HSBC Global Research

15 April 2020

Travel & Leisure

Exit strategies: The next steps

Equities
Hotels Restaurants & Leisure

- We consider how the leisure sector could reopen for business. It won't be straightforward and there will be challenges to navigate
- We see the quickest recovery in the gaming sector and, to some extent bus & rail. Pubs/restaurants could take time. Clear uncertainties around hotels, tour operators and cruise
- We see major medium-term opportunities for the survivors, especially pubs/restaurants and concessions. Travel companies' challenges may persist for longer

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Europe is preparing to exit its COVID-19 lockdown. Six countries have already laid out their plans as to how this will happen. And this provides some clues as to how others may respond, including the UK. Reversion to normality will only be gradual for the Travel & Leisure sector. Educational establishments should open quickly. But pubs and restaurants may only open a month later, and mass gatherings such as sporting events 2-3 months after that. Travel permission is highly uncertain, and requires both source and destination markets being open for business.

V, U, W, L: We have a first stab at predicting where the recovery will happen first and lay out our early thoughts, by subsector, in this note. Bookmakers look most likely to us as we see the potential for an early resumption of the sporting calendar, even it if is behind closed doors. Contract catering businesses and the UK bus & rail sector should benefit from the early return to work, though some parts will remain under pressure. Pubs and restaurants could be subject to difficult social distancing restrictions. And we have uncertainties around the speed with which travel-related areas such as tour operators, concessions, hotels and cruises will rebound given the potentially late lifting of travel restrictions and changing customer attitudes. Business could be anything but normal on the other side, and that's before we think of macroeconomic risks.

Riches across the ravine… Much of the early focus during the COVID-19 crisis has been around liquidity and cash burn. But there's a long-term opportunity to think about as well. We think there's potential for industry rationalisation across the sector, restoring pricing power. This is particularly relevant in pubs and restaurants. Concessions companies could also take market share that will benefit them as travel trends rebound. Bus & rail/bookmakers could benefit from lower regulatory risk than was commonly perceived. It holds out the hope of a rerating vs history.

… but threats too. It isn't all good. Working at home and the business travel squeeze could make life difficult for the contract catering companies and hotels. If true, the possibility of lower returns point to the risks of derating vs historical norms. Meanwhile, macroeconomic risk is a threat for all.

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The next steps

- European timetables suggest a staggered opening of the Travel & Leisure sector
- We think the gaming sector could recover early and quickly. Travel could be much later. For pubs and restaurants, there's a tricky interim period to navigate
- Survivors have major opportunities available in the long term. Lower competition and more benign trading/regulatory environments should help

Summary

The UK lockdown is under review, but looks set to be extended until May. But other European countries are lifting restrictions and investors should prepare themselves for what comes next. The point of this note is to 1) Draw on international developments to get an idea of when initial restrictions might be lifted 2) Lay out our early and high level thoughts on near-term challenges as our subsectors transition to normality and 3) Understand what the environment awaits for those that survive.

Plans laid out by other European countries so far

Country	Lockdown started	Sequence of events	Date	Source
Austria	16-Mar	Small Shops (<400 sq.m), DIY stores and garden centres	14-Apr	Reuters, 6 April 2020
		All shops, shopping centres and hairdressers	01-May	ING, 6 April 2020
		Restaurants, hotels and other service providers	**Mid May**	
		Big events	July	
Denmark	11-Mar	Day care centres and schools from grade 1 to 5	15-Apr	CNBC, 8 April 2020
		All remaining restrictions including small gatherings	After 4 weeks	Reuters, 6 April 2020
		Festivals and large gatherings	**September**	
Norway	12-Mar	Kindergartens	20-Apr	Bloomberg, 6 April 2020
		Schools from grade 1 to 4	27-Apr	
		Higher grades	Before summer	
		Large sporting and cultural events	**15-Jun**	
Czech Republic	13-Mar	Grocery stores, pharmacy and garden stores	Open	Reuters, 6 April 2020
		Shops selling building materials, hobby supplies or bicycles	Open (09-Apr)	Fox News, 8 April 2020
		Open-air sports activities without congregation	**Open (09-Apr)**	
		Leaving the country	14-Apr	
Spain	14-Mar	Construction and manufacturing businesses	Open (13-Apr)	CNBC, 13 April 2020
		Shops, bars and public spaces	**At least after 26-Apr**	The Guardian, 13 April 2020
Italy	9-Mar	Bookshops, stationers, children's clothes shops and forestry related occupations	14-Apr	Politico, 13 April 2020
		Gradual reopening of other sectors	4-May	Forbes, 13 April 2020
		Schools	September	CNBC, 13 April 2020

