

9th February 2010

Recommendation

Buy

MARKET DATA

6 month vol	5.1m
12 month share low	\$0.23
12 month share high	\$0.305
Market Risk	High
Liquidity Risk	Medium
Infrastructure Risk	Medium
Country Risk	Low

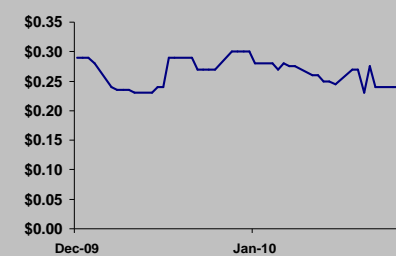
IRESS & DJC Research

ISSUED CAPITAL

Reuters/BBG	SXR:ASX
ASX	SXR
Share price	\$0.24
Mkt cap. ¹	\$47.9m
Ordinary shares on issue	199.6m
Options ²	3.04m

¹ Undiluted Source: IRESS
² Unlisted

RECENT PERFORMANCE



Source: IRESS

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Skywest Airlines Ltd (SXR)

Update & Upgrade on Recent Performance & Business Development

SXR, headquartered in Singapore, is the holding company for the major regional scheduled and charter airline operating in Western Australia. Since 8th December 2009, the shares have been quoted on the Australian Stock Exchange in addition to London's Alternative Investments Market. Results for the six months to December 2009 are due to be released in late February. We expect these to have benefited from the strength of the charter services undertaken for companies operating in the Western Australian (WA) resources and mining sector. As a consequence, we expect the company to post a half-year profit compared to the H1 loss incurred in the previous year.

Key Points

- The H1 operating statistics for scheduled regional services show that passenger numbers fell by 6.6% from 195,000 to 182,000. Revenue passenger kilometers declined by 5.6% from 155.7m to 147.0m. This compares with a greater decrease in available seat kilometres of 10.4% from 294.4m to 263.9m as resources were switched to the buoyant charter sector. Load factor rose from 52.9% to 55.7%. This is well above the level at which Skywest breaks-even (circa 48%).

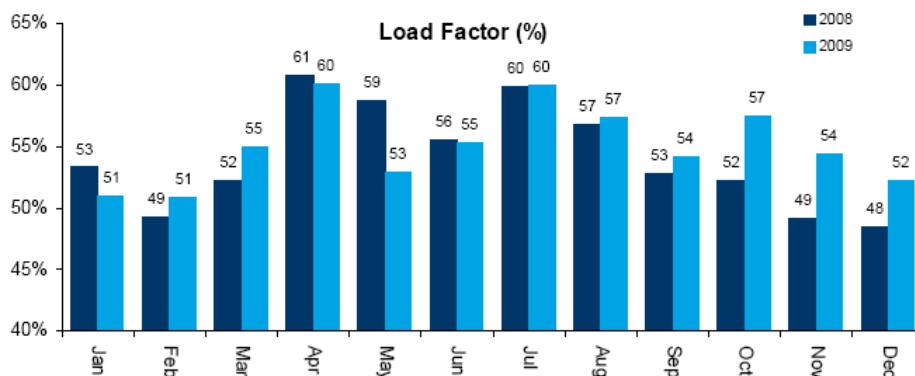


Fig 1: Load Factor

Source: WHI-Ireland

Y/E June	2009A	2010E OLD	2010 NEW	2011 OLD	2011E NEW	2012 E
Sales (S\$m)	180.9	185.0	190.0	200.0	205.0	220.0
PTP (S\$m)	5.1	5.8	7.2	8.6	10.2	13.3
EPS (Scents)	1.6	1.8	2.3	2.7	3.2	4.2
PE (x)	19.0		13.3		9.4	7.2
DPS (S cents)	1.0	1.0	1.2	1.5	1.6	2.1
Dividend Yield (%)	3.3		3.9		5.3	6.9

Fig 2: Investment summary

Source: WH-Ireland

- The main performance driver has again been charter services where Skywest operated 1,431 flights compared to 1,222 in the comparable period of last year. Charter revenues now represent around 60% of group income and these are derived from long-term contracts with major mining companies. By way of example, Skywest has contracts with Newcrest for 2-3 flights per week to Telfer, with Portman Iron for 5 flights week to Windarling mine, with Fortescue for at least 6 flights week to Cloudbreak mine and with Rio Tinto for over 15 return flights week to West Angelas and Barimunya.

