Tourism and Leisure Sector
Trip.com (TCOM US);
ETFMG Travel Tech (AWAY US)

Bottom fishing for cyclical stocks: Part 2

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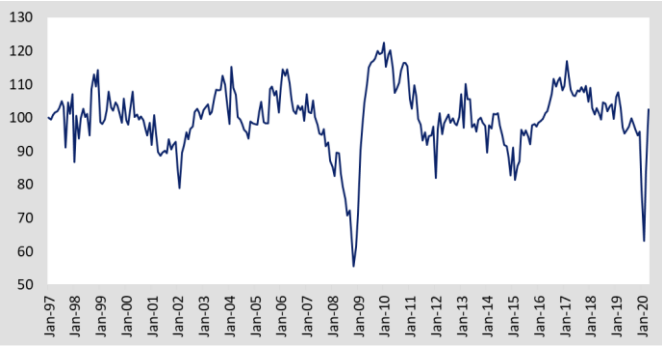
- Trip.com (TCOM US) & ETFMG Travel Tech (AWAY US) are our top picks for the tourism sector. We expect both to recover to the pre-COVID levels by the end of 2020. They represent a potential upside of between 17% and 18%.

"First In, First Out": China is walking out from the pandemic ahead of the world. Investors should now be clear about the timeline of the outbreak of COVID-19. China, as the earliest epicentre, had taken the most draconian quarantine measures to contain the contagion since late January. Owing to that, production and business activities resumed to normal levels in less than two months. As of mid-April, 91.4% of the private enterprises have restarted operations, 50% and 25% of which have reached more than 50% and 80% capacity utilisation rate respectively, according to the All-China Federation of Industry and Commerce. However, the rest of the epicentres in Europe and US are still a long away from fully re-opening of their economies, even going into the end of May.

According to the CEIC leading indicator* (China), which provides early signals to the turning point of an economic cycle, China is walking out from the economic downturn and is on the path to recovery. Although China in the near term is inevitably subject to the impact of the soft external demand due to the prolonged lockdowns in Europe and US, the domestic consumer market made up of its 1.4bn population is resilient enough to propel the recovery of the domestic economy. In other words, this time around, the service segment in China is taking the lead in terms of the normalisation of economic growth.

The implication for investors is that companies with mainly domestic-focused businesses, especially in the services sector, could be the first targets for bottom fishing. Although this is a hindsight view as some companies' stock prices have climbed back to pre-COVID level or even higher since mid-March, some counters have only recouped half their losses since February. Therefore, investors will still have opportunities to buy the dip among Chinese counters before their prices fully recover.

Figure 1: CEIC Leading Indicator Index for China



100 is the neutral level
Source: CEIC, KGI Research

*The components of the leading indicator are shown below:

1. PMI
2. Floor Space Sold: Commodity Buildings
3. Industrial Production: Automobiles
4. Short Term Interest Rate
5. Deposits
6. M2 Supply
7. FDI: No of Contracts
8. Real Effective Exchange Rate

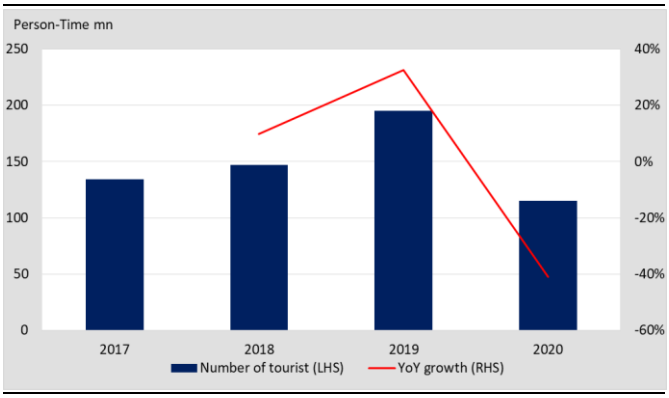
Tourism could have a better comeback

COVID-19 has resulted in significant pent up supply and demand in the service sector due to the implementation of social distancing measures. However, the scale and scope has varied across countries. China was among the earliest countries to execute lockdown orders in the most draconian way. Residents in the epicentres like Wuhan City were forced to stay home from late January until early April. Traffic controls and restrictions were imposed nationwide.

Not only were non-native persons disallowed from entering some first and second-tier cities, but they also reduced or suspended international inbound persons. At the moment, the number of international flights and ships to China has yet to resume to pre-COVID levels.

Therefore, tourism has been significantly impacted in a negative way over the past three months. The Labour Day holidays (two extra days' extension this year) was the first holiday during the pandemic period. Although most of the tourist attractions were re-opened, the number of tourists plunged by 40% YoY.

