

29 August 2007

BUY | \$2.40

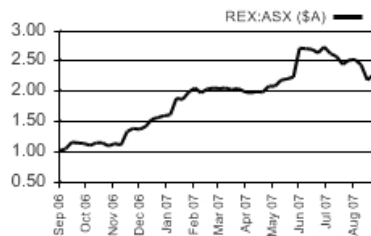
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Fully diluted shares
 on issue | 121M
 Market cap | A\$290.4M

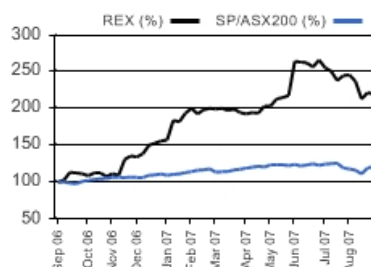
Performance & Valuation

Last Price | \$2.40
 52 wk hi/low | \$2.88 / \$1.02
 12 mth price target³ | \$3.20
 Valuation | \$3.15
 Valuation methodology | DCF

Share price performance



REX versus SP/ASX200



Regional Express Holdings Ltd | REX

FY07 results – just gets better

Key points

- REX reported its FY07 results on 29 August 2007;
- NPAT rose 50% on a revenue lift of 20% (19% up on passengers);
- EBITDA rose 78% to \$37.1M and margins (against passenger revenue) lifted 46% to 17.9% (or 16.6% on total revenue);
- Load factors again advanced to a critical capacity constraint level of 68.3%, while revenue per ASK (average seat kilometre) rose 5.8%.
- The dividend was disappointing at 6.6cps, but suggests a view that REX believes it can deploy its surplus capital to maximize shareholder wealth. We suggest this thinking may include strategic acquisitions of stressed regional airline operators.

Comment

Each result for REX leads to profit upgrades and share price upside. Today's announcement is no different and while the company's guidance for FY08 is a modest 10% advance in NPAT, we remain significantly more optimistic with a forecast rise in NPAT of just under 25%. Critically, adding the \$700k Pel-Air cost related to an unscheduled aircraft maintenance overhaul in FY07 and the \$1.5M bottom line benefit from the purchase of four aircraft coming off lease, we are already \$2M above the FY07 result.

Moreover, we believe the number of increased schedules (Broken Hill, Port Lincoln, Wagga Wagga, etc) and new routes (notably the first tentative toe in Queensland waters with Brisbane to Maryborough starting on 7 October 2007, plus Grafton, Taree, etc) will provide a very solid foundation for growth in FY08.

Investment View

We understand the reticence of some investors to be exposed to airline stocks and accept the argument, however a discount of 40%+ to the Industrials in FY08 is a severe disconnect and one that is totally unjustified. Using a more reasonable 20% discount, suggests a price for REX of \$3.30. This is more in line with our price target of \$3.20.

Earnings Summary

Y/E Jun	2006A	2007A	2008F	2009F
Revenue - A\$M	169.7	224.1	273.2	302.7
EBITDA - A\$M	25.1	37.1	52.8	58.2
NPAT (reported) A\$M	19.9	23.6	29.4	33.5
NPAT (normalised) A\$M ¹	17.8	23.6	29.4	33.5
EPS (diluted) - cents ²	17.4	20.2	24.3	27.7
EPS (diluted) - % chg	48.4	15.9	20.4	14.1
PER (diluted) - x ²	13.8	11.9	9.9	8.7
DPS - cents	5.0	6.6	7.0	8.0
Dividend Yield - %	2.1	2.8	2.9	3.3
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

