

**BUY**

Price **23p**  
Target Price **41p**

Reuters/BBG SKYW.L / SKYW LN  
Dual List: ASX SXR.AX  
Index FTSE AIM  
Sector Travel & Leisure  
Market Cap £46m  
Shares in Issue 200.04m  
NAV 17.8p  
Quick Ratio 0.9x  
Dividend Cover 4x  
Forecast sensitivity High

**Performance vs AIM**  
1 month: -8%  
3 months: +1%  
12 months: -15%  
**High/Low (p)** 33½ - 20½

**Key Data:**  
EPS CAGR 2-year 33%  
ROCE (FY1) 22%  
Aircraft in fleet 19

**Last Results** Prelims: Aug 11  
**Next Results** Interims: Feb 12  
**Next Event** Monthly operating stats



Source: Fidessa

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\* WH Ireland acts as broker and NOMAD  
# WH Ireland makes a market in this company

**Marketing Communication**

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**Skywest Airlines\*#**

**Commencement of live flights for Virgin Australia**

**Skywest Airlines (Skywest), named this month as International AIM company of the year, has recently taken delivery of its 3<sup>rd</sup> ATR 72 aircraft to be Virgin Australia branded under its wet-lease with the carrier. The first passenger flights under the agreement started 17 October 2011 although our current year forecasts assume only a modest contribution from the roll out. Encouragingly, Q1 operating stats showed a 17.7% increase in charter services flown and an improving load factor for scheduled services. Notwithstanding continuing high jet fuel prices and the potential fall out of an Australian Carbon Tax in FY2013, we believe the shares offer excellent value at just 5.1x current year earnings with a dividend yield of 4.9%. We reiterate our BUY stance and target price of 41p equivalent to 9x FY2012 earnings.**

Over the last six financial years the company has grown its revenue base by more than threefold and doubled earnings per share. Even in FY2011, in the face of record high fuel costs and significant one-off exceptional charges, Skywest managed to deliver earnings per share growth of 4% to 4.9¢. The non-recurrence of these costs and strong organic growth drivers give us confidence in our 2012 forecast of 8.1¢, an increase of 65%.

Skywest is a leading provider of charter services for the Fly-in Fly-out (FIFO) mining/LNG industry in Western Australia. With a project investment pipeline of up to A\$300-billion, the WA resources boom has a strong growth profile despite the global macroeconomic outlook.

The Australian Regional Airline Network (ARAN) with Virgin Australia could see Skywest more than double the size of its fleet at no capital cost, and with relatively little exposure to fluctuation in jet fuel prices. The network provides code sharing opportunities and a competitive edge when competing for charter contracts.

However Skywest is still subject to margin erosion from continuing high fuel prices on its own routes. We highlight this as a key risk to profits alongside the implications of an Australian carbon tax, a deterioration in the demand for minerals and metals from Western Australia and the usual generic risks associated with airline operations such as natural disasters.

We believe the shares offer excellent value at just 5.1x current year earnings with a dividend yield of 4.9%. We reiterate our BUY stance and target price of 41p equivalent to 9x FY2012 earnings.

Y/E June	2010A	2011A	2012E	2013E
Sales (\$m)	215.2	239.9	290.0	356.9
Pre-tax profit (\$m)	14.0	13.6	26.0	31.0
EPS (S¢)	4.7	4.9	9.1	10.9
P/E (x)	9.8	9.3	5.1	4.2
DPS (S¢)	1.2	1.2	2.3	2.7
Dividend Yield (%)	2.6	2.6	4.9	5.9

Exchange rate: S\$2:£GBP

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## Investment Case

This deal potentially doubles the size of Skywest's fleet...

### **Australian Regional Airline Network (ARAN) with Virgin Australia.**

In January 2011 Skywest announced that it had entered into an exclusive 10 year strategic alliance with Virgin Blue Group, since renamed Virgin Australia (Virgin) to service regional Australia, operating up to 18 new Virgin branded aircraft to a number of existing and new destinations around Australia and potentially doubling the size of Skywest's existing fleet. The agreement also includes the ability for Skywest to code-share on Virgin's domestic network.

...at little or no additional capital cost

Skywest will provide "wet-lease" services to Virgin. In accordance with industry standards for wet-leases, Skywest will provide the complete crew, maintenance and insurance for each aircraft to Virgin. Virgin will pay Skywest by the number of flight hours operated for each aircraft. Virgin will provide all fuel and covers all airport fees, duties and taxes. Virgin will also pay the operating lease on the planes hence eliminating Skywest's exposure to the capital investment of owning the aircraft.