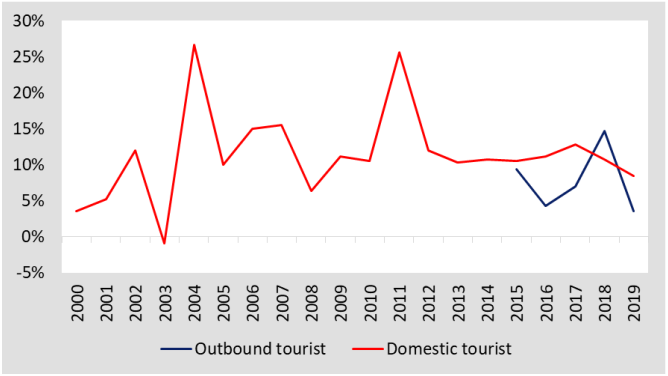
Figure 2: 2020 Labour Day holiday tourist count in China



3 days' holiday in 2017, 2018, and 2019; 5 days' holiday in 2020
Source: CEIC, KGI Research

We believe that tourism is suppressed due to both policies and fears over the virus. Neither of them will sustain long, in our view. Investors can take SARS in 2003 as a reference guide regarding the speed of the recovery. China was also one of the epicentres of the outbreak in 2003, and the domestic tourist growth turned negative, shown in Figure 3. But growth recovered quickly the following year, indicating that tourism not only recovered to normal but the demand was much more robust.

Figure 3: Domestic and outbound tourist growth



Source: CEIC, KGI Research

Psychologically, the short-term suppression of movement will lead to an intense rebound in outbound travel once restrictions are lifted. Logically, short-term lockdowns should barely change people's habits unless a new paradigm shift facilitates the overall community and improves the quality of life. 2003 SARS incubated online shopping, and E-commerce burgeoned after that. Social distancing was unexpectedly adopted to an even higher scale and broader scope during the COVID-19 period. Working from home could be the next norm, with the help of more advanced technologies than what was available 17 years ago. However, this sort of new norm should not have a significant impact on tourism because we think there is nothing that can substitute the experience of travelling in person.

Park capital with companies with asset-light model

Generally, the tourism sector is classified under the service industry. Investors could come up with many company names in the airlines, hotels and resorts, caterings, and tourist attractions. However, these are asset-heavy businesses, meaning that the owner or operators have a significant portion of persistent maintenance capex as well as compensation of a large employee base. The margin of safety in these businesses is low, which makes the companies suffer from more and longer pain once downturn strikes and are extended. Needless to say that these businesses have been expanding leverages to sustain profit growth. Heavy fixed costs drag the recovery of the businesses when the economy bottoms out. Therefore, from a rapid turnaround perspective, we prefer businesses with asset-light model and direct exposure to tourism.

We, therefore, recommend online booking travel agencies. Apart from having the abovementioned merits, this subsector is also tech-related, which is a trend that market participants have been pursuing for decades. To be more specific, these agencies own the most valuable assets that dwarf those brick-and-mortar ones, and that is booking and travelling data that is beyond geographical limitation. The potential of generating returns from this kind of intangible assets is much greater than any leisure facilities.

Below is the list of the online booking agencies (more than US$2bn market cap) with a regional or global client base:

Company Name	Stock Ticker	Main Revenue Source	Market cap (USD bn)
Tongcheng-Elong Holdings Ltd.	780 HK	China	3.7
Booking Holdings, Inc.	BKNG US	Netherlands	65.4
Expedia Group Inc.	EXPE US	Global	11.2
Trip.com Group Ltd	TCOM US	China	15.2
TripAdvisor Inc.	TRIP US	US & UK	2.6

Brief fundamental comparison

Over the past three years, Booking Holdings had the highest profitability that was also improving. In terms of liquidity, Booking Holding had better working capital control over peers (except TripAdvisor). However, China counters such as Tongcheng-Elong and Trip.com outperformed the global players, especially the former as it achieved net cash position as of December 2019. Furthermore, the two China platforms have much faster topline growth owing to the ongoing increase in the domestic and overseas travel demand.

Figure 4: Net profit margin

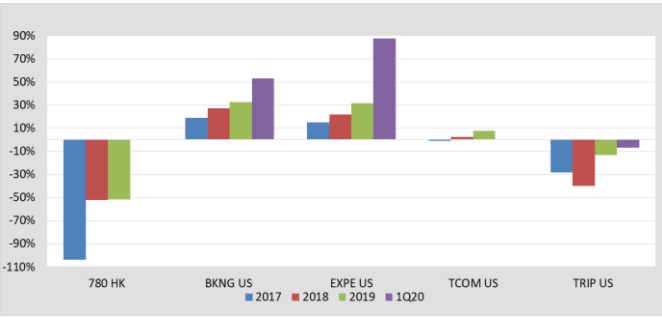
Source: Capital IQ, KGI Research

Figure 5: Quick ratio

	2017	2018	2019	1Q20
780 HK	1.0	1.6	1.6	
BKNG US	2.5	2.2	1.7	1.9
EXPE US	0.7	0.6	0.6	0.6
TCOM US	1.2	1	0.8	
TRIP US	2.6	2.2	1.2	2.5