Regional Express Holdings Ltd | 29 August 2007

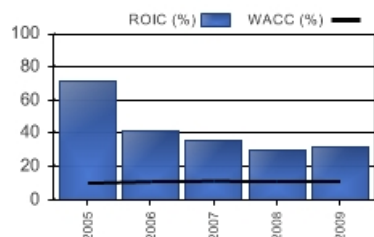


Valuation

Methodology: DCF¹

Key assumptions	
Beta	1.2
WACC %	11.3
Forecast period years	10.0
Risk premium %	5.5
PV cash flows \$M	370.6
less net debt/(add cash) \$M	(10.0)
add equity adjustments ²	0.0
Total	380.6
Fully diluted shares on issue M ²	121.0
Value per share \$	3.15

Return on invested capital



Ratio analysis

Year end Jun	07A	08F	09F
Revenue growth %	32.0	21.9	10.8
EBITDA growth %	47.8	42.2	10.2
EBITDA margin %	16.6	19.3	19.2
EBIT margin %	14.0	15.1	15.2
Tax rate %	29.3	30.0	30.0
ROA %	27.1	26.9	27.1
ROE %	29.4	26.4	24.9
Net debt/equity %	(12.7)	(17.2)	(30.6)
Net interest cover x	n/a	n/a	n/a
Capex to deprec'n %	178.0	106.4	112.6
NTA per share \$	0.79	0.96	1.17

Multiple analysis

Year end Jun	07A	08F	09F
Market cap \$M	275		
Net debt (cash) \$M	(10.0)		
Options \$M	0.0		
Enterprise value \$M	264.7		
EV/EBITDA x	7.1	5.0	4.5
EPS c	20.2	24.3	27.7
P/E x	11.9	9.9	8.7
Cashflow / Share c	31.0	31.2	38.3
Price / NTA x	3.1	2.5	2.1

Shares outstanding

Year end Jun	07A	08F	09F
Basic M	121.0	121.0	121.0
Other M	0.0	0.0	0.0
Fully diluted M	121.0	121.0	121.0

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	2006A	2007A	2008F	2009F
Profit & Loss Summary A\$M				
Operating revenue	169.7	224.1	273.2	302.7
Invest & other income	1.4	0.0	0.0	0.0
EBITDA	25.1	37.1	52.8	58.2
Depreciation/Amort	(4.2)	(5.7)	(11.6)	(12.1)
EBIT	20.9	31.5	41.3	46.1
Net Interest	0.9	0.8	0.7	1.8
Pre-tax profit	21.9	32.3	41.9	47.9
Tax expense	(6.3)	(9.4)	(12.6)	(14.4)
Minorities/Assoc./Prefs	2.2	0.8	0.0	0.0
NPAT	17.8	23.6	29.4	33.5
Non recurring items	2.1	0.0	0.0	0.0
Reported profit	19.9	23.6	29.4	33.5
add goodwill/non recurring	(2.1)	0.0	0.0	0.0
Adjusted profit	17.8	23.6	29.4	33.5
Cashflow Summary A\$M				
EBITDA	25.1	37.1	52.8	58.2
Working capital changes	3.7	0.0	0.0	0.0
Interest and tax	0.9	(2.3)	(10.7)	(11.9)
Other operating items	1.4	1.4	(4.4)	0.0
Operating cashflow	31.2	36.3	37.8	46.3
Required capex	(7.3)	(10.1)	(12.3)	(13.6)
Maintainable cashflow	23.9	26.2	25.5	32.7
Dividends/Other	0.0	(5.8)	(8.0)	(8.5)
Acq/Disp	(23.8)	(28.5)	(9.2)	0.0
Other investing items	(4.8)	1.4	0.0	0.0
Free cashflow	(4.7)	(6.6)	8.3	24.2
Equity	35.0	1.4	0.0	0.0
Debt inc/(red'n)	(7.0)	(1.0)	(8.3)	(24.2)
Balance Sheet A\$M				
Cash & deposits	23.6	18.6	23.7	48.0
Inventories	4.1	6.7	4.1	4.1
Trade debtors	8.6	12.4	8.5	8.5
Other curr assets	0.0	0.0	0.0	0.0
Total current assets	36.3	37.8	36.3	60.6
Prop., plant & equip.	45.6	110.7	120.6	122.2
Non-curr intangibles	0.8	7.4	7.4	7.4
Non-curr investments	14.3	0.0	0.0	0.0
Other non-curr assets	3.3	2.3	2.3	2.3
Total assets	100.3	158.1	166.6	192.4
Trade creditors	23.5	30.0	23.5	23.5
Curr borrowings	0.0	2.4	2.4	2.4
Other curr liabilities	6.5	18.0	15.0	15.7
Total current liab.	30.0	50.4	40.9	41.6
Borrowings	0.0	3.2	0.0	0.0
Other non-curr liabilities	1.5	2.0	1.9	1.9
Total liabilities	31.5	55.6	42.8	43.5
Minorities/Convertibles	0.0	0.0	0.0	0.0
Shareholders equity	68.8	102.5	123.8	148.9