Source: HSBC, various sources

Timetables gradually emerging
Steadily, we are starting to see European countries lay out their strategies for exiting their lockdown periods. We have collated this in the table above. To the extent we can see it, lockdowns are easing around 4-6 weeks after they began. And progress to normality is slow.

For those countries where we can see it, it will be around another 2-4 weeks after lockdown eases before restaurants will be open, and 2-3 months (or more) before the public can attend large events, such as football matches. Freedom to travel internationally is very questionable, with Austria saying that it could potentially take until a vaccine is discovered.

And of course, the risk of further COVID-19 flare-ups could delay timetables further. Singapore and Hong Kong have both introduced new social distancing measures in response to this. A return to normality will be far from straightforward.

Subsector level implications
As we see it: Gaming companies are well positioned for a quick recovery. So are bus and rail companies, but with some caveats. For the eating and drinking out companies, there could be a difficult transition period, but with major market share opportunities for the survivors. The greatest uncertainties appear to hang over the hotel and travel companies. There are also questions for the contract catering groups, albeit potentially less acute.

Gaming sector

This industry could rebound quickly once sporting events restart. Royal Ascot 2020 will not be able to take place as an event open to the public is bad news for lovers of the turf, but this has been in company guidance since the start of the outbreak. Meanwhile, English football could resume in June and horse racing could also begin the same month. This would alleviate concerns around cash burn (only really still relevant to William Hill). Betting shops may still remain closed but they tend to be less busy than pubs, except at rare peak events, so an early return to business is possible.

What would await on the other side? Macroeconomic weakness is a concern and is reflected in our forecasts. But, independent retail bookmakers, already under pressure from the restrictions on FOBTs (fixed odds betting terminals), could yield further market shares to the bigger players. Meanwhile the decision of the Competition and Markets Authority to pass the merger of Flutter (owner of Paddy Power and Betfair) with Stars (owner of Skybet) will only consolidate the market even further.

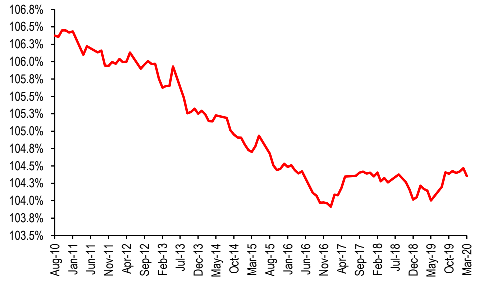
There's already increasing evidence that competition has eased, as the charts comparing English Premier League overrounds (a measure of returns to the bookmakers) suggests. And this will only be accelerated by the merger, in our view. Regulatory risk has not gone completely, but 1) It was already less than commonly perceived in the UK and 2) The new reality is that governments will need tax revenue from somewhere. All in, then, we expect the gaming sector to emerge in good health.

Conclusion: Near-term risks likely to decrease further. The new operating environment is more benign than feared.