The new aircraft will offer greatly improved fuel efficiency

It is intended that the planes in the Alliance will be brand new twin prop ATR 72s manufactured in Toulouse France. These planes are intended to progressively replace Virgin Australia's E-170 regional jets while enabling the introduction of new services and additional frequencies on existing routes. The new ATR aircraft are configured with 68 new-generation seats. They offer 60% better fuel efficiency than a typical regional jet hence improving margins on existing routes and bringing into play routes that would have been previously economically unviable. We therefore believe that it is in Virgin's interest to fully implement the ARAN as soon as is practical, with the main brake on the pace of the roll out being the speed at which the manufacturer can effect delivery.

We expect new aircraft delivery on a regular basis over the next two years

Skywest took delivery of the first ATR 72 in August and is expected to have received a total of four by the end of calendar year 2011 and at least a further four by the end of calendar year 2012. Services using the aircraft commenced in October 2011, and the first routes serviced include:

- Double daily week-day return Brisbane to Gladstone;
- Daily return Brisbane to Port Macquarie;
- Double daily Sydney to Port Macquarie; and
- Up to six daily return services between Sydney to Canberra

The agreement strengthens Skywest's competitive position

As well as a completely new revenue stream the alliance will provide significant synergies for Skywest to leverage its existing corporate travel offer for the resources sector and to charter clients across Australia and internationally. The new routes will bring the Eastern side of Australia into play for Skywest increasing the amount of entry points into its route network, and allowing workers to be flown in from more destinations. This will increase Skywest's competitive edge when competing for large FIFO contracts.

Over Q1 2012 the number of charter services flown have increased 17.7%

### **Charter market**

In FY2011 more than half of Skywest's revenues were generated by charter services, most of which service the fly-in fly-out (FIFO) workforces of natural resource operations. According to the The Chamber of Minerals and Energy (CME), the WA resources sector employs close to 90,000 people with approximately 52 per cent or 46,800 employed on FIFO rosters. The workforce has approximately doubled over the last five years and CME's State Growth Outlook predicts this figure to increase as more employees choose FIFO over relocating to regional WA. This sector is poised for continued rapid growth, and in the first three months of FY2012 Skywest laid on 832 charter services, up 17.7% against the same period last year, against a capacity increase of 15.9% suggesting much improved rates.

Demand is being driven by massive capital investment in natural resources projects

The CME estimates the Western Australian project investment pipeline at around A\$300-billion, of which around A\$107-billion has been committed, with a further A\$116-billion currently under consideration, and a further A\$77-billion possible. The Growth Outlook predicts a shortfall of 33,000 workers in the WA resources sector over the next 12-18 months.

Our target price of 41p equivalent to 9x current year earnings

### Peer group comparison and valuation

We have compiled a peer group of 7 airlines based largely on those competing in the same geography as Skywest as well as some better known regional and low cost carriers in Europe. On an earnings basis there are a wide range of prospective multiples across the group from below 5x through to over 15x. Given Skywest's potential growth profile through the ARAN with Virgin, and exposure to the FIFO charter market (both of which offer an element of margin protection in the face of high fuel prices) we argue that Skywest does not merit a rating at the bottom of this range. Over the last six financial years the company has grown its revenue base by more than threefold and doubled earnings per share. We believe that in the medium term Skywest has the potential to double its revenue again. We argue that, as the robust nature of revenues from the wet-lease with Virgin emerges, that the shares will enjoy something of a re-rating. Our target price of 41p, equivalent to 9x current year earnings, is as such undemanding. We reiterate our BUY stance.

Fig 01: Peer Group

#### Skywest Airlines Ltd.

##### Selected Financials Comparison

All values in millions of British Pounds, except per share items.

