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Avation* - Agreement to supply Virgin Blue/Skywest strategic alliance with up to 18 aircraft. Reiterate buy at 89.5p with a target price of 150p

Avation, the aircraft leasing company announced on 10th January that it had entered into an agreement with Skywest Airlines and Virgin Blue Airlines to provide a fleet of up to 18 new aircraft which will operate in Australia. The aircraft will be purchased by Avation who will grant standard 10 year operating leases to Skywest, who will in turn operate the aircraft on behalf of Virgin Blue under a 'wet' lease and codeshare arrangement.

The Board believes that given the quality of the lessee, the fixed term and the fact the aircraft are new, Avation PLC is well placed to utilise Government-backed Export Credit Agency Financing. Avation will shortly be making an application for finance facilities.

In a recent conference call the joint Chairman of Skywest and Avation, Jeff Chatfield indicated that Skywest may also seek to upgrade its existing fleet, which currently stands at 18 aircraft. Given its increasing bargaining power, Avation would seem to be a likely choice of provider.

The Skywest/Virgin Blue strategic alliance is a highly significant step for Avation who stands to more than double its fleet in the medium term. Given that the first planes are likely to be delivered in the middle of calendar year 2011, we assume no financial impact for the current financial year. The company has guided that 6-8 further planes are likely to be in operation by the end of the year ending June 2012.

We have used this opportunity to introduce 2012 forecasts. We estimate that the deal will enhance revenues by some 20% in 2012 based on an average of 3 extra planes being leased across the course of the year. We estimate that this will help operating profits to rise 25% to GBP8.27 million. However our forecasts show that increased finance charges will mean that pre-tax profits and earnings per share will grow at a slower but still impressive 19%.

Key Data	
EPIC	AVAP
Share Price	89.5p
Spread	87p - 92p
Total no of Shares	28.53 million
Market Cap	£25.5 million
NMS	4,000
12 Month Range	57p - 89.5p
Market	Full List
Website	www.avation.net
Sector	Diversified Industrials
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The exact pace of the roll out of new planes remains to be seen. The key factors driving this will be the ease by which Avation is able to obtain the financing it requires, and the level of demand for Skywest and Virgin Blue's new joint services. However we anticipate that the roll out should be complete by the year ending June 2014. On this basis we are confident that Avation will be able to double its earnings per share to 12.6p. Our **target price of 150p** implies a price to earnings multiple of just shy of 12x, which we believe is appropriate given the growth profile. Should the partnership prove successful, there is scope for the fleet to grow even further. Our stance is **buy**.

Year to 30th June	Revenue (GBP million)	Pre-tax Profit (GBP million)	Diluted Earnings Per Share (p)	Price Earnings Ratio	Dividend Per Share (p)	Dividend Yield (%)
2009A	16.3	4.99	9.2	9.7	0.5	0.6%
2010A	17.6	3.55	6.3	14.2	0.6	0.7%
2011E	17.6	3.55	6.3	14.2	0.6	0.7%
2012E	21.1	4.22	7.4	12.0	0.7	0.8%

Source: Growth Equities & Company Research



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