GVC - Buy: Enough Fuel in the tank – 7 April 2020

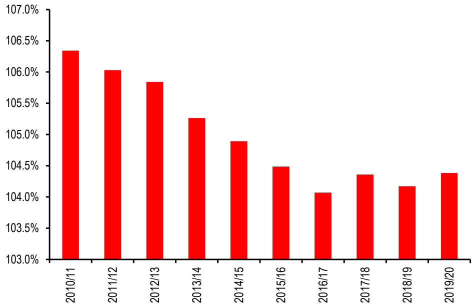
UK Bookmakers: When all bets are off – 23 March 2020

Premier league overrounds have stabilised



Source: Betexplorer, HSBC

Bookmaker overrounds by Premier league season



Source: Betexplorer, HSBC

Bus and rail

Bus and rail companies should be prime contenders for a V-shaped recovery. Services are still working. When people go back to work, they will have to use them and children still have to be taken to school. Long distance services (coaches and rail) would seem more vulnerable to a slower recovery, reflecting a potentially slower recovery in air travel and, perhaps, a reticence to climb back into confined tubes of metal. And even bus use has a high discretionary component, as we show below. We'd also point to two further risks:

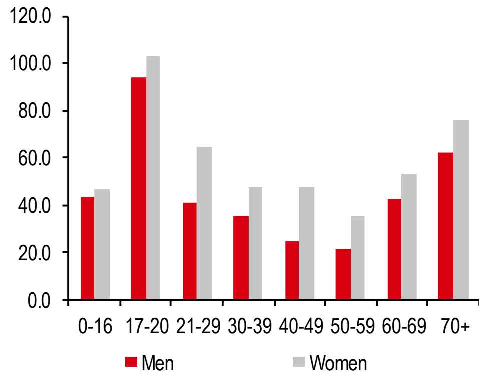
1. Social distancing rules could continue to impact bus operators – in Wuhan, for example, passengers have to scan a QR code that indicates their health, and have to sit apart. That could clearly be damaging for loads. However, we suspect it is not politically/socially acceptable in the UK and it's worth noting that, in Austria, the obligation is simply for passengers to wear facemasks.
2. Rail contracts technically revert to old terms in six months, when emergency measures end. That would make them highly uneconomic. So further renegotiation seems likely.

Where the is a benefit for the sector, though is that regulatory risk must likely decline. Following the COVID-19 crisis, we cannot imagine mayoral authorities (such as Greater Manchester) being willing to take the financial risk associated with bus operations. So, compared to the environment we expected before, this is a risk that has probably now gone.

Conclusion: Quick recovery, but with some caveats.

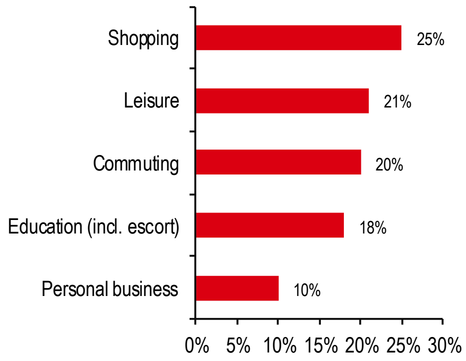
National Express - Buy: The direction of travel is clear – 14 April 2020

Local bus use by age and gender



Source: National Travel Survey

Purpose of local bus trips, 2018



Source: National Travel Survey

Pubs and restaurants

The speed of a recovery has been called into question by the Restaurant Group. When we have modelled the sector, we have assumed three months of closure, and then an immediate return to previously expected levels of business. However, RTN said that it is only planning for a phased reopening of its restaurants and that, by the year end, only two thirds of its estate may be operational again. It also potentially expects some restrictions on operations immediately following lockdown. If this takes the form, for example, of only one table in every two being used, then it reduces revenues further. This is problematic, given fixed costs.

Such an approach isn't necessarily the way that things will work in practice, but it would potentially intensify the risks around cash burn at the operators – and also covenant risk for those with securitised debt. However, for those that make it through to the other side, the outlook could be meaningfully better. We note in particular the likelihood that supply exits the industry. Weaker financed competitors could well be pushed out of business for good. We note, for example, that Carluccio's has gone into administration while Famous Brands, owner of Gourmet Burger Kitchen, has said that it will not provide any more financing.

