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Skywest Airlines* -Update - Reiterate 'Buy' at 16.5p; Target Price 32.5p

Since we commented on Skywest Airlines* following the company's interim results in February, Western Australia's largest regional airline has reported a further five months of increased regular passenger numbers. The company has additionally announced it is to provide services under a further scheduled charter deal, has leased another aircraft and has extended the licence period for the coastal network licence it operates. We highlight some pertinent risks but consider the current earnings prospects and balance sheet to merit a near 100% uplift in the share price to 32.5p. Currently at 16.5p, our stance remains **buy**.

For the year to 30th June the company has reported a 1.61% increase in regular passengers carried and a 9.04% increase in charter services flown. Load factor, the company's calculation of which does not include charter passengers, has improved from 51.59% to 54.31%. This performance provides the backdrop for some of the other announcements Skywest has made since its 22nd February interim results announcement.

On 10th March Skywest announced a scheduled charter agreement with CITIC Pacific Mining, the majority shareholder of which is large, diversified Chinese state-owned enterprise, CITIC Group. This is for services between Perth and Karratha and provides for anticipated revenue to Skywest of Australian \$10.4 million for the initial one year term, with a term extension option available, scope and revenue to potentially increase should additional services be required and the deal subject to monthly fuel rise and fall calculations. The agreement is significant (Skywest's revenue in the six months ended 31st December 2009, for example, was A\$87.04 million) and also allows 10% of seats to be sold to regular travelling members of the public. This latter point also highlights how Skywest is differentiated from typical airlines – with its 'dual' business model enabling it to boost efficiency and being in-line with government transport policies.

This accordance with transport policies has undoubtedly helped the company gain an extension to its coastal network licence – the destinations on which are subject to periodic tendering and review. Skywest's licence has been extended to 27th February 2011, with a Western Australian Government review of Intrastate Airservice Arrangements expected to lead to various requests for

Key	Data
EPIC	SKYW
Share Price	16.5p
Spread	16p – 17p
NMS	10,000
Total no of shares	199,600,000
Market Cap	£32.9 million
12 Month Range	6.25p – 21.5p
Market	AIM
Website	www.skywest.com.sg
Sector	Travel & Leisure
Contact	Jeff Chatfield Executive Chairman 07783 942553

proposals and Skywest to, once again, participate in this process. The periodic tendering and review for destinations on the coastal network of Western Australia does mean a degree of risk to Skywest. However, the airline has been providing services in Western Australia for 46 years, offers – as mentioned - the ability to combine regular passenger and charter services in line with government policy and also continues to provide a strong service – being, for example, the leading Australian airline for on time departure punctuality in February according to The Australian Government's Bureau of Infrastructure, Transport and Regional Economics. Skywest thus looks impressively strongly positioned and talks of seeking “the opportunity to extend and increase the services and destinations in its network within the regulatory framework”.

Skywest's location of operations means that the company's performance is particularly linked to the resources industry – with its main charter clients being the major mining operators in Western Australia. Whilst we continue to believe the broad sector outlooks remains positive, a further potential risk to Skywest is the well-documented proposed changes in the Australian resources sector tax regime. However, since initially announced, the proposed changes have been altered in a way that has “encouraged” major miners BHP Billiton, Rio Tinto and Xstrata - and we do not believe the Australian government would want to cause too much disruption to an industry which is critical to the country's economy.

As we noted in our analysis of Skywest's February interims, the company's strong performance suggests our forecasts of a pre-tax profit of Singapore \$21 million and earnings per share of 3.25p may prove conservative. However, even on these numbers, the shares, at their current 16.5p, trade on an earnings multiple of little more than 5.1. Though a couple of pertinent risks have been highlighted, we still see by far the most likely course is that Skywest grows robustly in the next few years fuelled by continuing demand for commodities. As such, we maintain that an earnings multiple of 10 and resultant 32.5p share price remain more than merited. We note that Chairman Jeff Chatfield and Non-Executive Director John Jost sold shares on 16th April but they retain 16.08% and 1.91% of the issued share capital respectively, clearly aligning their interests with those of shareholders. Together with the company's strong cash generation, a solid balance sheet and potential dividend yield of more than 4.2%, our stance remains **buy**.

Forecasts Table

Year to 30th June	Turnover (\$million)	Pre-tax Profit (\$million)	Earnings Per Share (p)	Price Earnings Ratio (x)	Dividend Per Share (p)	Dividend Yield (%)
2008A	184.20	12.75	1.97	8.3	0.6	3.6
2009A	180.85	5.14	0.68	24.3	0.4	2.6
2010E	220.00	21.00	3.25	5.1	0.7	4.2

Source: Company and Growth Equities & Company Research

***Skywest Airlines is a corporate client of Bishopsgate Communications, which is owned by Rivington Street Holdings, the ultimate owner of GE&CR. The SF f1ps Smaller Companies Growth Fund, managed by another subsidiary of Rivington Street Holdings, owns shares in Skywest.**



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