Company Name	Fiscal Period	Price (17-Oct-2011)	Market Value	Sales	Price / EPS			EBIT Margin %	Dividend Yield%	
					FY1	FY2	Per Share			
Skywest Airlines Ltd. (SKYW-GB)	06/2011	0.23	46.0	120.0	5.05	4.23	1.3	9.2	4.9	
<b>Peer Summary Analysis</b>										
		Mean	1.35	1,309.5	2,835.0	9.51	7.06	0.9	3.0	3.0
		Median	0.66	592.8	2,066.2	8.64	7.00	0.5	1.8	4.6
<b>Peer Universe (7 comps)</b>										
Virgin Blue Holdings Ltd. (671593)	06/2011	0.23	509.7	1,832.6	15.90	7.42	0.9	(6.5)	0.0	
Air New Zealand Ltd (642656)	06/2011	0.54	592.8 <sup>2</sup>	2,066.2	7.77	7.00	0.8	3.8	7.5	
Qantas Airways Ltd. (671034)	12/2010 <sup>1</sup>	1.00	2,266.1	8,803.1	7.15	5.75	0.6	(2.6)	3.0	
Regional Express Holdings Ltd. (B0MT66)	06/2011	0.64	84.9	140.7	4.98	4.48	0.7	9.1	7.9	
Flybe Group Ltd. (FLYB-GB)	03/2011	0.66	49.0	595.5	11.03	4.20	0.5	1.6	0.0	
easyJet Plc (EZJ-GB)	03/2011 <sup>1</sup>	3.54	1,523.5	3,068.4	8.64	9.81	1.0	1.8	4.5	
Ryanair Holdings Plc (RY4B-IE)	06/2011 <sup>1</sup>	2.83	4,140.4	3,338.6	11.11	10.75	1.6	13.5	0.0	

<sup>1</sup> Data is LTM.

<sup>2</sup> Market value calculated using all classes of shares for the company.

Source: FactSet Fundamentals, FactSet Estimates, FactSet Daily Prices, User Defined Comparables

Source: WH Ireland research / Company data

## 2011 Audited Results

Revenues increased 11% to S\$239.9m

Skywest Airlines, Western Australia's leading regional airline, issued full year results for the year ending 30 June on 29 August, continuing its unbroken run of annual double digit revenue growth. Revenues increased 11% to S\$239.9m and pre-tax profit decreased 3.3% to S\$13.6m against a backdrop of high jet-fuel prices and significant one-off costs relating to new aircraft implementation and a new hangar. However adjusting for the one-off costs brings us to an underlying pre-tax profit of S\$18m up 28.5%, highly creditable in this environment. The company recommended a final dividend of 1.2S¢ in line with its recently announced minimum dividend payout policy, 25% of net earnings.

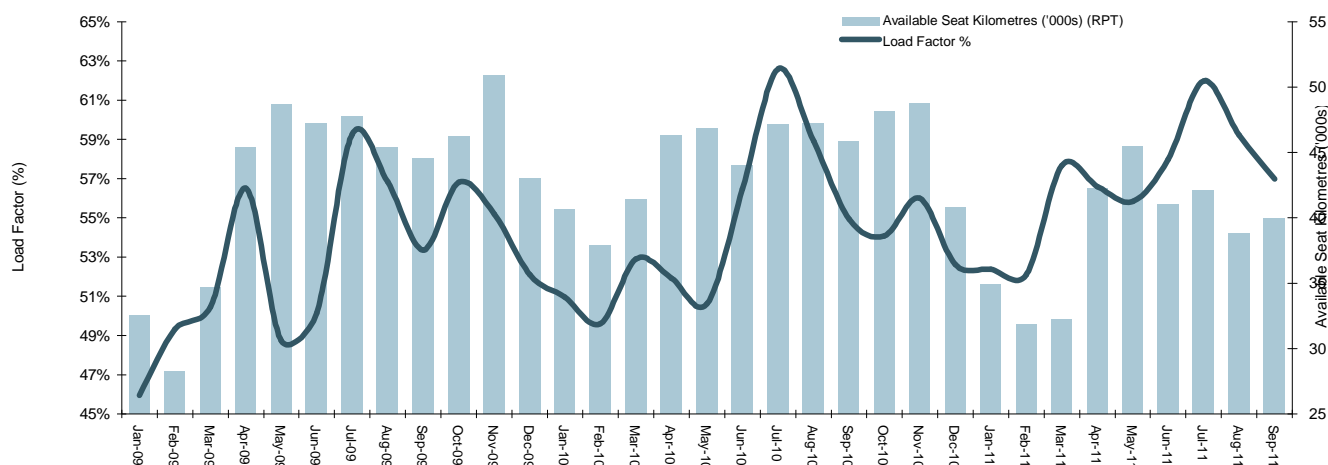
The results compared favourably to Skywest's peer group

When put in context with recent published results from other Australian operators, the impressive performance of Skywest is more striking. On 24 August, Regional Express Holdings announced a decrease in net profits of 28.5% to A\$17.6m on a revenue increase of 4.8% to A\$ 201.3m for FY 2011. Nevertheless the shares were up 4.7% on the day. Similarly, on the following day, Virgin Australia announced EBIT losses of A\$18.4m on revenues of A\$3.2bn. The company's shares were up 14.9% on the day. Qantas continues to struggle with net returns on revenue of only 1.7%. Skywest's higher growth profile and focus on industrial charter services to the natural resources sector in WA has allowed it to outperform its peers, better absorbing high fuel prices and one-off cost of investments to expand its fleet and infrastructure.

