13 September 2006

PRICE | $1.16

Regional Express Holdings Ltd | REX

FY06 results

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Fully diluted shares
on issue | 115.0M

Market cap | A$121.9M

Performance & Valuation

Last Price | $1.16

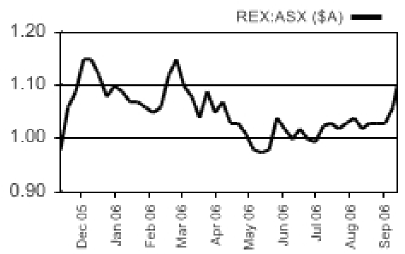
52 wk hi/low | $1.18 / $0.95

12 mth price target[3] | $1.71

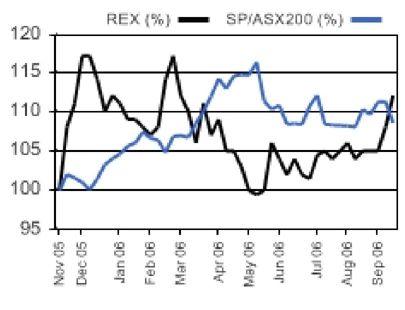
Valuation | $1.66

Valuation methodology | DCF

Share price performance



REX versus SP/ASX200



Key points

- The company announced its FY06 results on 12 September 2006.
- The key arithmetic was ahead of Prospectus with a bottom line (A-IFRS) reported of $15.7M.
- Passenger revenue (with a little assistance from Air Link, acquired in December 2005) rose 19% YoY, with total revenue up 20.5%.
- Load factors advanced to 66.9% (c/f 65.4% pcp) and revenue per ASK increased 6.1% YoY.
- Cash at year end was $23.6M, with operating cashflows nudging $27M.
- The competitive dynamic has moved substantially in REX's favour with the withdrawal by QantasLink from three routes. REX also withdrew from Armidale/Sydney and Melbourne/Devonport due to losses incurred and questionable future commercial metrics.
- The company declared a maiden dividend of 5cps (unfranked).

Comment

It is hard to fault this result and the share price has reacted accordingly, as investors voted with their feet. And in spite of a 40% increase in fuel costs (rising from 14.5% of total costs to 17.8%), fare prices rose on average just 3.3%, the company introduced cost savings and achieved productivity gains of $3M and passenger traffic rose by 15%.

In addition, EBITDA margins rose from 7% in FY05 to 12.3%. We anticipate (and have forecast) further advances in FY07, largely due to better load factors (underpinned by the sole carrier status on three routes following withdrawal by QantasLink) and some further cost management.

Investment View

We remain confident that the company can achieve further margin expansion and profit growth (in fact 14% in eps) in FY07. We have moved both our valuation and share price target forward and yes it is an airline, but on a 7.6x FY07 PER we believe it has none of the risks associated with the major airlines, like QAN which is priced around 15x in FY07. And even if that argument doesn't resonate in the minds of investors, a grossed up yield of 9.3% in FY07 will address some of the nervous tension associated with a natural reticence to be long airline stocks.

Earnings Summary

Y/E Jun	2005A	2006A	2007F	2008F
Revenue - A$M	142.0	169.7	186.3	200.1
EBITDA - A$M	10.1	20.9	25.1	27.7
NPAT (reported) A$M	6.5	15.7	17.4	18.7
NPAT (normalised) A$M[1]	4.3	13.6	17.4	18.7
EPS (diluted) - cents[2]	7.3	13.3	15.1	16.3
EPS (diluted) - % chg	n/a	82.1	14.0	7.3
PER (diluted) - x[2]	15.8	8.7	7.6	7.1
DPS - cents	0.0	5.0	7.5	8.0
Dividend Yield - %	0.0	4.3	6.5	6.9
Franking - %	0	0	100	100

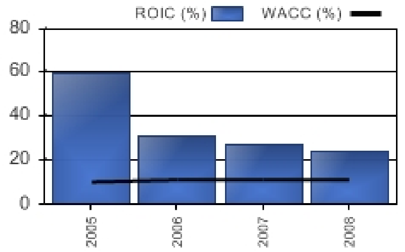
Notes:
1. Normalised earnings is pre goodwill, amortization and after adding back non-recurring items.
2. Based on normalized earnings.
3. Price target is calculated by moving current valuation one year forward.