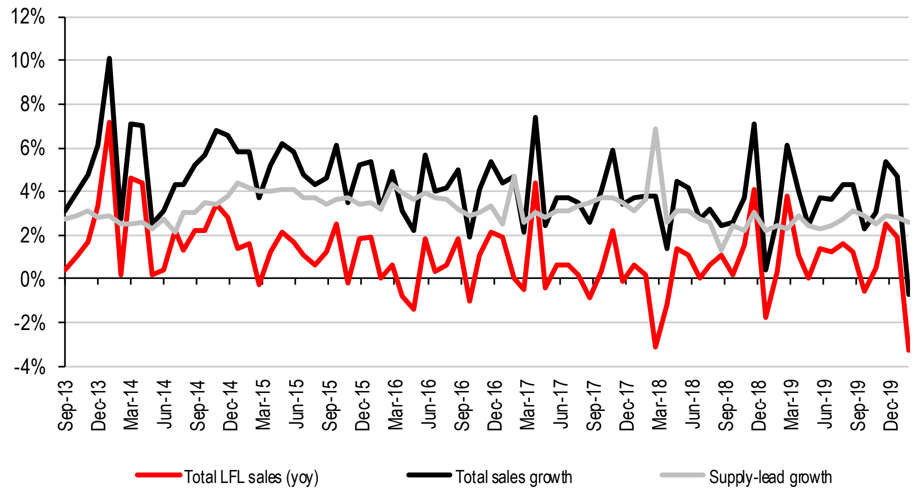
As the next chart illustrates, oversupply is the issue that has dogged the industry in recent years. Tepid like-for-like sales have been driven by expansion of new space, not a shortage of demand. If that expansion of new space now halts, the outlook could be meaningfully better, restoring pricing power to the sector and enabling it to better offset the cost inflation that has long been an issue. Of course, there could also be a recession to navigate. But the sector should be better placed to navigate the shocks.

Conclusion: Near-term uncertainties and interim recovery period will be tricky to manage, but major opportunities for those that make it out the other side.

Restaurant Group - Buy: See you on the other side – 7 April 2020

UK Pubs: Closing time – 31 March 2020

Like-for-like sales growth has been held back by steady expansion of new space



Source: Coffer Peach

Food services

The shock to food services companies is clearly severe. Compass said that it was expecting its revenues to dip by 50% in the last two weeks of March. Sodexo said subsequently that even over the June-August quarter, it expects group revenues to be -15% y-o-y.

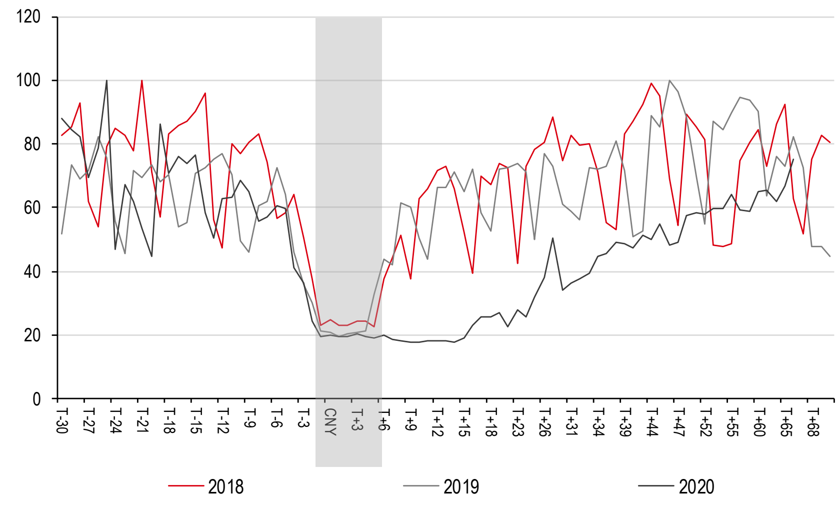
The key measure for how long the problems persist is how quickly people can return to work. HSBC's China Work Resumption Barometer indicates that from the calendar New Year, which is when the lockdown started, it took around three months to get back to 100%. Social distancing rules may mean that revenues in the sports and leisure segment are depressed for even longer still. Note that in Austria, no mass gatherings are expected until the end of June, which is six weeks after the restrictions are eased.