Source: Capital IQ, KGI Research

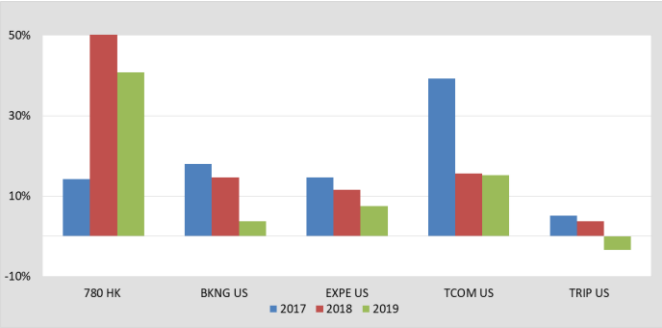
Figure 6: Net debt/Equity



780 HK: Negative equity and positive net debt in 2017, positive equity net and net cash in 2018 and 2019

Source: Capital IQ, KGI Research

Figure 7: Revenue growth



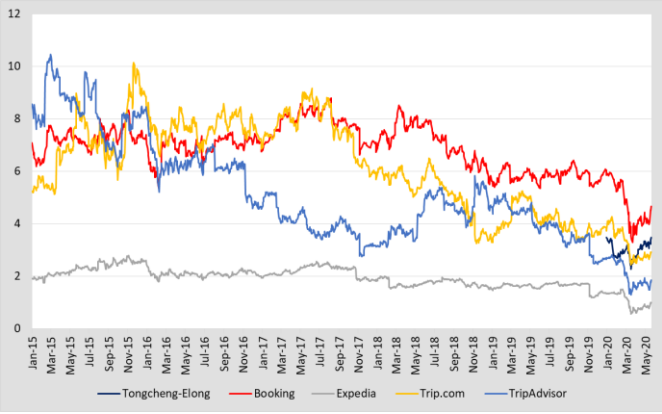
780 HK: 109% revenue growth in 2018

Source: Capital IQ, KGI Research

Attractive valuation

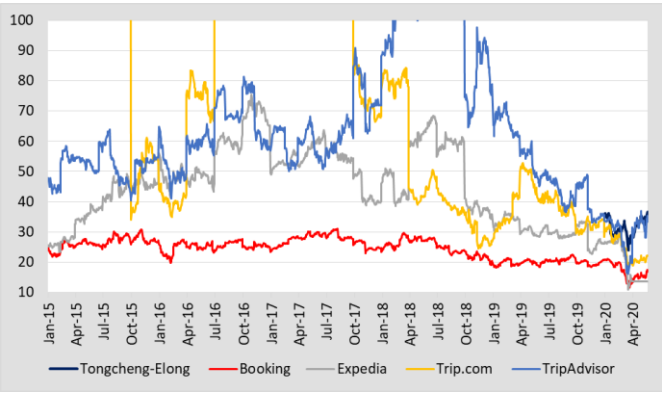
Except for Tongcheng-Elong whose share price has since surpassed its pre-COVID level, the rest of its peers have yet to recover fully. The price multiples could indicate that the current level justifies the substantial fall in earnings this year, but tourism could recover sooner than expected if COVID-19 is contained in 2H20. From a forward-looking perspective, the stock prices will be back to at least pre-COVID level by the end of 2020. Tongcheng-Elong has shown of the resumption of confidence in China's tourism market, and we expect Trip.com to catch-up soon.

Figure 8: Price/Sales



Source: Bloomberg, KGI Research

Figure 9: P/E



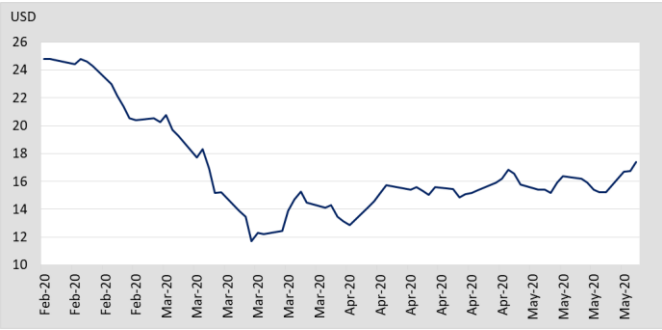
Source: Bloomberg, KGI Research

Trading recommendation

We recommend Trip.com (TCOM US) for investors who hold the same upbeat view of the recovery of tourism in China. The upside potential is 18% from the last closing price of US$25.72 to the pre-COVID price of US$30.36.

In addition, we recommend a newly-listed ETF since February 2020 for investors who need a diversified portfolio. This ETF is the ETFMG Travel Tech ETF (AWAY US). We estimate that the upside potential is 17% from the last closing price of US$17.4 to the pre-COVID US$20.42.

Figure 10: ETFMG Travel Tech price performance since inception



Source: Bloomberg, KGI Research

Figure 11: Top 10 holdings in the ETF

Company	Weight
Uber Technologies Inc.	12.2%
Booking Holdings Inc.	8.8%
Lyft Inc. Cl A	8.2%
Trip.com Group Ltd. ADR	6.7%
Tongcheng-Elong Holdings Ltd.	5.9%
Expedia Group Inc.	5.4%
Amadeus IT Group SA ORD	5.3%
Trainline PLC	4.7%
TravelSky Technology Ltd.	4.2%
Temairazu Inc ORD	4.0%

Source: Bloomberg, KGI Research

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