On 5 June 2006 The Rivkin Report, Australia's leading stock market newsletter, published the following update on REX to its subscriber base. REX was first recommended by The Rivkin Report on 23 May 2006.

For those who missed it, REX reported its 3rd quarter results recently. We are comfortable with its results to date. Their 50% ownership in Pel-Air is ‘expected to achieve annual budget’ while the total REX business is ‘on target to meet prospectus forecasts’. Furthermore, the small Air Link acquisition is achieving improved load factors and increased passenger numbers.

Year to date, REX has flown 864,000 passengers, which represents 76% of their full year forecast of 1,135,000. Their full year number looks achievable given seasonality; the 3rd quarter is the least profitable. The important load factor is currently YTD 66.2%, which is slightly above the forecast 65.7% FYE06 as outlined in the prospectus… this is very pleasing. As noted to subscribers in our original recommendation, REX has been impacted by higher fuel costs, however we were correct in our analysis that fuel as a total of total costs hasn’t surpassed 20% (19.6% to be exact). This also means our analysis on the impact of the fuel surcharge is also correct, that is that REX is handling the increase in oil prices without damaging forecast results at this point.

Other important measurements of profitability such as Revenue/Average Seat Kilometre and total cost/average seat kilometre are tracking right on budget. YTD revenue is $110.2m, which grosses up to $115.9m total revenue if we include the gain on sale of the dormant subsidiary, interest revenue, a small government grant and other bits and pieces. Nevertheless, we are comfortable with these revenue numbers. As we flagged in our initial report on REX, a one-off $800k profit is within the result and needs to be treated as one-off.

Profit before tax for the 9 months was $17.0m, which is nearly 80% of their forecast of $21.5m while NPAT was $12.0m, which is also nearly 80% of their prospectus forecast of $15.1m. The implication is that, ignoring the one-off profit, it is tracking right on prospectus numbers. In light of the recent fuel cost and infrastructure cost increases, this should be viewed as a solid result.

Given REX made a loss of $24.3m in 2003, achievement of the $15.1m prospectus profit will mean a three year, $40m turnaround. Clearly this is a smart management team.
Given REX is essentially a service business, we support the board’s decision to encourage staff ownership in REX and to align every parties interests equally. Effectively, REX is awarding employees with share gifts and share options where REX will set up two trust accounts wheres share will be bought back on market and held in trust. Structured sensibly with trading windows and blackouts, this highlights the importance and value that REX’s board places upon their employees.

We spoke with management and were satisfied with feedback on the 3rd quarter results and outlook. As such, at $1.02, REX is trading on a current year PE of 7.8 times and a 5.4% yield. On our estimates, it is on FYE07 PE of 6.7 times and a 6.4% fully franked yield. For the solid growth prospects and good management, we believe that is great value.

More recently, REX announced the withdrawal of their Armidale services effective from July 2…the route was ‘too thin’ to make profits in, and, given it was incurring losses on the route, should be positive for profits.

REX is currently trading at $1.02 and so some subscribers should have been able to get set by now. REX remains a buy at around $1.02. There is no point in chasing this stock and paying more as the risk/reward ratio changes as you pay more. If you cannot buy at around our limit, we would rather you did not buy shares at all rather than pay too much.

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