

27th August 2009

Skywest Airlines*

Research Update – reiterate ‘Buy’ at 8.625p; Target Price 32.5p

On 20th August Western Australia’s largest regional airline, AIM-listed Skywest, announced that it expected to benefit from a significant increase in capacity following the A\$50 billion Gorgon gas project deal, which is to represent Australia’s largest ever resources development. The company already flies the bulk of employees to the Western Australia region under existing charter contracts on behalf of various mining customers and Gorgon is “*expected to lead to a significant infrastructure and employment boon for Western Australia over the coming decades*”. Even before this improvement in outlook, Skywest’s position at the heart of a strong resources sector with significant growth prospects looked to not be reflected in the share price and at 8.625p, with the company capitalised at £16.78 million, trading on a prospective price earnings multiple of less than 3, yielding more than 8% and with £10.99 million of net tangible asset backing at the last balance sheet date, our stance remains **buy**.

Key Data

EPIC	SKYW
Share Price	8.625p
Spread	8p – 9.25p
Total no of shares	194,500,000
Market Cap	£16.78 million
12 Month Range	2.625p – 13.75p
Market	AIM
Net Cash	A\$7 million (est.)
Website	www.advent.com.sg
Sector	Travel & Leisure
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Skywest represents a different proposition from other UK quoted airline operators – with it flying various passenger routes within Western Australia which are operated under an exclusive State Government licence as well as having secure earnings from multi-year charter contracts with, typically major, resource companies. In particular, these enable it to pass fuel price changes onto its customers and with regular passenger airlines having been in well publicised turmoil as a result of deteriorating economic conditions and fuel price volatility, Skywest’s dual business model has and continues to come into its own. For the year ended 30th June 2009 regular passenger numbers were down 10% compared to the prior year, but the charter business continued to thrive – with charter services 67% ahead. The ability of the company to combine regular and scheduled charter passengers on the same flight (in line with Western Australian Government policy and a valuable proposition to resource sector clients which are required to support local communities) as well as to redeploy its assets between the two segments as necessary enables comparatively high levels of efficiency.

Looking forward, Skywest's strategy is focussed on growing both its regular passenger transport and scheduled charter businesses. As well as the anticipated boost from Gorgon, the company continues to see the Western Australia tourism industry as a growth opportunity and on the scheduled charter side can be expected to continue to aggressively pursue long-term contracts as and when they become on offer. Its ability to do so should be further enhanced by the anticipated near-term introduction of an integrated Global Navigation Satellite System which should save time and fuel, enhance safety and schedule reliability and allow operation at night to certain mining related airports that would otherwise be impossible. Skywest understands that it will be the first operator to have such facilities in operation in Australia.

Despite the operating climate, Skywest announced both an expansion of its route network and increase in the frequency of some existing services in March and in the 20th August announcement revealed it is considering further expansion of the route network to facilitate requirements due to the Gorgon Project. Earlier this month the company had already announced an agreement to acquire a further jet aircraft, noting *"significant growth opportunities in the mining and resource sector all over Western Australia"*. There are risks to consider along with this positive outlook; including further economic deterioration and/or significant commodity price declines as well as rising fuel costs affecting the company's regular passenger business in particular. However, the signs are now of economic stabilisation rather than further decline and a transparent fuel levy policy is operated in the pricing of tickets to the general public, which to an extent mitigates fuel cost issues.

Despite the challenges of the past year, we believe Skywest will have remained comfortably profitable in the year to 30th June 2009 and for the current year believe a pre-tax profit of Singapore\$21 million and earnings per share of 3.25p are achievable. Considering the company's strategic position we continue to believe a current year price earnings multiple of at least 10 is warranted – suggesting a target price of 32.5p. At the current 8.625p, despite strong balance sheet support, the shares trade on a lowly 2.7 times forecast earnings and yield more than 8%. Management has shown its view of the value the market has been attributing to the company, having bought back 5 million shares for £327,000 so far in calendar 2009, with Executive Chairman Jeff Chatfield and Non-Executive Director John Jost also having added to their shareholdings in the company and taking them to 16.04% and 1.85% respectively. Additionally, hoping to address its valuation, the company announced in May that whilst it remained committed to AIM it was considering a dual listing in Australia. This would almost certainly give the shares a boost as new Australian investors come in – comparable Australian listed companies trade on high teens ratings - but in any case at anywhere around current levels we consider Skywest shares, based on fundamentals, a clear **buy**.



Forecast Table:

Year to 30th June	Turnover (\$ million)	Pre-tax Profit (\$ million)	Earnings Per Share (p)	Price Earnings Ratio	Dividend Per Share (p)	Dividend Yield (%)
2007A	130.49	12.70	1.21	7.1	0.70	8.1
2008A	184.20	14.48	1.82	4.7	0.48	5.6
2009E	175.0	8.00	1.20	7.2	0.66	7.7
2010E	190.0	21.0	3.25	2.7	0.70	8.1

*Skywest Airlines is a corporate client of Bishopsgate Communications, which is owned by Rivington Street Holdings, the ultimate owner of GE&CR. The SF t1ps Smaller Companies Growth Fund, operated by another subsidiary of Rivington Street Holdings, owns shares in Skywest.

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