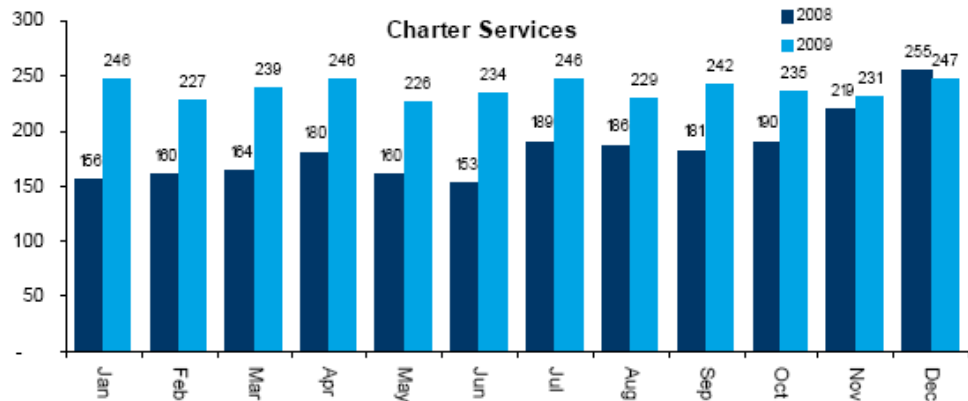


Fig 3: Charter Services

Source: WH-Ireland

- Residual revenues are derived from scheduled regional services to and from WA destinations where the long-term macro driver is the mining and resources investment cycle. Skywest has seen above average growth over last five years, as indeed has WA traffic, compared to the overall market. According to the Bureau of Infrastructure, Transport and Regional Economics (BITRE), the five-year CAGR of regional traffic in WA has been 13.7% versus the overall Australian market of 9%. In FY08, regional growth was 15.1% -v- 7% overall.
- Future market forecasts, again from BITRE, continue to favour the resource rich states of WA and Queensland. Perth is expected to continue leading the growth in hub airports with projections of passenger number growth rising from 7.1m in 2006 to 17.7m in 2026 (CAGR of 4.7%). This projection is underpinned by the rapid growth in intrastate traffic.

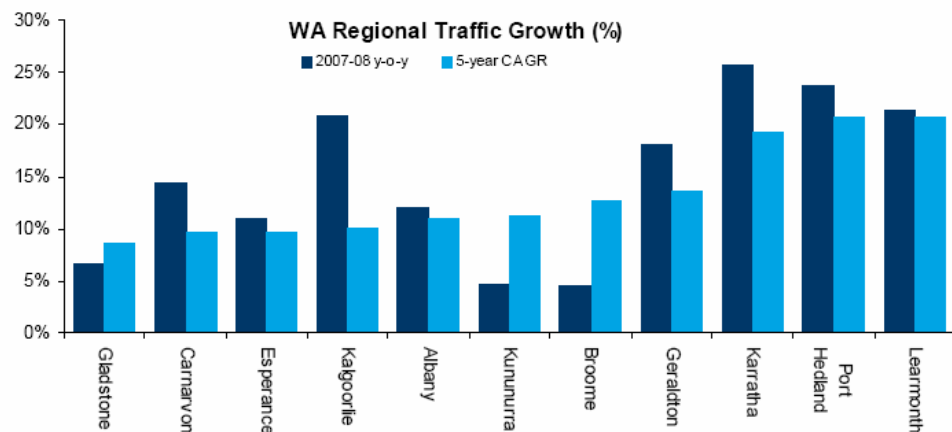


Fig 4: WA Regional Traffic Growth

Source: WH-Ireland

- In November, Skywest agreed the purchase of an additional Fokker 50 aircraft from a European owner for US\$2.01m. The consideration will be met over the subsequent 19 months from internal cash flow. The acquisition will increase Skywest's fleet to 17 aircraft and potentially lower the ongoing costs for the cross hire of aircraft from other airlines. The additional F50 will also be used for freight delivery in Western Australia.
- A new financing arrangement was completed in December allowing Skywest to draw down a US\$4.0m Aircraft Acquisition finance facility from a subsidiary of a major UK bank. The facility was used to secure finance for the acquisition of a ninth Fokker 100 jet, which was announced in August 2009. Originally this aircraft was to be funded over 6 months from cash flows. This vendor finance facility for US\$4.05m has now been repaid ahead of schedule. The new facility has a term of 60 months with an annual interest rate of 6.2%.
- The average age of the remaining fleet of Fokker aircraft is 18½ years as shown in the following table.

