

August 23, 2019

Dear Clients and colleagues:

Summer is almost over, vacations have largely been taken and the return to school is imminent. This week Global Alpha is taking a look at some of the trends in travel, hotels and lodgings that have been observed this year and their impact on some of our related holdings.

In terms of air traffic, global revenue passenger kilometres (RPK) was up 5% year over year in June, which is slightly below the 20-year average growth rate of 5.5%. On a regional basis, in North America RPK growth fell to 3.1%, its lowest level since October 2017, driven by the weakest US domestic RPK data since early 2018. RPK growth has also been trending downward in Latin America, a reflection of weakening economic conditions in the region. Europe has been one of the bright spots, outperforming the overall market with year-over-year RPK growth of almost 6%. The driver behind this performance was an 8.6% year-over-year increase in Europe's largest market, namely internal flights within Europe. Asia Pacific RPK growth was slower than the overall industry with Japan easing and Australia continuing on a downward trend.

The hotel industry reported mixed results in the second quarter. In the US, occupancy was down 0.1% to 70%, but the average daily rate and revenue per available room both increased by just over 1%. The US hotel industry has been experiencing one of its longest expansion cycles; however, June saw a year-over-year contraction, only the second month to do so since mid-2010. The last weeks of July are also showing negative data, with occupancy, average daily rate and revenue per available room all down. This is in stark contrast to Europe which during the second quarter experienced high occupancy at 75.6%, an increase of 0.7% year over year, and very solid increases of 3.4% in average daily rate and 4.1% in revenue per available room.

The Mexican hotel industry had a very difficult second quarter. Occupancy and the average daily rate were down 3.1%, driven by a slowdown in demand, while revenue per available room was down over 6%. The 61.8% occupancy level in the second quarter of 2019 was the lowest experienced in a second quarter since 2013. Negative headlines, such as continued US travel advisory messages about certain states in Mexico and the seaweed problems encountered on Cancun and Riviera Maya beaches, have been a problem for tourism in Mexico. Elsewhere in the region, negative press about US tourist deaths in the Dominican Republic and worsening relations between the US and Cuba have impacted the lodging industry in these countries and led to large decreases in revenue per available room.

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The ever-increasing supply of Airbnb properties continues to challenge the established lodging industry, and while Airbnb was originally thought to be a larger threat to economy hotels, the luxury segment is also being affected.

Increased airport activity is beneficial for one of our holdings, Autogrill, a global leader in food and beverage concessions at airports and on motorways. Autogrill is market leader in the US, Canada, Italy and Benelux countries, has a top three market position in most of continental Europe and the Nordics, and is a burgeoning presence in Asia. Within the food and beverage space, travel concession finds itself in a very attractive position. Autogrill has the scale and experience needed to be successful in a complex operating environment that is controlled by government authorities and landlords. Security at airports is a barrier to entry for new competitors, and travel concessions face limited competition from e-commerce due to their captive audience and need-based purchasing. The average traveler is typically from a more favourable financial demographic, with a propensity to spend, and the higher average dwell time during travel only increases the opportunity to spend. With continued steady growth in global traffic, coupled with increasing passenger spending and possible new contract wins at airports, Autogrill shows potential for sustained revenue growth.

Our exposure to the hospitality industry comes through Spanish hotel operator, Melia, which owns and manages hotels and resorts. It currently manages more than 380 hotels in 40 countries with 7 brands covering the premium, upscale and midscale hotel segments. Melia is the third largest hotel group in EU and the second largest in Latin America.

Melia has a few different management models: (1) it owns the hotel and controls its operations, (2) it leases the hotel and acts as operator, (3) it operates a hotel under one of its brands on behalf of the hotel owner and receives a fee for its management services, and (4) under the franchise model, the owner operates the hotel under one of the Melia brands and contracts the sales and marketing services to Melia. The company intends to develop premium and upscale hotels as a priority in its strategy and aims to sign up more hotels under the management or franchising models. The company has been experiencing some of the aforementioned problems in Mexico, the Dominican Republic and Cuba (albeit Cuba accounts for a very small share of revenues), but its European operations posted strong revenue per available room growth in the first half of the year. Melia expects low single-digit revenue per available room growth for 2019.

Have a great weekend.

The Global Alpha team

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