RPT load factors and charter services showed an improvement...

The key factor behind this performance is the strength of charter services for resources sector companies operating in Western Australia. The number of Charter services increased by c.3.4% with available seat kilometres increasing by some 15% in the year. Meanwhile, the FY operating statistics for scheduled regional services (RPT or Regular Passenger Transport) show that the load factor rose from 54% to 56.1% - a 2.2% improvement.

Fig 02: RPT Load Factor and ASKs



Source: WH Ireland research / Company data

... as did Skywest's balance sheet

Despite the one off costs arising in the period, net operating cash flows still came in at S\$20.8 million. Given that the hangar expenses were expensed through the P&L it was not surprising to see a fall in net capex to \$21.8m from \$25.8m. Overall Skywest showed an improvement in its short term liquidity position, with the Balance Sheet showing a net current liabilities position of S\$0.8m vs net current liabilities of \$11.3m at the previous year end.

## Financial estimates

### Profit & Loss

#### FY2012

Operating statistics so far suggest our RPT revenue forecasts are conservative

Our 2012 forecasts show the benefits of a robust demand for charter services and a full year contribution from Skywest's largest plane the A320-200. We also anticipate revenue growth driven by the roll out of the ARAN alliance with Virgin. Our forecasts for RPT traffic assume a reduction in capacity (Available Seat Kilometres or ASKs) of 11% which should allow planes to fly fuller and more profitably. We are hence anticipating a load factor of 58% nearly 2 percentage points higher than FY 2011 and an increase in average yield per passenger of 3%. Skywest's latest operating statistics to date show a capacity reduction of 9.06% and a load factor of 59% suggesting that our forecast for RPT revenues of S\$97.3m (down 5.7% year on year) is on the conservative side.

We are forecasting an increase of 33% in freight and charter revenue to S\$182.5m.

We are assuming a 15% increase in Charter capacity and a 20% increase in the amount of services flown. Q1 operating stats showed a 15.87% increase in capacity and a 17.7% increase in services flown, although on a monthly basis September services were up 20.7%, which was particularly encouraging. The above assumptions together with an assumed 11% increase in revenue per charter service flown (reasonable given the use of the A320 and implied rise in ASKs per charter service) result in a forecast increase 33% in freight and charter revenue to S\$182.5m.

Fig 03: Income Statement (S\$m)

Year to June	2010A	2011A	2012E	2013E
<b>Revenue</b>	<b>215.2</b>	<b>239.9</b>	<b>290.0</b>	<b>356.9</b>
<i>Growth y-o-y</i>	18.7%	11.5%	20.9%	23.1%
Other Income	0.8	2.4	0.0	0.0
Aircraft operating costs (ex fuel)	(37.2)	(35.9)	(39.5)	(46.2)
Fuel costs	(45.5)	(56.0)	(74.1)	(82.1)
ARAN operating costs	0.0	0.0	(6.6)	(20.7)
Other Expenses	(80.7)	(98.4)	(105.5)	(135.6)
<b>EBITDAR</b>	<b>52.6</b>	<b>52.0</b>	<b>64.3</b>	<b>72.4</b>
<i>Margin</i>	24.4%	21.7%	22.2%	20.3%
Aircraft Rental	(22.8)	(18.9)	(18.9)	(20.8)
Depreciation & Amortisation	(14.9)	(18.8)	(18.8)	(20.7)
<b>Operating Profit</b>	<b>14.9</b>	<b>14.3</b>	<b>26.6</b>	<b>30.9</b>
<i>Margin</i>	6.9%	6.0%	9.2%	8.7%
Net Interest	(0.9)	(0.7)	(0.6)	0.2
<b>Pre-tax Profit</b>	<b>14.0</b>	<b>13.6</b>	<b>26.0</b>	<b>31.0</b>
Taxation	(4.8)	(3.7)	(7.8)	(9.3)
<b>Post-tax Profit</b>	<b>9.2</b>	<b>9.8</b>	<b>18.2</b>	<b>21.7</b>
Hedging	0.0	(0.6)	0.0	0.0
FX	0.3	3.3	0.0	0.0
Total Comprehensive Income for the year	9.6	12.5	18.2	21.7
<i>Earnings per share (S¢)</i>	4.7	4.9	9.1	10.9
<i>Dividend per share (S¢)</i>	1.2	1.2	2.3	2.7

Source: WH Ireland research / Company data

It remains to be seen how costs and revenues for the 'wet lease' with virgin will be reported but at this stage we are assuming a separate disclosure.