Final results analysis & outlook

Regional Express Holdings Ltd | 29 August 2007



Year end Jun	2006A	2007A	2008F	2009F
Divisional Summary A\$M				
Revenue				
Division 1	169.7	224.1	273.2	302.7
EBIT				
Division 1	19.6	31.5	41.3	46.1
Margin %				
Division 1	11.5	14.0	15.1	15.2

1 | Result detail

Highlights

Rex produced a very solid FY07 result, with a bottom line advancing 50% and above our forecast of \$22.4M by 5.4%. The company suggested guidance this year of 10% growth in NPAT, which we believe is conservative.

The only disappointment was the dividend which, at 6.6cps, was significantly below our forecast of 10cps. This is a moot point and reinforces the time worn argument around capital management – that is, growth vs income. There is little doubt in our mind that the continuing challenging environment in regional Australia is telling on the less capitalised and smaller operators and this plays directly into the hands of a cashed up and conservatively capitalised company (ie REX). Moreover, the operating statistics (that equal the best in the world); share price performance since listing (up 140%) and ROE a nudge under 30%, suggests that the argument favouring cash retention, rather than cash distribution, is powerful.

Key results statistics are presented below:

FY07 Income Statement				
Year ended June (\$M)	2005	2006*	2007	Chg (FY06/07)
Passenger revenue	139.8	166.2	200.1	20.4%
Total revenue**	144.7	174.3	207.1	18.8%
Fuel cost**	-19.7	-27.4	-32.5	18.6%
Other costs & expenses**	-115.8	-127.0	-145.2	14.3%
NPAT	6.5	15.7	23.6	50.3%

Source: REX

Notes: * FY06 includes Air Link from December 2005. ** For comparative purposes, Pel-Air's results have been excluded.

FY07 Key Performance Indicators				
Year ended June (\$M)	2005	2006*	2007*	Chg (FY06/07)
EBITDAR	18.6	28.6	44.1	54.4%
Leases	8.5	7.7	7.0	-8.9%
EBITDA	10.1	20.9	37.1	77.6%
EBITDA (margin, %)**	7.0%	13.3%	17.9%	45.8%
Before tax profit margin	6.3%	12.6%	14.7%	16.7%
Fuel % total cost*	14.5%	17.8%	18.3%	2.8%
Net asset per share (\$)	0.38	0.59	0.85	44.1%

Source: REX and Tricom Equities.

Notes: * For comparative purposes, Pel-Air's results have been excluded. ** Based on passenger revenue only.

FY07 Key Operating Statistics

Year ended June	2005	2006*	2007*	Chg (FY06/07)
Passengers ('000s)	1,038	1,195	1,416	18.5%
ASKs (M)	610	684	782	14.3%
Average fare (\$)	134.60	139.10	141.30	1.6%
Average fare (excl. fuel levy)	124.20	119.30	118.50	-0.7%
Load factor	65.40%	66.90%	68.30%	1.4% pts
Revenue/ASK (cents)	22.80	24.20	25.60	5.8%
Total cost/ASK (cents)	22.20	22.60	22.70	0.4%
Total cost/ASK (excl fuel) (cents)	19.00	18.60	18.60	0.0%

Source: REX.