Valuation

Methodology: DCF[1]

Key assumptions	
Beta	1.3
WACC|%	11.2
Forecast period|years	10.0
Risk premium|%	5.5
PV cash flows|$M	156.0
less net debt/(add cash)|$M	(20.0)
add equity adjustments[2]	15.0
Total	191.0
Fully diluted shares on issue|M[2]	115.0
Value per share|$	1.66

Return on invested capital



Ratio analysis

Year end Jun	06A	07F	08F
Revenue growth|%	19.5	9.8	7.4
EBITDA growth|%	107.7	19.8	10.4
EBITDA margin|%	12.3	13.5	13.8
EBIT margin|%	9.9	10.5	10.7
Tax rate|%	35.5	30.0	30.0
ROA|%	20.6	20.2	20.0
ROE|%	24.6	24.2	23.0
Net debt/equity|%	(34.3)	(29.6)	(21.2)
Net interest cover|x	n/a	n/a	n/a
Capex to deprec'n|%	172.7	101.9	126.2
NTA per share|$	0.59	0.65	0.74

Multiple analysis

Year end Jun	06A	07F	08F
Market cap|$M	122		
Net debt (cash)|$M	(20.0)		
Options|$M	0.0		
Enterprise value|$M	86.9		
EV/EBITDA|x	4.2	3.5	3.1
EPS|c	13.3	15.1	16.3
P/E|x	8.7	7.6	7.1
Cashflow / Share|c	26.4	16.3	19.3
Price / NTA|x	2.0	1.8	1.6

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$M				
Operating revenue	142.0	169.7	186.3	200.1
Invest & other income	0.2	1.4	0.0	0.0
EBITDA	10.1	20.9	25.1	27.7
Depreciation/Amort	(2.6)	(4.2)	(5.5)	(6.3)
EBIT	7.5	16.7	19.6	21.3
Net Interest	(0.6)	0.9	1.2	1.0
Pre-tax profit	6.9	17.6	20.7	22.3
Tax expense	(2.6)	(6.3)	(6.2)	(6.7)
Minorities/Assoc./Prefs	0.0	2.2	2.9	3.1
NPAT	4.3	13.6	17.4	18.7
Non recurring items	2.2	2.1	0.0	0.0
Reported profit	6.5	15.7	17.4	18.7
add goodwill/non recurring	(2.2)	(2.1)	0.0	0.0
Adjusted profit	4.3	13.6	17.4	18.7
Cashflow Summary | A$M				
EBITDA	10.1	20.9	25.1	27.7
Working capital changes	7.1	3.7	0.1	0.0
Interest and tax	(0.6)	0.9	(4.4)	(5.5)
Other operating items	(13.6)	1.4	(2.0)	0.0
Operating cashflow	2.9	27.0	18.8	22.1
Required capex	(5.9)	(7.3)	(5.6)	(8.0)
Maintainable cashflow	(3.0)	19.7	13.2	14.1
Dividends/Other	0.0	0.0	(10.4)	(8.6)
Acq/Disp	(2.7)	(23.8)	(4.0)	(9.7)
Other investing items	0.2	(4.8)	0.0	0.0
Free cashflow	(5.6)	(8.9)	(1.1)	(4.2)
Equity	0.2	35.0	0.0	0.0
Debt inc/(red'n)	8.6	(7.0)	1.1	4.2
Balance Sheet | A$M				
Cash & deposits	4.5	23.6	22.4	18.2
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	35.0	30.8
Prop., plant & equip.	28.9	45.6	49.7	61.1
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	106.1	116.3
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	5.3	5.4
Total current liab.	27.0	30.0	28.8	28.9
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	30.2	30.4
Minorities/Convertibles	0.0	0.0	0.0	0.0
Shareholders equity	22.4	68.8	75.9	85.9