We estimate that planes wet-leased by Virgin will generate revenue per plane of S\$2.6m and a contribution to operating profit pre central costs of S\$0.2m.

In figure 03 below we outline what we believe the typical revenue of one plane under the Virgin ARAN on an annual basis will derive. We estimated the amount of available seat kilometres based on the length and frequency of the early ARAN routes recently announced. Although revenues are based on hours flown, the data available makes it more practical to base our forecasts on a margin on ASKs. We have assumed an ex fuel cost per ASK of 3.1S¢ derived from Skywest's 2011 accounts and operating statistics. We will assume that fuel is paid directly by Virgin. Our maintenance assumptions take into account the fact that the ATR 72's are brand new and should cost less to maintain than the rest of Skywest's fleet. We have used a figure of S\$700k per plane. We are assuming a margin of 9% above operating costs and maintenance. In total we estimate a total revenue per plane of S\$2.6m and a contribution to operating profit pre central costs of S\$0.2m.

Skywest has recently taken delivery of its third ATR 72 plane

Over the course of the year we are assuming an average ARAN fleet of four aircraft equating to additional revenue of S\$10.2m. Skywest has recently taken delivery of its third ATR 72 plane and could have up to five further aircraft by the end of the financial year. At this stage we have not included any contribution from ticket sales or cost saving incentives. There is therefore some upside potential to these numbers.

We are forecasting a total revenue increase of 20.8% in 2012 to S\$290m

We are forecasting a total revenue increase of 20.8% in 2012 to S\$290m. We are assuming no change to operating costs per ASK and a 20.2% increase in fuel price (based on IATA economic forecasts) to US\$114 per barrel of jet kerosene. Our model shows that every \$1 change in the average annual cost of a barrel of fuel has an impact of S\$0.65m on operating profits. Whilst Skywest is partially hedged against fuel price fluctuations it is difficult to estimate to what extent.

**Fig 04: ATR 72 revenue profile**

<b>Estimated revenue profile of ATR 72-500 wet lease S\$m</b>	
Average 1 way distance (km)	500
Average single flights per week	30
Annual ASKs (km)	53,040,000
Cost per ASK ex fuel (2011) S\$	0.031
Operating cost per plane ex fuel	1.64
Maintenance	0.7
<b>Total cost</b>	<b>2.34</b>
Margin 9%	0.21
<b>Total Revenue per Plane</b>	<b>2.56</b>

Source: WH Ireland research / Company data

We see EBITDAR margins rising 50 bps to 22.2%..

We are forecasting a moderate 7% increase in other operating costs and a 5% reduction in Engineering costs (despite the ARAN roll out) due to the non-recurrence of expenses relating to the introduction of the A320 in 2011. This brings us to a forecast Earnings before Interest, Tax, Depreciation and Aircraft Rental (EBITDAR) of S\$64.3m representing a 50 basis points increase in margin to 22.2%.

..and an 85% increase in EPS

We estimate the Skywest fleet size (ex ARAN) to remain at 16 aircraft over FY 2012. Given that the ATR 72 leases will be paid by virgin we anticipate no change in aircraft rental or depreciation charges during the period. Our pre-tax profit forecast shows an increase of 91% to S\$26m. A closer review of the tax regimes by which Skywest is governed has led us to reduce our expected tax rate from 38% to a blended rate of 30%. This equates to an earnings per share figure of 9.1S¢ up 12% from our previous estimate of 8.1S¢. Skywest's dividend payout policy of at least 25% suggests a minimum annual dividend of 2.3S¢ (2S¢).

**FY2013**

In 2013 we anticipate an average usage of 10 ATR 72s under the ARAN agreement and assume a slightly longer increase in average journey (600km) as more routes come on stream. We also factor a 5% increase in operating costs per ASK and a 10% increase in maintenance charges per plane. We maintain our margin assumption of 9%. On this basis we see total revenue from the 'wet-lease' trebling to S\$31m and the operating margin thereon increasing at the same rate to S\$2.6m.

