WHIreland

20 October 2009

EMERGING COMPANIES RESEARCH

MARKETING COMMUNICATION

MORNING COMMENT

Buy
Unchanged

Price	10p (S¢22.8)
Target price	12p
Reuters/BBG	SKYW.L / SKYW LN
Index	FTSE AIM
Sector	Transport
Market Cap	£19m (S$44m)

*WH Ireland acts as Broker and Nomad. This document has not been prepared in accordance with legal requirements designed to promote the independence of investment research.

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Skywest Airlines*

Preliminary Results: strong H2 performance reverses H1 loss

- **For the year ended 30 June 2009 (FY09), Skywest reported revenue of S$180.9m upon which pre-tax profit of S$5.1m was earned.** The comparable figures for FY08 were S$184.2m and S$12.8m respectively. Note that our presentation treats dividends received as financial income rather than revenue. **This is a particularly impressive result in the circumstances and it more than reverses the pre-tax loss of S$2.5m incurred in the first half.**

- Management had to contend with several adverse factors during the year including worsening economic conditions, a significant drop in the value of the Australian dollar against the US dollar and the impact of escalating fuel prices earlier in the period when oil reached US$140 per barrel. **It was mainly currency factors and fuel costs that lay behind the H1 loss. In response, management shifted the strategic focus from pursuit of growth to fiscal conservatism.**

- The operating statistics show that passenger numbers on scheduled regional services fell by 9.9% from 387,000 to 349,000. Revenue passenger kilometres declined by 1.5% from 317.9m to 313.2m. This compares with an increase in available seat kilometres of 0.9% from 562.0m to 566.9m, consistent with a decline in load factor from 56.6% to 55.3%. **The star of the show was charter services with Skywest operating 2,614 charter flights in FY09 compared to 1,566 in FY08. For the year under review, charter revenues climbed to over 50% of group income.**

- **For the year as a whole, gross margin increased from 52.1% to 55.7% but operating margin was held back primarily by the increased rental cost of aircraft.** Before rental costs on leased aircraft and depreciation costs (mainly relating to owned aircraft), the EBITDAR margin fell from 20.4% to 20.1%. Rental costs rose from S$15.0m to S$20.0m (8.1% of sales to 11.0%) with three more aircraft being operated. After these costs, the operating margin fell from 6.7% to 2.9%. Included within operating expenses, cross hire costs were higher than they might have been because fleet growth was held back in response to the economic climate. Thus the airline has not always deployed as many aircraft as it was potentially able.

Y/E June	2008A	2009A	2010E	2011E
Sales (S$m)	184.1	180.9	185.0	200.0
PTP (S$m)	12.8	5.1	5.8	8.6
EPS (S¢)	4.6	1.6	1.8	2.7
P/E (x)	4.9	14.3	12.4	8.4
DPS (S¢)	2.5	1.0	1.0	1.5
Dividend Yield (%)	11.0	4.4	4.4	6.6

Source: WH Ireland estimates

- In the event, **operating profit fell by 57.8% from S$12.3m to S$5.2m.** With lower average cash balances during the year, a small net interest charge was incurred (compared to interest receivable in FY08) with the result that **group pre-tax profit fell by 59.7% from £12.8m to £5.1m.**

- Weighted shares in issue was slightly lower as a result of buying back 4 million shares for cancellation and 1 million for Treasury. But the effective tax rate rose from 27.9% to 38.2%. In consequence, **basic EPS declined by 65.3% from S¢4.61 to S¢1.60. Fully diluted EPS fell by 64.3% from S¢4.34 to S¢1.55.** A final dividend of S¢1.0 is proposed.

- **Looking beyond the current economic and financial crisis – and it is worth recording that Australia has been much less affected than other developed economies – management sees huge growth potential for Western Australia.** This is particularly true in light of recent announcements of massive resource development such as the A$50bn Gorgon Gas Project where Skywest expects to benefit from a significant increase in capacity. Gorgon is set to produce a significant infrastructure and employment spin-off for WA over the next three decades and will be Australia's largest ever resources development. Skywest already flies the bulk of employees to the region under its existing 'fly-in fly-out' charter contracts on behalf of various mining customers and is also the primary provider of air travel to the North West Shelf's major service hubs such as Karratha and Exmouth.

- **Scheduled 'fly-in fly-out' contracts provide strong baseline recurring revenues. Skywest is well placed to capture more such business in WA and is tendering for various other charter contracts.** The airline has acquired another Fokker 100 jet, which is slated for operating additional charter services. Initially, the aircraft has been purchased outright costing US$5m cash including refurbishment costs and securing regulatory approval. Once commissioned, it is likely that a sale and leaseback deal will be signed. The aircraft will lower Skywest's costs for the cross hire of aircraft from other airlines and increase the fleet to 16 aircraft.

- Skywest also continues to provide conventional airline services to all of the major airports in Western Australia and beyond. This regular airline business for the general flying public continues to grow within a relatively stable environment. **The scheduled route network continues to expand.** During the period, the Government extended the Airline's exclusive licence for the Coastal Network of Western Australia.

- **Looking to the immediate future, we believe a year of consolidation is in prospect, as global economic conditions begin to ease, before reasonable growth returns in FY11.** For its part, management too anticipates "a slow down in the rate of growth due to the global crisis of confidence in the broader economy associated with the credit institutions". Rapid changes in exchange rates and fuel costs still represent a significant risk to the business but recent trends have been benign with the strengthening of the Australian currency and lowering of oil prices. Moreover, agreement has been reached with the workforce providing labour cost certainty to the group for 1 year in the case of pilots and 3 years for engineers.

- **Based on 10x estimated earnings for FY11, we maintain a target price of S¢27 (currently circa 12p) giving upside potential of about 20% in the share price.**

Disclosures

WH Ireland Recommendation Definitions

Buy
Expected to outperform the FTSE All Share by 15% or more over the next 12 months.

Outperform
Expected to outperform the FTSE All Share by 5/15% over the next 12 months.

Market Perform
Expected to perform in line with the FTSE All Share over the next 12 months.

Underperform
Expected to underperform the FTSE All Share by 5/15% or more over the next 12 months.

Sell
Expected to underperform the FTSE All Share by 15% or more over the next 12 months.

Speculative Buy
The stock has considerable level of upside but there is a higher than average degree of risk.

Share Price Target
The share price target is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon.

Stock Rating Distribution
As at the quarter ending 30th September 2009 the distribution of all our published recommendations is as follows:

Recommendation	Total Stocks	Percentage %	Corporate
Buy	32	35%	7
Speculative Buy	11	12%	11
Outperform	21	23%	3
Market Perform	19	20%	2
Underperform	8	9%	0
Sell	1	1%	0
Total	92	100%	23

This table demonstrates the distribution of WH Ireland recommendations. The first column illustrates the distribution in absolute terms with the second showing the percentages.

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