.	28.9	45.6	69.6	70.3
Non-curr intangibles	0.2	0.8	0.8	0.8
Non-curr investments	0.0	14.3	17.2	20.3
Other non-curr assets	7.0	3.3	3.3	3.3
Total assets	55.4	100.3	108.6	120.6
Trade creditors	21.9	23.5	23.5	23.5
Curr borrowings	0.5	0.0	0.0	0.0
Other curr liabilities	4.6	6.5	5.9	6.3
Total current liab.	27.0	30.0	29.4	29.8
Borrowings	4.1	0.0	0.0	0.0
Other non-curr liabilities	2.0	1.5	1.4	1.4
Total liabilities	33.1	31.5	30.8	31.3
Minorities/Convertibles	0.0	0.0	0.0	0.0
Shareholders equity	22.4	68.8	77.8	89.3

Final results analysis & outlook

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Year end Jun	2005A	2006A	2007F	2008F
Divisional Summary A\$M				
Revenue				
Division 1	142.0	169.7	196.8	217.5
Air-Link	0.0	0.0	7.0	7.2
EBITDA				
Division 1	9.9	19.6	29.0	34.3
Air-Link	0.0	0.0	0.9	0.9
Margin %				
Division 1	7.0	11.5	14.7	15.8
Air-Link	0.0	0.0	12.8	12.8

1Q07 Result detail

Highlights

Rex has produced a very impressive 1Q07 result, both in terms of financial and operational performance. The result was well above our expectations and significantly above the company's internal budgets. As a consequence, the company has provided guidance of 20% uplift in NPAT in FY07 (\$18.8M). At the release of its FY06 arithmetic in September, it provided guidance of 10% uplift.

The financial highlights were as follows:

1Q07 result detail

Quarter ended 30 September	1Q06*	1Q07	% ch
\$M			
Passenger revenue	40.3	49.3	22%
Total revenue	41.3	51.1	24%
Fuel cost	6.3	9.0	43%
Other costs & expenses	29.8	34.8	17%
NPAT	3.9	5.7	46%

*Does not include Air Link results
Source: REX and Tricom Equities.

The results reflected a number of milestones and key performance indicators and operating statistics were, in the main, as good as it gets:

Key performance metrics

Quarter ended 30 September	1Q06	1Q07	% ch
Passengers	287,418	344,449	20%
ASKs (M)	171	191	12%
Ave fare \$	140	143	2%
Ave fare \$ (Excl. fuel levy)	122	120	-2%
Load factor (%)	65	68	3.0%pts
Revenue/ASK (cents)	24	26	9%
Total cost/ASK (cents)	21	23	9%
Total cost/ASK (cents) (Excl. fuel)	17	18	5%
Fuel % total Cost	17	20	3.1%pts
PBT margin (%)	14	16	1.6%pts

Source: REX and Tricom Equities

All the numbers went the right way, with passenger numbers up 20% and the load factor rising a massive 3 percentage points. The load factor in FY05 was 65.4% and 66.9% in FY06. Air fares continued to fall (excluding fuel levy adjustments) and revenue per ASK (average seat kilometres) and costs per ASK matched out (both up 9%). These results were achieved despite a rise in fuel costs of 43% (lifting fuel to 20% of total costs, c/f 17% pcp).

Fuel costs have fallen since October (jet fuel lags crude prices) and we estimate that the savings to be around \$0.5M over the two months to November 2006. However, this is a dangerous metric to annualize as it assumes that there will be no downward adjustment to the fuel price levy (added to some, but not all, air tickets) and that oil prices don't rise again.

We understand that Pel-Air achieved a 30% lift in earnings for the quarter, largely driven by increased charter activity.

The company has around \$20M in cash at present, although we estimate that will fall to \$5.3M by year end. Our cash reconciliation is as follows:

Summary of cashflow

Year ended June (\$M)	2007F
Opening cash	23.5
EBITDA	29.9
Sale of aircraft	0.0
Tax	(5.3)
Headquarters acquired	(4.0)
Dividends paid	(11.5)
New aircraft ¹	(15.6)
Staff bonus (FY06)	(1.8)
Pel-Air (25% of agreed total price)	(6.0)
Other	(4.1)
Closing cash	5.1

Source: REX and Tricom Equities

Notes: 1. We understand that prior to the new lease for 25 additional aircraft over the next three years, the company had committed to acquiring five more planes. We have assumed four of these planes were acquired for cash and one was leased. We have also added a Beech 1900 (US\$2.7M), which is to be acquired for Airlink and a Westwing (US\$1.5M), which will be acquired by REX and leased to Pel-Air.

Looking forward

As a rough rule of thumb, the 1H is always the strongest half (representing around 55% of the FY result). The 1Q is usually the second strongest quarter, followed by the December quarter which is the strongest three months in the year to June. If we assumed the physics remain the same, our simple back-of-the-envelope analysis of the FY07 result is as follows:

- NPAT of \$5.7M 1Q07 (fact)
- 2Q07 stronger – lets say \$6.5M (NPAT).
- 1H07 \$12.2M (NPAT)
- 2H07 represents 45%, suggesting a final six months of \$10M (FY07 of \$22.1M NPAT).

We are a little more circumspect in our final arithmetic, although our forecast for FY07 is \$20.5M (up 18% from our previous forecast).

Trading conditions are particularly buoyant in the current quarter and this is in spite of some, albeit slight, negative impact from the drought. However, as the company has maintained for some time, the drought has never gone away from some parts of regional NSW and Victoria and although its severity has increased, it has had almost no effect on REX's passenger traffic.

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

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