Notes: * For comparative purposes, Pel-Air's results have been excluded.

It is hard to fault this result and it clearly shows the momentum the company is enjoying as it provides a first class regional air travel service at a bargain basement price. Excluding the fuel levy, average fares fell 0.7% to \$118.50 per one way ticket. Load factors again advanced and indicate capacity constraints that justify the company's earlier decision to lease a further 25 Saab 340B aircraft over the two years to FY09. The first of those new aircraft was delivered just before year end June.

Cashflow

Cash at year end was just under \$20M, after the company spent \$23.5M purchasing new planes. Moreover, in July, REX spent a further \$9.2M for four aircraft (signaled at its 3Q07 result's announcement), which (on the basis of lease costs of US\$37k each per month) will save the company a notional A\$2.2M per annum.

Cash from operations advanced 45% in the year.

Cashflow Statement

Year ended June (\$M)	2006	2007	Chg
Cashflow from operations	27.0	39.0	44.6%
Purchase of aircraft	-10.9	-23.5	
Purchase of other PPE	-7.3	-10.1	
Acquisition of subsidiary	-2.3	-5.0	
Acquisition of associate	-12.1	0.0	
Other	-0.4	2.2	
Net cash from/(used) in financing activities	-33.0	-36.3	10.0%
Cash and cash equivalents at year end	23.6	18.6	-21.1%

Source: REX and Tricom Equities

Subsidiaries

The result for Pel-Air was down by 13% (pre tax) due to unscheduled maintenance of one of its aircraft. This was noted in the first half results for FY07. That said, sales revenue advanced 11% and aircraft hours rose by 6.6%. Pel-Air is now a 100% owned by REX (the remaining 25% was acquired on 29 June 2007).

Pel-Air			
Year ended June (\$'000)	2006	2007	Chg
Sales revenue	32,811	36,451	11.1%
Profit before tax	6,004	5,224	-13.0%
Aircraft hours	16,329	17,400	6.6%

Source: REX.

Air Link (100% REX) had a spectacular year, with pre-tax profit up over 600% on passenger revenues rising by 48%.

Air Link			
Year ended June (\$'000)	2006	2007	Chg
Sales revenue			
Passengers	6,118	8,966	46.6%
Freight	45	55	22.2%
Charter	615	1,021	66.0%
Total	6,778	10,042	48.2%
Profit before tax	374	2,832	657.2%
Passengers (number)	42,021	51,592	22.8%
Average fare (\$)	146.00	174.00	19.2%

Source: REX.

2 | Outlook and valuation

The way forward

The company provided guidance for FY08 of 10% growth on the bottom line. Prior to this result announcement, we had forecast a 25% lift in NPAT this year. Our revised forecast for FY08 of \$29.4M NPAT maintains that same momentum – ~25% up on FY07. Our arithmetic is largely premised on organic growth, although we would not rule out possible opportunistic acquisitions as other smaller regional airline operators struggle. We also believe that with a toe in the water in Queensland, this may be a precursor to full submersion and that strategy would gain some critical leverage through a possible strategic acquisition.

We have become more circumspect in our dividend forecasts and kept the payout ratio at sub 30% (32% for FY07). We believe this is abnormally conservative and suggest it might be one area where REX may surprise on the upside. Nonetheless, as noted above, the company's posturing on distributions is possibly signaling a more aggressive growth strategy on the back of acquisitions.

Valuation

Our valuation of REX currently stands at \$3.15, 4% above our previous valuation. REX is currently on an EV/EBITDA multiple FY08 of 5.0X and 4.5X FY09. Moreover, it is on a PER of 9.9X FY08 and 8.7X FY09. And while investors may have some reservations about airlines, it is arguable that the discount to the market is a reality stretch and the gap must close.

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