Embracing Opportunities That Crowds Avoid

By Henry Polkinghorne, , 03 Mar 2021

Platinum's philosophy of "thinking differently" means we look for opportunities that are out of favour and against popular opinion. This involves looking for investments in areas undergoing considerable change. It also nearly always involves feeling uncomfortable at the point of initial purchase, with the most recent and clearest example being our investment in travel and travel-related industries throughout 2020.

In our June 2020 quarterly report, CIO and CEO Andrew Clifford disclosed that travel had become a key theme in the flagship global equity portfolio, concluding that "... our view is that travel will return to favour in time and that the advent of an effective vaccine will facilitate a recovery". Indeed, the announcement of a successful vaccine candidate lit a match under the share prices of many travel-related stocks, but the speed at which this took place in November was a reminder that if you wait until these types of announcements are made, you can often miss a significant amount of the return opportunity. For example, if you had waited until the Pfizer/BioNTech vaccine announcement on 9 November 2020 to purchase Booking Holdings, you would have already missed the 84% bounce from the stock's 23 March 2020 low.[1]

So, why were we confident to step into travel-related names at the point of maximum pain in an industry? In a crisis, there is always a sector at the epicentre that sees the largest market overreaction to the near-term news. We have seen situations like these before. An example of this, was during the 2008-09 Global Financial Crisis (GFC) where we acquired a position in McGraw Hill[2], the parent company of Standard & Poor's Global Ratings (S&P). Ratings agency stocks at that time were viewed by the market as having significant regulation risk, after providing what proved to be inaccurate ratings for what were perceived as safe investments. The common thought from the market back then was "why would anyone give these companies business again? SELL". Platinum used this opportunity to BUY. We sold out of our position for a tidy profit a short time later, once the market corrected their overreaction and negative view of the business models.

Fast forward to March 2020 and we had just experienced the most aggressive hit to the global economy that we had seen in decades. Anything travel related was sold off heavily, as restrictions on the movements of people forced a shuttering of the industry globally. The market questioned whether people would travel again. For example, local names like Qantas lost two-thirds of its value in the space of a month in March and then raised A$1.4 billion of capital via an institutional placement in June.[3] Once more, the common thought in March was "We can't travel so why would anyone give these companies business again? SELL". Again, Platinum used this opportunity to BUY selected high-quality travel-related stocks on seriously depressed multiples.

For many years, travel has been one of the world's most consistent growth industries with air passenger numbers having grown a remarkable 5.6% p.a. compound for 50 years.[4] This was in spite of recessions, wars, oil shocks, the September 11 2001 terrorist attacks and the introduction of multiple technologies (e.g. the internet, live streaming etc) that would theoretically reduce the need for travel.

Prior to COVID-19, travel industry growth had recently accelerated due to: booming demand from emerging economies as disposable incomes rise (driven by the Chinese who are the world's largest outbound travellers); consumers in the developed world spending more on 'experiences'; and the continued reduction in the cost and accessibility of travel, thanks to low-cost carriers and accommodation platforms, such as Airbnb. We believe these drivers are unlikely to have gone away. Travellers may have disappeared for now, but the innate human desire to travel has not.

If we use the historical base rate of growth of 5.6% p.a., will COVID-19 change this? There are two major issues to consider: Firstly, confidence in travelling safely; and secondly, the likelihood of corporate traveller demand falling due to the universal adoption of video calls.

On the issue of travelling with confidence, while this will repair in time, clearly a vaccine/therapeutic was required for more rapid improvement in sentiment. The research and insights from our healthcare portfolio manager and resident virologist Dr Bianca Ogden, gave us strong confidence that a vaccine would be available in 2020 and faster than the market was anticipating. This proved to be true.

On the issue of video calls replacing corporate travel, as noted by portfolio manager Clay Smolinski in the June 2020 quarterly report, we have no doubt that certain categories of business travel will be reduced but face-to-face contact is an essential part of most industries' sales process. Once we segmented corporate travel by purpose, we assumed video calls would displace 20-25% of corporate travel, which given corporate travel is roughly 30% of total travel by passengers, would result in the total market shrinking by approximately 8%.[5]

Using these numbers we felt that even if the industry rebased lower, there were good reasons to believe it would return to trend growth and any lost ground would be made up swiftly once confidence returns. That gave us the assurance and motivation to look for specific companies to invest in, while the market continued their overreaction.