<u>Model</u>	<u>Year Built</u>	<u>MTOW</u>	<u>Type</u>	<u>Engines</u>	<u>Registered Owner</u>
F50	1991	20,820kg	Turboprop	2 x P&W	Skywest Airlines Pty Ltd
F50	1990	20,820kg	Turboprop	2 x P&W	Skywest Airlines Pty Ltd
F50	1987	20,820kg	Turboprop	2 x P&W	Skywest Airlines Pty Ltd
F50	1987	20,820kg	Turboprop	2 x P&W	Skywest Airlines Pty Ltd
F50	1987	20,820kg	Turboprop	2 x P&W	Skywest Airlines Pty Ltd
F50	1987	20,820kg	Turboprop	2 x P&W	Skywest Airlines Pty Ltd
F50	1987	20,820kg	Turboprop	2 x P&W	Skywest Airlines Pty Ltd
F100	1995	43,090kg	Turbofan	2 x R-R	Capital Lease Aviation
F100	1994	43,090kg	Turbofan	2 x R-R	F100 Pty Ltd
F100	1994	43,090kg	Turbofan	2 x R-R	F100 Pty Ltd
F100	1993	43,090kg	Turbofan	2 x R-R	F100 Pty Ltd
F100	1992	43,090kg	Turbofan	2 x R-R	F100 Pty Ltd
F100	1991	43,090kg	Turbofan	2 x R-R	Capital Lease Aviation
F100	1991	43,090kg	Turbofan	2 x R-R	Capital Lease Aviation
F100	1991	43,090kg	Turbofan	2 x R-R	F100 Pty Ltd

Fig 5: Current fleet

Source: WH-Ireland

- This month, the Kalgoorlie to Melbourne service will be reinstated. Operation on this route had temporarily ceased because the aircraft was required for other services. With the entry into service of the new F100 aircraft, this route can again be operated.
- Skywest has also commenced due diligence on an Airbus A320-200 for lease. This is for potential use on charter operations for the mining sector, potentially involving expanded operations to and from the Pilbara region.
- In line with the objective to manage fuel cost risk, Skywest purchases fuel hedges from time to time. Recently it entered into a cashless collar in respect of 25% of its overall fuel requirements at current spot market rates for the first six months of 2010.
- Skywest has continued to make periodic buy-backs of its own capital. So far this year, 3m shares have been repurchased for Treasury with 3.6m new shares issued for options exercised. The issued share capital is now 195.6m with 4m held in Treasury.
- At the outset of FY10, we expected a year of consolidation, fearing that Australia might not be immune to the global financial crisis. In the event, it has been one of the few economies

to emerge relatively unscathed from the mayhem. Meanwhile, the WA resources and mining sector has remained very strong. The macro background for Skywest is, therefore, better than we envisaged. In addition, the upward trend in fuel cost has been mitigated by the strength of the Australian dollar. Also labour cost certainty has been cemented through agreements with the pilots and engineers.

- These factors lead us to believe that our original estimates were overly conservative and we are taking the opportunity to raise these ahead of the Interim Results. The corresponding enhancements to EPS are 24.4% (FY10) & 17.9% (FY11), albeit from low bases. We have also added a longer range forecast for FY12 when we believe the business will see its profitability restored to levels last seen in FY08.
- **To arrive at a target share price, we have capitalised these earnings at the average prospective multiple of two comparator companies quoted on the UK Stock Exchange: Easy Jet and Ryan Air. We have taken consensus forecasts and normalised each to a June 2011 year-end. On this basis, we attribute a valuation of (Singapore) S\$46.7 per share (EPS of S\$3.2 capitalised on a PER of 12.4), currently equivalent to approximately 21p per share or \$AUD 0.38 (at AUD/SGD 1.23). This is a premium of over 50% to the current share price and we therefore reiterate our 'Buy' recommendation.**

Disclosure**RCAN0859**

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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.

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