Year end Jun	2005A	2006A	2007F	2008F
Divisional Summary|A$M				
Revenue				
Division 1	142.0	169.7	179.3	192.9
Air-Link	0.0	0.0	7.0	7.2
EBITDA				
Division 1	9.9	19.6	24.2	26.8
Air-Link	0.0	0.0	0.9	0.9
Margin|%				
Division 1	7.0	11.5	13.5	13.9
Air-Link	0.0	0.0	12.7	12.8

1 | Result detail

Highlights

Rex produced a very solid inaugural result as a listed company. The result was in line with our expectations and a nudge above Prospectus forecasts:

The highlights of the result were:

FY06 Income Statement Review

$M	FY05	Prospectus	FY06A[1]	Chg YoY	Chg Prospectus v Actual
Passenger Revenue	139.8	144.7	166.2	18.9%	14.9%
Total Revenue	144.7	148.6	174.3	20.5%	17.3%
Fuel Costs	-19.7	-24.0	-27.4	39.1%	14.2%
Other Costs & Expenses	-115.8	-114.6	-127.0	9.7%	10.8%
NPAT	6.5	15.1	15.7	141.5%	4.0%

Source: REX and Tricom Equities.
Notes: 1. The reported numbers included Air Link which was consolidated from December 2005.

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

FY06 Key Performance Indicators

$M	FY05	FY06A	Chg YoY
EBITDAR	18.6	28.6	53.8%
Leases	8.5	7.7	-9.4%
EBITDA	10.1	20.9	107%
EBITDA (margin, %)[1]	7.0%	12.3%	5.3% pts
Before Tax Profit Margin	6.3%	12.6%	6.3% pts
Fuel % Total Cost	14.5%	17.8%	3.3% pts
Current Ratio	0.73	1.21	65.8%
Return on Average Equity[2]	55.8%	34.5%	-21.3% pts
Return on Average Total Assets[2]	14.0%	20.2%	6.2% pts
Net Asset Per Share	$0.38	$0.59	55.3%

Source: REX and Tricom Equities.
Notes: 1. On passenger revenue. 2. REX estimates (our numbers on page 2 differ and this depends on assumptions).

FY06 Key Operating Statistics

	FY05	FY06A	% Chg YoY
Passengers ('000s)	1,038	1,195[1]	15.1%
ASKs (M)	610	684	12.1%
Average Fare ($)	134.6	139.1	3.3%
Average Fare (excl. fuel levy)	124.2	119.3	-3.9%
Load Factor	65.4%	66.9%	1.5% pts
Revenue/ASK (cents)	22.8	24.2	6.1%
Total cost/ASK (cents)	22.2	22.6	1.8%
Total cost/ASK (excl fuel) (cents)	19.0	18.6	-2.1%

Source: REX.
Notes: 1. Includes Air Link passengers of 21k for the year.

Load factors up again!

The company continues to push the envelope on its load factors, despite an average increase in its average seat kilometres (ASKs, a measure of capacity) by 12.1%. Moreover, real average fares fell (after removing the fuel price subsidy added to ticket prices to compensate for higher fuel costs). The nominal reduction in ticket prices was 3.9%, while costs (excluding fuel) fell 2.1% (measured as total cost/ASK).

Fuel remains the bogeyman

Fuel as a percent of total costs rose to 17.8% (c/f 14.5% FY05). The fuel bill in fact increased a massive 40% to $27.4M for the year.

But productivity gains achieved

The company achieved cost savings during the year and productivity gains, both of which contributed to the reduction in total cost/ASK. REX noted that it locked in $3M in productivity benefits during the year.

Aircraft configuration changing

REX continues to deploy the larger Saab aircraft (34 seat capacity) and replace its Metro 23 fleet (19 seat capacity). A total of four Saab aircraft were added to the fleet during the year (now 26 Saabs) and two Metro's were disposed of, reducing its numbers to three at year end. A further two Saabs have been purchased and $4.1M is to be paid this year, with delivery due in December 2006.