We see total revenue from the 'wet-lease' trebling to S\$31m.

..and charter revenue rising a further 33%

We believe that demand for Charter services will continue to be robust and forecast a 15% increase in both capacity and services flown, as well as a 5% increase in revenue per service flown. This results in a 33% increase in revenue from charter and freight services to S\$220.6m.

We see 8% growth in RPT revenues

In 2013 Skywest's RPT traffic should start to benefit from the synergies related to the ARAN and we anticipate a moderate increase in capacity of 3% and an increase in load factor to 61%, with an assumption that yields remain flat. We forecast a total increase of 8% in RPT revenues to S\$105.4m giving an overall revenue forecast for Skywest of S\$356.9m up 23% on 2012's estimate. We are maintaining our fuel price assumption at US\$114 per barrel. As Skywest starts to add resources ahead of a continued roll out and fleet upgrade in the years beyond 2013, we believe that there will be a requirement to expand its back office activities ahead of this. Consequently we are factoring in a decrease in EBITDAR margin of nearly 2 percentage points to 20.3%. Nonetheless our forecasts show an increase in EBITDAR of 12.5% to S\$72.4m. We are assuming a 10% increase in depreciation and rental costs allowing for a moderate increase in the size of Skywest's own fleet. We believe the improving balance sheet will allow net interest to turn positive in 2013 to the tune of S\$0.2m allowing an increase in pre-tax profits of 19.3% to S\$31m. We are rolling forward our 2012 tax rate (30%) and dividend payout (25%) assumptions into 2013, bringing us to an earnings per share estimate of 10.9S¢ (9.6S¢). and a dividend of 2.7S¢ (2.4S¢).

and 19.3% growth in pre-tax profits

### Cashflow statement

We expect Skywest's strong cash conversion record to continue in 2012 and see operating cash flows rising broadly in line with operating profit, nearly doubling to S\$42.6m. However the increasing cash-tax burden means that our forecast net operating cash flow forecast increases at a slower, but still an impressive 64% to S\$34.2m. We expect a further 14% improvement in 2013.

Our forecasts show 5.4x of cash dividend coverage

The dividend should cost Skywest S\$4.6m in 2012 rising to \$5.4m in 2013 equating to cash cover of 5.4x. Our estimates are not currently assuming any increase to Skywest's proprietary aircraft ownership and we therefore see capital expenditure reducing and stabilising at about S\$10m per annum.

**Fig 05: Cash Flow Statement S\$m**

Year to June	2010A	2011A	2012E	2013E
<b>Operating cash flows prior to working capital</b>	<b>29.2</b>	<b>33.4</b>	<b>45.4</b>	<b>51.5</b>
Increase in Inventories	(0.4)	(0.7)	(1.1)	(1.3)
Increase in Receivable and Pre Payments	(3.1)	(13.2)	(8.1)	(9.8)
Increase in Payables	13.4	2.3	6.4	7.7
<b>Cash from operations</b>	<b>39.2</b>	<b>21.7</b>	<b>42.6</b>	<b>48.2</b>
Interest expense paid	(0.9)	(0.7)	(0.6)	0.2
Income tax paid	(2.4)	(0.7)	(7.8)	(9.3)
Interest income received	0.3	0.3	0.0	0.0
Guarantee income received	0.4	0.2	0.0	0.0
<b>Net cash generated from operations</b>	<b>36.5</b>	<b>20.8</b>	<b>34.2</b>	<b>39.0</b>
Decrease/(increase) in long-term receivables and prepayments	(10.0)	2.2	0.0	0.0
Purchase of other investments	(0.4)	(0.5)	0.0	0.0
Proceeds from sales	0.1	0.6	0.0	0.0
Dividend income received	0.0	0.0	0.0	0.0
Acquisition of PPE	(25.5)	(19.4)	(10.0)	(10.0)
Proceeds from disposal of PPE	0.0	1.0	0.0	0.0
<b>Cash flows from investing activities</b>	<b>(35.9)</b>	<b>(16.1)</b>	<b>(10.0)</b>	<b>(10.0)</b>
<b>Net cash from financing activities</b>	<b>5.6</b>	<b>(7.6)</b>	<b>(4.6)</b>	<b>(5.4)</b>
<b>Change in cash</b>	<b>6.2</b>	<b>(3.0)</b>	<b>19.7</b>	<b>23.6</b>
<b>Change in net cash/debt</b>	<b>(15.5)</b>	<b>1.5</b>	<b>13.3</b>	<b>15.9</b>
<b>Year end net debt</b>	<b>(27.2)</b>	<b>(25.7)</b>	<b>(12.4)</b>	<b>3.5</b>