Stepping from this industry view to the fortunes of specific companies, it's important to remember the travel industry is incredibly diverse and we can be very selective in the types of businesses in which we invest. Some of our investments have very attractive industry economics, two or fewer competitors and strong growth prospects. The businesses must also have the financial capacity to withstand a couple of turbulent years if necessary.

This led us to invest in capital-light internet booking platforms and software providers, such as online travel agents (OTA) Booking Holdings (the world's largest and owner of Booking.com, Priceline and OpenTable among others) and Trip.com. Both companies have significant cash buffers to weather the storm, primarily serve leisure customers where there are no disintermediation concerns, help hotels fill unsold rooms and have seen their competitive positions improve as smaller peers have exited.

Trip.com is China's largest OTA, making the bulk of its profit via commissions from selling hotel rooms and flights. Today, China is the largest outbound tourist market in the world, with 75 million outbound flights in 2019 (excluding Hong Kong and Macau), growing at 15% p.a.[6] The growth potential becomes apparent when noting that less than 15% of Chinese nationals hold a passport.[7] They clearly desire to travel and already Chinese domestic air travel is back to pre-COVID levels. With the tailwind of market growth, we believe that Trip.com can grow strongly for many years. Due to the COVID-19 crisis we were able to invest in this stock at 13x 2019 earnings.[8]

Another stock that we purchased on the March lows was Amadeus IT Group - a technology provider to the global travel and tourism industry. The economics of its Global Distribution System (GDS) are excellent. There are just three providers, high barriers to entry and fragmented customers and suppliers. Amadeus adds value to the travel industry in two ways. Firstly, it helps travel providers, primarily airlines, to sell in the most efficient way, through a large network of traditional and online travel agencies. Its core technology enables real-time search, pricing, booking and ticketing. It leads with 44% market share versus the weaker peers, Sabre and Travelport.[9] Secondly, Amadeus helps airlines, hotels and airports to run various business-critical processes (reservations, inventory, departure controls), saving them money by transforming a fixed cost into a variable cost. Given the volatile nature of their business, airlines prefer to pass on their fixed costs and simply pay c. €1 (A$1.60) per passenger to Amadeus instead for their services.[10] Amadeus invests heavily in research and development (R&D) and provides their systems for a fraction of what each airline would need to spend.

COVID-19 has had a dramatic impact on travel-related businesses and Amadeus has not been immune. But again, here was the opportunity. If you can look through the short-term business deterioration and have confidence that people will eventually travel again, in our view, Amadeus should emerge as an even stronger player against its competitors and new entrants. Reflecting the attractive industry economics of these two business segments, Amadeus made a 28% operating margin and 18% return on capital over the last decade. Profits tripled over the same period.[11] With growth tied to passenger volumes, short-term assumptions of a longer-term issue by the market allowed us to invest in this great business at 16x 2019 earnings.

In conclusion, a number of our travel holdings have performed exceptionally well since their March lows, with the vaccine announcement in early November giving them additional impetus.[12] We are now seeing more interest in the sector, after it has recovered significantly. This is giving us the chance to reduce and even exit some of our travel exposure into this strength. This is the Platinum process at work. It requires a contrarian mindset, a willingness to do the research early, being ready to seize the opportunity in a crisis and look to sell and recycle this capital into the next emerging idea as consensus plays catch up.

[1] Source: FactSet Research Systems, in local currency terms.
[2] Renamed to S&P Global in 2016.
[3] Source: FactSet Research Systems.
[4] Source: International Civil Aviation Organisation.
[5] Source: Platinum Investment Management Limited.
[6] Source: Morgan Stanley.
[7] Source: Chinese National Immigration Administration, JP Morgan.
[8] 2019 earnings were used due to earnings forecasts having less value than normal due to COVID-19 impacts.
[9] Source: Statista Research Department.
[10] Source: Amadeus company report, Platinum Investment Management Limited.
[11] Source: Amadeus company report, Platinum Investment Management Limited.

[12] Source: FactSet Research Systems, as at 28 February 2021.