

Regional Express Holdings REX

Ready for take-off?

Price: **\$1.06** Target: **\$1.50**
Recommendation: **BUY**

REX has a number of growth initiatives that are coming to fruition in FY12, including the restructure of Pel-Air, which continues to build its business in medivac, defence and fly-in fly-out contracts. In addition, REX's Australian Airline Pilot Academy (AAPA), has recently announced an international accreditation that will see the training of international pilots for the first time. We believe that these growth initiatives could result in these divisions representing 30-40% of group revenue significantly diversifying away from the passenger business. We continue to rate REX a BUY given its discount to our blended valuation of \$1.57 per share, the strong EPS growth forecast for FY12 and FY13 and potential upside from new contract wins.

Investment highlights

A mini monopoly: Formed in 2002 from the merger of Kendall and Hazelton airlines, REX is Australia's largest independent regional airline. Its business model is built around servicing 35 small regional routes, of which REX is the sole provider of services on 24 routes, representing approximately 65% of current available seat kilometres (ASK's). This lack of competition of the bulk of its routes places REX in a strong position to withstand a difficult environment whilst benefiting when passenger numbers rise.

Pel-Air set to drive growth: REX's freight and charter business, Pel-Air, is expected to drive a bulk of the growth in FY12 and FY13 as it expands further into the medivac, defence and mining sectors through additional contract wins. From 1 July 2011, Pel-Air began its 10 year Air Ambulance contract in Victoria (revenue of ~20m pa) and recently won a 3 year extension on an existing defence contract (~16m pa). Further penetration in the fly-in-fly-out market and a further large defence contract (~\$20m pa), currently being tendered for, would see Pel-Air represent approximately 30% of group revenue.

Australian Airline Pilot Academy: Following its completion in May 2010, AAPA has been serving as a ready supply of pilots into REX. More recently, the company received accreditation from the General Civil Aviation Authority of the United Arab Emirates and have started training external pilots under their program. Management expect to train 60 cadets from the UAE per annum. Together with internal trainees of 30, this would take enrolments close to the current capacity and expect annual revenue could reach ~\$6-7m.

Outlook: We are forecasting strong EPS growth in FY12 (23.7%) and FY13 (11.6%) driven by the contribution of the new medivac and defence contracts as well as continued penetration into mining services contracts. This growth will be supported by REX's passenger business which is in a very strong competitive position and as such has proven to be reasonably resilient through the cycle.

Recommendation and valuation: Our BUY recommendation on REX reflects the steep discount to our blended valuation of \$1.57 per share. In our opinion, the current implied FY12 multiples (PE: 5.5x and EV/EBIT: 3.8x) do not reflect REX's competitive position, balance sheet capacity and growth profile.

Key financial information

Y/E June		2010A	2011A	2012F	2013F
Revenue	\$m	229.7	239.6	268.8	280.4
EBITDA	\$m	37.0	34.4	44.2	47.2
Reported NPAT	\$m	24.6	17.6	21.8	24.3
Normalised NPAT	\$m	20.3	17.6	21.8	24.3
EPS (adj)	CPS	18.0	15.6	19.3	21.5
EPS growth	%	-2.8	-13.5	23.7	11.6
PER	x	5.9	6.8	5.5	4.9
EV/EBITDA	x	3.7	3.8	2.8	2.3
DPS	c	6.6	7.1	8.0	9.0
Yield	%	6.2	6.7	7.5	8.5

Stock data

Market capitalisation	\$120.2m
Issued capital	112.9m
Volume (monthly average)	1.1m
12 month low	\$0.80
12 month high	\$1.20

Valuation & pricing data

DCF valuation	\$1.76
EBITDA valuation	\$1.51
PE valuation	\$1.46
12 month price target	\$1.50

Share price drivers

New routes	↑
Evidence AAPA gaining traction	↑
Further medivac/mining contracts	↑

12 month share price performance



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Profit & loss (\$m)	2010A	2011A	2012F	2013F
Revenue	229.7	239.6	268.8	280.4
EBITDA	37.0	34.4	44.2	47.2
Depreciation	-9.9	-11.1	-11.6	-11.7
Amortisation	-0.1	-0.1	-0.1	-0.1
EBIT	27.1	23.3	32.4	35.4
Net interest expense	0.0	0.8	-1.3	-0.7
NPBT	27.1	24.1	31.1	34.7
Tax expense	-6.7	-6.5	-9.3	-10.4
NPAT – reported	24.6	17.6	21.8	24.3
Adjustments	4.3	0.0	0.0	0.0
NPAT – adjusted	20.3	17.6	21.8	24.3

Cashflow (\$m)	2010A	2011A	2012F	2013F
Operating EBITDA	37.0	34.4	44.2	47.2
- Interest & tax paid	-6.7	-5.7	-10.7	-11.1
+/- Change in work. cap.	1.0	-1.7	0.6	8.9
- Other	-1.3	7.3	0.0	0.0
Operating cashflow	30.0	34.4	34.1	45.0
- Capex	-17.7	-29.2	-12.0	-12.0
- Aquisitions/divestments	-41.7	6.6	-3.4	-3.4
- Other	0.4	1.2	0.0	0.0
Free cashflow	-28.9	13.0	18.8	29.6
- Ord dividends	0.0	-7.3	-8.0	-9.0
- Equity/other	-0.5	0.0	-1.3	0.0
Net cashflow	-29.4	5.7	9.5	20.6
Cash at beginning of period	15.5	10.4	19.1	20.6
+/- Borrowings/other	24.3	3.0	-8.0	-18.0
Cash at end of period	10.4	19.1	20.6	23.2