Source: WH Ireland research / Company data

## Balance sheet

As at the 31st June 2011 Skywest had net assets of S\$70.3m and net tangible assets of S\$53.1 million. The company had a net debt balance of S\$25.7m. However within this figure the company includes its non interest bearing short term payables of S\$30.5m. Stripping this out leaves the company with a net cash position of S\$4.8m. We believe this is a more accurate reflection of the company's liquidity as the payables are in fact more than offset by receivables.

Our forecasts show that the company's profitability and cash generative qualities ought to greatly strengthen the company's asset base over the forecast period. By 2013 we expect the company to have increased net assets by 42% to S\$100.3m. We forecast net debt to have been eliminated and stripping out the payables actually gives a net cash position of \$48m suggesting that dividend payouts may rise above the current 25% payout level.

**Fig 06: Balance Sheet S\$m**

Year to June	2010A	2011A	2012E	2013E
PPE	58.2	62.8	54.0	43.3
Intangible assets	17.2	17.2	17.2	17.2
Other receivables	2.9	3.1	3.1	3.1
Prepayments	7.0	4.8	4.8	4.8
<b>Non current assets</b>	<b>85.4</b>	<b>87.8</b>	<b>79.0</b>	<b>68.3</b>
Inventories	4.4	5.1	6.2	7.5
Trade and other receivables	23.5	31.8	38.5	46.5
Prepayments	2.1	6.9	8.3	10.1
Other investments	0.5	0.5	0.5	0.5
Cash and equivalents	12.9	10.0	29.6	53.2
<b>Current assets</b>	<b>43.4</b>	<b>54.3</b>	<b>83.1</b>	<b>117.7</b>
Provisions	5.0	6.6	6.6	6.6
Income tax payable	2.0	3.1	3.1	3.1
Borrowings	2.9	1.2	1.2	1.2
Trade and other payables	32.8	30.5	36.8	44.5
Revenue received in advance	12.1	12.5	12.5	12.5
Finance lease liability	0.0	0.4	0.4	0.4
Derivative financial instruments	0.0	0.8	0.8	0.8
<b>Current Liabilities</b>	<b>54.7</b>	<b>55.2</b>	<b>61.5</b>	<b>69.2</b>
<b>Net current assets/ (liabilities)</b>	<b>(11.3)</b>	<b>(0.9)</b>	<b>21.6</b>	<b>48.5</b>
Provisions	0.9	1.1	1.1	1.1
Borrowings	4.3	2.7	2.7	2.7
Other payables	0.1	0.0	0.0	0.0
Finance lease liability	0.0	0.9	0.9	0.9
Deferred tax liabilities	9.3	11.9	11.9	11.9
<b>Non current liabilities</b>	<b>14.7</b>	<b>16.6</b>	<b>16.6</b>	<b>16.6</b>
<b>Net assets</b>	<b>59.5</b>	<b>70.3</b>	<b>84.0</b>	<b>100.3</b>
Share Capital	43.8	43.9	43.9	43.9
Reserves	1.4	4.5	4.5	4.5
Retained Earnings	14.3	21.9	35.6	51.8
<b>Total Equity</b>	<b>59.5</b>	<b>70.3</b>	<b>84.0</b>	<b>100.3</b>

Source: WH Ireland research / Company data

## Risk factors

We estimate that every US\$1 dollar change in fuel price would have a S\$650k impact on Skywest's total fuel cost for FY2012

### Jet Fuel Prices

We estimate that Skywest paid an average of US\$94.8 per barrel for jet fuel over 2011, an estimated 23% higher than in 2010. As at 30<sup>th</sup> September international jet fuel prices stood at US\$122.1/barrel, 29% higher than our estimated 2011 paid prices but lower than their three year peak of US\$137 in April 2011. (Source: IATA and US Energy Information Administration) We are assuming an average price of US\$114 for 2012 in line with IATA forecasts. Based on our estimates every US\$1 dollar change in fuel price would have a S\$650k impact on Skywest's total fuel cost for FY2012 at constant currencies. Under the ARAN with Virgin Australia, Skywest is not subject to fuel price fluctuations as the cost is borne by Virgin. Jet fuel prices are not directly linked to crude oil prices but there is close correlation. Some industry commentators are bearish over the oil price. Whilst we are not attempting to predict the oil price in this document we note that OPEC has recently downgraded its demand forecasts for 2012 and the remainder of 2011.