Competitive dynamic changing and in REX favour

REX withdrew services on two routes – Melbourne to Devonport and Sydney to Armidale - during the year as both were unprofitable. However, with the attrition by QantasLink from several key competitive routes, REX finished the year with only five routes (out of its 38) where it went head-to-head with QantasLink. Moreover, QantasLink has since withdrawn from the Burnie/Melbourne route leaving REX with head-to-head competition with Qantas on just four routes.

Cash is king and counting

The cash balance as at 30 June 2006 was $23.6M. REX has no debt, other than some off balance sheet debt related to its operating leases. This amounts to $20M over five years and $7.76M due in the next 12 months.

Dividends r cometh!

The company declared a final dividend (unfranked) of 5cps. REX would not be drawn on future dividend policy other than to state that the 5cps declared was at the "upper limit" of its band, provided in its Prospectus (30-40% of earnings in the first year of listing). We have assumed a payout ratio of around 50% of eps going forward, without guidance from the company. Also, as the company has minimal tax losses it can use this year and beyond (although this situation could improve and depends on discussions with the ATO), we have assumed that all future dividends are fully franked.

2 | Outlook

The way forward

10% improvement this year

The company did not provide hard forecasts for FY07, although noted that it was anticipating an improvement of about 10% in earnings. One of the most notable improvements we envisage this year is the marked (and favourable) change in route dynamics.

Route dynamics have moved significantly in REX's favour

During the year just gone, routes shared with QantasLink fell from eight to five. Since then, QantasLink has withdrawn from the Burnie/Melbourne route, leaving 34 of REX's 38 routes uncontested by QantasLink. REX also withdrew from Sydney/Armidale and Burnie/Melbourne during the year. While it is difficult to reconcile the benefits of these changes, in its IPO Prospectus REX noted that a one percentage improvement in its average (across the company) load factors adds $2M to EBITDA. We have assumed in our forecasts that load factors on Burnie/Melbourne, Adelaide/Port Lincoln and Adelaide/Kingscote improve significantly this year and total load factor improves to just under 70% (c/f 65.4% in FY05).

EBITDA margins going up

It is a combination of these improved load factors and some (albeit modest) improvement in cost management, which drive our advance in EBITDA margin to 13.5%, from 12.3%.

Furthermore, the company did make some general observations regarding the year ahead and which give us some comfort around our forecasts:

Positive company outlook

- The regional travel market (both business and leisure) is expected to remain "robust".
- Passenger traffic is forecast to advance and fuel prices remain "firm".
- Target to maintain profit margin from tighter cost management, and
- Expect charter and freight activities to "continue to grow".

Our forecasts show an advance in eps in FY07 and FY08 of 14% and 7.3% respectively. Cash remains at around $21M by June 2007 and then declines following our assumptions re the further acquisition of additional aircraft in FY08. We estimate net cash in FY08 of $13.5M.

Some of our key assumptions are noted below:

Operating Statistics/Assumptions

Y/E June	FY05	FY06	FY07F	FY08F	FY09F	FY010F
Passengers	1,038,000	1,195,344	1,206,936	1,283,799	1,300,703	1,313,012
Passenger growth (%)		15%	1%	6%	1%	1%
Revenue/passenger ($)	134	139	145	147	149	151
Revenue/passenger growth (%)		4%	4%	1%	1%	1%
RPK (M)	399	457	462	492	498	503
ASK (M)	610	684	662	695	695	695
Load factor (%)	65.4%	66.9%	69.8%	70.7%	71.6%	72.3%
Yield (NPAT/ASK)	1.0%	2.3%	2.7%	3.6%	3.6%	4.0%
AUD/USD exchange rate		0.745	0.745	0.745	0.745	0.745
Crude oil price (US$)		80.00	80.00	80.00	80.00	80.00
Fuel % revenue (%)	14.4%	16.1%	16.8%	16.8%	16.7%	16.6%

Source: REX and Tricom Equities.

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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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