Balance sheet (\$m)	2010A	2011A	2012F	2013F
Cash	10.3	19.0	20.6	23.2
Inventories	7.7	10.4	9.1	9.5
Debtors	13.4	16.9	10.8	11.2
PPE	174.8	185.7	193.2	205.8
Intangibles	7.3	7.5	7.0	6.8
Other assets	5.1	0.0	0.0	0.0
Total assets	218.8	239.6	240.6	256.5
Borrowings	26.0	29.0	22.9	12.9
Trade creditors	34.7	39.1	32.3	42.1
Other liabilities	7.5	10.6	10.6	10.6
Total liabilities	68.2	78.8	65.8	65.6
Net assets	150.6	160.8	174.8	191.0

Board of Directors/Substantial Shareholders

Board of Directors	Shares (m)	%
Lim Kim Hai – Executive Chairman	18.5	16.4
The Hon. John Sharp – Deputy Chairman	0.4	0.4
James Davis – Managing Director	0.2	0.2
Chris Hine – Independent Director	0.2	0.1
Lee Thian Soo – Non-Executive Director	11.4	10.1
Ronald Bartsch – Non-Executive Director	0.0	0.0

Substantial Shareholders	Shares (m)	%
Kim Hai Lim	18.5	16.4
Joe Tiau Tjoa	16.2	14.4
Thian Soo Lee	7.7	6.8
Joo Chye Chua	7.5	6.6
Hui Ling Tjoa	5.8	5.1
Top 20 Shareholders	86.4	76.5

Valuation ratios	2010A	2011A	2012F	2013F
EPS (cps) – adjusted	18.0	15.6	19.3	21.5
P/E (x)	5.9	6.8	5.5	4.9
PER rel – all ind. (%)	-59	-59	-57	-57
PER rel – small ind. (%)	-61	-56	-57	-55
Enterprise value (\$m)	135.9	130.2	122.5	109.9
EV/EBITDA (x)	3.7	3.8	2.8	2.3
EV/EBIT (x)	5.0	5.6	3.8	3.1
DPS (cps)	6.6	7.1	8.0	9.0
Dividend yield (%)	6.2	6.7	7.5	8.5
Franking (%)	100	100	100	100
CFPS (cps)	26.6	30.5	30.2	39.9
P/CFPS (x)	4.0	3.5	3.5	2.7

Profitability ratios	2010A	2011A	2012F	2013F
EBITDA margin (%)	19.2	17.1	20.5	21.3
EBIT margin (%)	11.8	9.7	12.1	12.6
ROE (%)	13.8	11.1	12.7	13.0
ROA (%)	9.7	8.0	9.9	10.4
ROIC (%)	11.1	8.7	11.3	11.1

Balance sheet ratios	2010A	2011A	2012F	2013F
Net debt (cash)	15.7	10.0	2.3	-10.3
Net gearing (%)	10.4	5.0	0.2	-6.5
Interest cover (x)	nm	-28.4	24.1	n/a
NTA per share (\$)	1.27	1.36	1.49	1.63
Price/NTA (x)	0.8	0.8	0.7	0.6
EFPOWA (m)	112.9	112.9	112.9	112.9

Growth ratios	2010A	2011A	2012F	2013F
Sales revenue (%)	-7.2	4.3	12.2	4.3
EBITDA (%)	1.3	-7.0	28.3	6.8
EBIT (%)	-1.0	-14.0	39.3	9.2
NPAT (%)	7.2	-13.5	23.7	11.6
EPS (%)	-2.8	-13.5	23.7	11.6
DPS (%)		7.6	12.7	12.5

Interim analysis	1H11A	2H11A	1H12F	2H12F
Passenger revenue (\$m)	102.5	98.8	112.7	102.8
EBIT (\$m)	12.2	11.1	14.8	17.7
EBIT margin (%)	11.9	11.2	13.1	17.2
NPAT (\$m)	8.8	8.8	8.8	13.0
EPS (cps)	7.7	7.8	7.7	11.5
DPS (cps)	0.0	7.1	0.0	8.0

Valuation	2012F
Normalised EBITDA multiple (x)	
EBITDA (\$m)	44.2
Target EBITDA multiple (x)	4.1
Net debt (cash) (\$m)	10.0
Implied valuation	170.4
Per share	\$1.51

Target PE multiple	
EPS (c)	19.3
PE target (x)	7.6
Per share	\$1.46

Discounted cashflow	
Cost of equity	19.0%
Cost of debt	8.3%
Net debt/Net debt + equity	10.3%
WACC	17.6%
Terminal growth rate	2.0%
Per share	\$1.76