

1 June 2007

BUY | \$2.73

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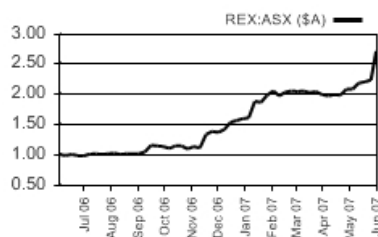
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Fully diluted shares
on issue | 116.5M
Market cap | A\$319.7M

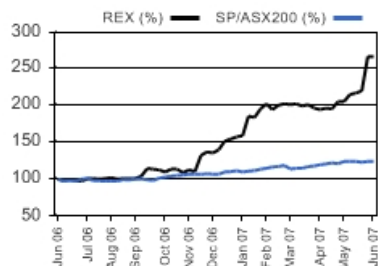
Performance & Valuation

Last Price | \$2.73
52 wk hi/low | \$2.88 / \$0.96
12 mth price target³ | \$2.98
Valuation | \$3.04
Valuation methodology | DCF

Share price performance



REX versus SP/ASX200



Regional Express Holdings Ltd | REX

3Q07 results – simply spectacular (again)!

Key points

- REX reported a very strong 3Q07 result on 30 May 2007.
- NPAT was up 52%%, on a lift in passenger revenue of 21%.
- Bottom line for the nine months was \$17.4M, 10% above the full year result for FY06.
- Pel-Air was down 6%, although revenue rose 16.7%. It was noted at the time of the 1H07 results that Pel-Air had some unusual engine maintenance costs which reduced earnings in 1H07 by about US\$0.6M (A\$0.8M).
- Passenger numbers advanced by 20%, average fares, excluding fuel surcharges, fell 1.8% (were also down 3.1% in 1H07) and cost per ASK (excluding fuel) rose 1.6% (against a lift in revenue per ASK of 7% [6.9% for 1H07]).
- The company has lifted guidance to 40% NPAT advance in FY07.

Comment

The results for 3Q07 were as good as they get and the 2.2% point increase in the load factor pushed REX almost to its capacity limit. This is a nice problem to have and will be redressed through an earlier decision to acquire a further 25 Saab 340B aircraft over the three years to FY09. The company maintains load factors at or below 70% per destination and when a route reaches this limit, it adds more planes and flight schedules.

The company has also decided to buy five planes that it currently operates under lease, saving \$1.5M per annum in FY08 and beyond.

Investment View

REX has \$22M sitting in cash and cash equivalents and expects this to reach \$26M by year end and prior to the acquisition of the five planes as their leases expire.

We made a number of adjustments to our future forecasts, notably in relation to the stronger cash position; plane purchases (after lease expiration which is accretive) and bullish forecast of future passenger volumes observed by the Chairman. Our valuation has also increased and our share price target now sits at a nudge under \$3.00. That figure rises to \$3.40 on a lower (and we would suggest very arguable) WACC of 10.5%.

Earnings Summary

Y/E Jun	2006A	2007F	2008F	2009F
Revenue - A\$M	169.7	198.0	271.4	302.7
EBITDA - A\$M	20.9	33.6	49.3	54.2
NPAT (reported) A\$M	15.7	22.4	28.1	32.4
NPAT (normalised) A\$M ¹	13.6	22.4	28.1	32.4
EPS (diluted) - cents ²	13.3	19.0	23.7	27.3
EPS (diluted) - % chg	82.1	43.2	24.7	15.3
PER (diluted) - x ²	20.6	14.4	11.5	10.0
DPS - cents	5.0	10.0	12.0	13.5
Dividend Yield - %	1.8	3.7	4.4	4.9
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 | 1 June 2007

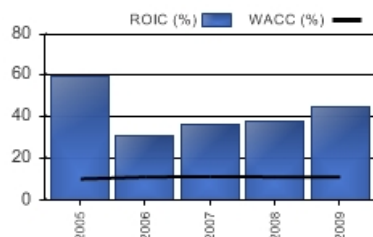


Valuation

Methodology: DCF¹

Key assumptions	
Beta	1.2
WACC %	11.3
Forecast period years	10.0
Risk premium %	5.5
PV cash flows \$M	343.8
less net debt/(add cash) \$M	(10.0)
add equity adjustments ²	0.0
Total	353.8
Fully diluted shares on issue M ²	116.5
Value per share \$	3.04