All in then, maybe some delays in rebuilding revenues. But what does the new landscape look like? Our concern would be that changing working practices stick, and that employers begin asking employees to start working some of the time from home, perhaps hot-desking for the remainder in order to save on real estate costs. Operators appear to think there's relatively limited financial threat from this, and that margins could be maintained as they would be able to flex costs accordingly. That's true, but it *could* impact returns on capital if capex requirements remain unchanged. In the near term, there's also a threat from recession eating into like-for-like sales in FY21.

There may be more scope for consolidation of smaller players. But this is something that was well underway anyway.

Conclusion: Return to work likely to be early. But potential longer-term structural change is not helpful to returns.

China work resumption barometer



Source: HSBC Qianghai Securities

Food services - Concessions

Concession companies are going through unprecedented times, where air traffic volumes are close to fully collapsing, capacity in recent weeks is down well over 75% in some US markets and load factors are making flying routes less sustainable. This is mirrored in the rail and motorway channels, with most markets enforcing working from home practices and operators also doing their part to ensure they comply with government guidelines and closing stores.

Operators have been aggressive in cutting costs, taking out more costs than we would have originally envisioned, but necessary in times where some regions are effectively not generating any revenues. SSP Group has recently done an equity and debt raise, which the company expects will see it through the worst of the COVID-19 impact on travel, which it expects to result in a worst-case scenario of YoY revenue declines (presumably volume led) of c80-85% in Q2/Q3 (calendarised) and c45% in Q4 (calendarised).

Many suppliers and landlords have been accommodating in the concession space, especially as passenger volumes decline to nil in many regions. This has allowed operators to defer or not pay rent and remove minimum rent guarantees which would be have made business models during this time untenable.

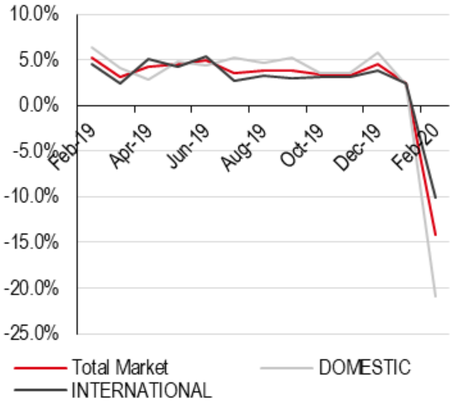
Coming out of this, we would expect the immediate market of concessions to reduce as smaller and some medium-sized businesses to lose out, leaving the surviving businesses to win market share. There is also a more fundamental question on contracts which have increasingly been more favourable for landlords, we would expect the remaining body of operators to take a more aggressive stance on negotiating contracts with mechanisms on volume expectations being better reflecting in terms.

Conclusion: Near term there is significant uncertainty on when we all start travelling. For the surviving companies who have enough financing, we expect them to take market share.

SSP Group - Buy: Prepare for the worst, hope for better – 30 March 2020

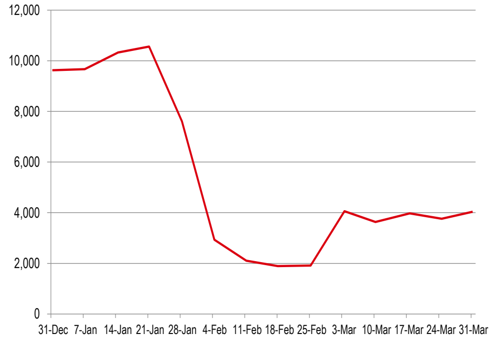
European concessions: Mask on / mask off – 3 March 2020

IATA: YoY Traffic growth (Global)



Source: IATA

China Top 25 airport traffic – COVID-19 impact and recovery



Source: Flightradar

Travel and Hotels

One of the most impacted sectors within the Leisure space, the tour operators, cruise and hotel companies have in many regions had to close or suspend most of if not all their operations as regions go through periods of lockdown.