There is a consensus in the industry that these costs will be passed onto customers

### Australian Carbon Tax

The Australian lower house of parliament has recently passed a bill to introduce a carbon tax from July 2012 at a rate of 23 Australian dollars per metric ton. Skywest has yet to provide guidance on the potential cost impact of the tax, but it appears that domestic airlines may prefer to opt into the scheme rather than paying higher fuel duty. Other Australian airlines such as Qantas and Virgin have indicated that they intend to pass the cost on to the end user with Virgin estimating an average cost of A\$3 per passenger per flight. The cost may be partially mitigated through the purchase of carbon credits. Furthermore the drafting of this bill has been extremely politically divisive in Australia, and it is not unfeasible that a change of Government could see this legislation reversed or significantly amended.

WA's ties with developing Asia and the wealth of major existing resources projects provide better protection than in many other regions

### Economic risk

Like any airline the demand for Skywest's services, particularly its scheduled routes, is closely linked to consumer and business confidence. Western Australia is by no means immune to a deteriorating world economy but the state's close ties with developing Asia and the wealth of major existing resources projects provide better protection than in many other regions. According to the latest economic forecasts from the Chamber of Commerce and Industry WA the local economy is expected to grow by 6.5% this financial year, accelerating to 7% in 2012-13. Mining projects and the exploitation of WA's massive Liquefied Natural Gas (LNG) resources (Chevron have recently signed off a A\$29.6bn LNG project) are the most important growth drivers. However in the event that there is a significant drop in industrial demand from Asia, and prices in WA's dominant metals, Gold and Iron Ore, collapse, then this is likely to be detrimental to demand for both Skywest's chartered and scheduled services.

### Currency risk

Skywest's operating currency is the Australian Dollar and its reporting currency is the Singapore dollar. Furthermore some of its aircraft rental commitments are denominated in American dollars. Therefore for UK investors a deterioration in the strength of the Australian dollar against the US\$ (more expensive fuel) or Sterling (negative for earnings translation) would be unfavourable.

### Airport access and competition

The policies of the Western Australian Government may impact access to some of the airports that the Airline currently serves. In the worst case, the Government could potentially restrict access to certain ports or introduce unsustainable levels of competition to airports that cannot support competition. Thus far relationships with the authorities appear favourable with Skywest providing vital connections to more remote destinations

such as Geraldton and Ravensthorpe. Furthermore further growth in the demand for FIFO services is likely to encourage further competition.

**Generic Airline Risks**

Skywest is subject to the same generic risks faced by the entire industry such as natural disasters, epidemics of infectious diseases, terrorism, industrial action, delays in aircraft delivery and mechanical failure.

## 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 30 September 2011 the distribution of all our published recommendations is as follows:

Recommendation	Total Stocks	Percentage %	Corporate
Buy	53	85%	32
Speculative Buy	3	5%	3
Outperform	4	7%	2
Market Perform	2	3%	2
Underperform	0	0%	0
Sell	0	0%	0
<b>Total</b>	<b>62</b>	<b>100%</b>	<b>39</b>

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

### Conflicts of Interest Policy

This research is classified as being "non-independent" as defined by the FSA's Conduct of Business Rule 12.3. Please refer to [www.wh-ireland.co.uk](http://www.wh-ireland.co.uk) for a summary of our conflict of interest policy.

### Analyst Certification

The research analyst or analysts attest that the views expressed in this research report accurately reflect his or her personal views about the subject security and issuer.

Within the past 12 months, WH Ireland has received compensation for investment banking services from this company.

WH Ireland acts as broker and NOMAD to this company.

### Summary of Company Notes

Headline	Date	Price	Price Date/Time
Review	28 May 2009	8.5p	27 May 2009: 1200
Commencement of live flights for Virgin Australia	25 October 2011	23p	23 October 2011: 10:35

### Summary of Security Recommendations

Recommendation	From	To	Analyst*
BUY	28 May 2009	30 August 2011	PA
BUY	30 Aug 2011	Current	CA

\*Current Analyst (CA), Previous Analyst (PA)

### Disclaimer

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