Return on invested capital



Ratio analysis

Year end Jun	06A	07F	08F
Revenue growth %	19.5	16.7	37.1
EBITDA growth %	107.7	60.7	46.7
EBITDA margin %	12.3	17.0	18.2
EBIT margin %	9.9	14.1	14.3
Tax rate %	35.5	30.1	30.0
ROA %	20.6	25.9	31.1
ROE %	24.6	28.9	30.1
Net debt/equity %	(34.3)	(21.6)	(27.6)
Net interest cover x	n/a	n/a	n/a
Capex to deprec'n %	172.7	84.2	65.4
NTA per share \$	0.59	0.77	0.78

Multiple analysis

Year end Jun	06A	07F	08F
Market cap \$M	320		
Net debt (cash) \$M	(10.0)		
Options \$M	0.0		
Enterprise value \$M	309.7		
EV/EBITDA x	14.8	9.2	6.3
EPS c	13.3	19.0	23.7
P/E x	20.6	14.4	11.5
Cashflow / Share c	26.4	23.5	34.5
Price / NTA x	4.6	3.6	3.5

Shares outstanding

Year end Jun	06A	07F	08F
Basic M	115.0	118.7	118.7
Other M	0.0	0.0	0.0
Fully diluted M	115.0	118.7	118.7

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	2007F	2008F	2009F
Profit & Loss Summary A\$M				
Operating revenue	169.7	198.0	271.4	302.7
Invest & other income	1.4	2.6	0.0	0.0
EBITDA	20.9	33.6	49.3	54.2
Depreciation/Amort	(4.2)	(5.7)	(10.4)	(10.1)
EBIT	16.7	27.9	38.9	44.2
Net Interest	0.9	1.2	1.3	2.2
Pre-tax profit	17.6	29.1	40.2	46.4
Tax expense	(6.3)	(8.7)	(12.1)	(13.9)
Minorities/Assoc./Prefs	2.2	2.1	0.0	0.0
NPAT	13.6	22.4	28.1	32.4
Non recurring items	2.1	0.0	0.0	0.0
Reported profit	15.7	22.4	28.1	32.4
add goodwill/non recurring	(2.1)	0.0	0.0	0.0
Adjusted profit	13.6	22.4	28.1	32.4
Cashflow Summary A\$M				
EBITDA	20.9	33.6	49.3	54.2
Working capital changes	3.7	(0.4)	0.5	0.0
Interest and tax	0.9	(5.1)	(8.9)	(10.8)
Other operating items	1.4	(0.5)	0.0	0.0
Operating cashflow	27.0	27.7	41.0	43.5
Required capex	(7.3)	(4.8)	(6.8)	(7.6)
Maintainable cashflow	19.7	22.8	34.2	35.9
Dividends/Other	0.0	(4.5)	(26.1)	(16.0)
Acq/Disp	(23.8)	(30.6)	(2.0)	0.0
Other investing items	(4.8)	3.5	0.0	0.0
Free cashflow	(8.9)	(8.8)	6.1	19.9
Equity	35.0	6.3	0.0	0.0
Debt inc/(red'n)	(7.0)	(1.2)	(6.1)	(19.9)
Balance Sheet A\$M				
Cash & deposits	23.6	19.8	25.9	45.7
Inventories	4.1	4.6	4.1	4.1
Trade debtors	8.6	8.5	8.5	8.5
Other curr assets	0.0	0.0	0.0	0.0
Total current assets	36.3	32.9	38.5	58.3
Prop., plant & equip.	45.6	74.1	72.5	70.0
Non-curr intangibles	0.8	0.8	0.8	0.8
Non-curr investments	14.3	15.1	15.1	15.1
Other non-curr assets	3.3	3.3	3.3	3.3
Total assets	100.3	126.2	130.2	147.6
Trade creditors	23.5	23.5	23.5	23.5
Curr borrowings	0.0	0.0	0.0	0.0
Other curr liabilities	6.5	9.5	11.5	12.4
Total current liab.	30.0	33.0	35.0	35.9
Borrowings	0.0	0.0	0.0	0.0
Other non-curr liabilities	1.5	1.4	1.4	1.4
Total liabilities	31.5	34.4	36.3	37.3
Minorities/Convertibles	0.0	0.0	0.0	0.0
Shareholders equity	68.8	91.8	93.9	110.3