It is unclear just how quickly traffic will rebound from this, especially as major source and destination markets would have to open fully at the same time (or both be open to travel concurrently) to ensure aspirational travel plans or intentional plans can even be delivered.

No operator has guided to a likely path to recovery, however Carnival has said that it does not expect bookings to return to normal levels quickly following the COVID-19 disruption. We believe they are acutely impacted but the return to any kind of return of normality in travel, would be led by air travel, with dependent subsectors following suit quickly behind.

Another key risk in the sub-sector is the timing of markets opening up to travel. As we get closer to the summer months, there would need to be a rebound in bookings quickly to fulfil furloughed capacity. However, if markets open up too late, it's very likely that the key trading months will be missed and only a portion of pent-up demand used for Winter travel.

What may help the industry is how governments have started to allow travel operators to hold onto customer deposits to be used for future use. This will help manage working capital and improve prospects for operators survival.

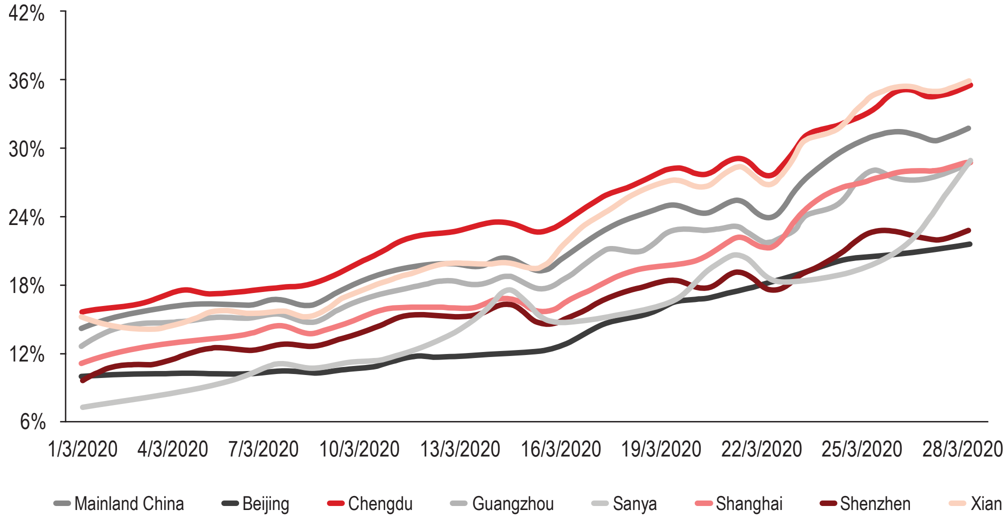
Hotels are slightly different as operators such as IHG and Accor operate asset light models, unlike Whitbread. So, IHG and Accor do not have major operational gearing issues and have been proactive in cutting fixed costs to improve cash conservation.

Hotel occupancy data from the earlier impacted Chinese markets, suggest some improving trends, but it would be too early to call this a recovery, as hotels are seeing occupancy at c30%. We would need to see recovery in business travel (which makes up over 50% of hotel nights), which would be a better indicator of a sustainable route to recovery.

Cruise companies are the most impacted, as the latest halt of service has been extended from the end of May to the end of June, by the US Centre for Disease Control. The perception of cruising between existing and new customers remains unclear (existing cruise customers typically make up 70% of bookings). While we are seeing some anecdotal instances of good booking demand for 2021 *(Cruise Industry News)*, we believe pricing power will suffer significantly to encourage demand. Growing ship supply will also create short-term cash management issues.

Conclusion: Recovery is dependent on markets opening up and for some, it needs markets to open in time for key trading seasons. As a result, operators have to focus on short-term cash sustainability and like other sectors will likely see reduced competition coming out of the other side. We would expect pricing power to be in the hands of the customer and some sub-sectors, may not get back to where they were before this crisis in the short term.

China Hotels Occupancy Recovery



Source: STR

TUI AG - Hold: Making it to summer – 20 March 2020

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