Final results analysis & outlook

Regional Express Holdings Ltd | 1 June 2007



Year end Jun	2006A	2007F	2008F	2009F
Divisional Summary A\$M				
Revenue				
Division 1	169.7	198.0	271.4	302.7
EBITDA				
Division 1	19.6	31.0	49.3	54.2
Margin %				
Division 1	11.5	15.7	18.2	17.9

1 | Result detail

Comment

Rex produced a very strong 3Q07 result, which was spiced by bullish forecasts of continuing robust organic growth, significantly more cash than we had estimated and doubling of this year's FY guidance to 40% above NPAT for FY06. A full set of numbers are not typically available from these briefings, although the company's key financial arithmetic and operating statistics are as below:

3Q07 results

Nine months to 31 March	3Q06 (\$M)	3Q07 (\$M)	% change
Passenger revenue	122.1	148.2	21.4%
Total revenue	127.2	153.3	20.5%
Fuel cost	19.5	24.2	24.1%
Other costs and expenses	92.6	107.3	15.9%

Source: REX and Tricom Equities.

FY06 Key Operating Statistics

Nine months to 31 March	3Q06	3Q07	% change
Passengers ('000s)	872,225	1,045,071	19.8%
ASKs (M)	505	573	13.5%
Average Fare (\$)	140.00	141.80	1.3%
Average Fare (excl. fuel levy)	120.90	118.70	-1.8%
Load Factor	66.3%	68.5%	2.2% pts
Revenue/ASK (cents)	24.20	25.90	7.0%
Total cost/ASK (cents)	22.20	23.00	3.6%
Total cost/ASK (excl fuel) (cents)	18.40	18.70	1.6%
Total cost/ASK (excl fuel and employee profit share) (cents)	18.20	18.40	1.1%
Fuel % total costs	17.3%	18.4%	1.1% pts
PBT margin	13.3%	15.6%	2.3% pts

Source: REX and Tricom Equities

It is hard to fault this result and it clearly shows the momentum the company is enjoying as it provides a full class regional air travel service at a bargain basement price. Excluding the fuel levy, average fares fell 1.8% to \$118.70 per one way ticket and the Choice Magazine accolade as best airline in Australia, as rated by its passengers, shows a very high level of satisfaction amongst its core traveling base.

We understand that cash is around \$22M at present and predicted to be \$26M by year end, before the possible acquisition of four aircraft for \$10M. These aircraft are currently on leases which are costing US\$37,000 each per month and suggest cash savings of around \$2.7M per annum. The benefit from this shift to owning the aircraft is around a net post tax positive of \$1.5M (after adjusting for opportunity cost and higher depreciation) per annum from FY08 and beyond.

The only possible negative was the statement that the NSW Government is reviewing sole operator routes in NSW, some of which REX currently has a licence to operate. The key kpi is 50k or fewer passengers per annum per route to maintain the sole operator status for that route. That said, the company's own submission has requested that all routes be opened to competition and that no sole operator licenses be maintained on any route.



As REX observed, no other carrier can match its cost base and the economics, even with passenger numbers double the NSW bar, are unsustainable for two carriers. Thus, it opines, the monopoly status on these routes is fundamentally irrelevant.

2 | Outlook and valuation

The way forward

The company upgraded its guidance from 20% upside this year over the pcp to 40%. We have made a small adjustment to this year's earnings (down by 4.7% to \$22.4M) and have upgraded our future forecasts. Notably, the cash position; plane purchases (after lease expiration) and bullish forecast of future passenger volumes have provided the catalyst for our more optimistic future earnings' expectations:

- We have lifted FY08 bottom line by 25%; and
- FY09 has been increased by 15% to NPAT of \$32.4M.

Valuation

Our valuation of REX currently stands at \$3.04, 35% above our previous valuation. This is due to:

- Our revised forward earnings (noted above); and
- Our revised up current cash position (we had assumed no cash on hand as at 30 June and now believe it will be closer to \$20M).

This is in spite of our WACC rising to 11.3% from 11.2% and, we would suggest, is arguably too high, given the clinical execution of the business strategy since listing and generally improved fundamentals of the local (and global) airline industry. On a more reasonable assumption of 10.5% discount, our valuation rises to just under \$3.40.

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

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