WILSONS

Swapping the couch for an ocean view

Our weekly view on Australian Equities

25 March 2021

Services to benefit as COVID-19 restrictions ease

The vaccine rollout is likely to drive the reopening of economies in 2QCY2021.

This report looks at which companies stand to benefit from a reallocation of spending, from goods consumption to services, as COVID-19 restrictions continue to be eased.

We estimate that across just three sectors there is almost $A40bn of market cap that could be impacted if investors were to rotate out of goods-focused companies. Services related companies across Consumer Discretionary, Consumer Staples and Industrial sectors have a combined market cap $A5bn below pre-COVID levels.

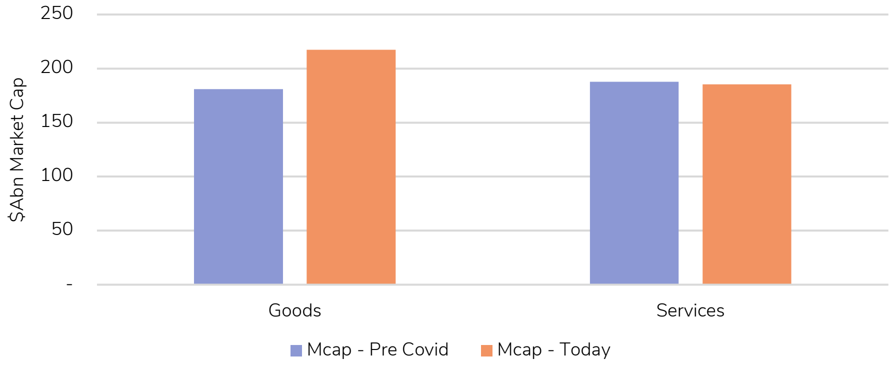
The 'service reopening' thematic will likely gather momentum across the 2HCY21 and into 2022 as global lockdown restrictions are eased. This is likely to be accompanied by sizeable returns in revenue and earnings for many services-based businesses.

In our view, the consumer behaviour change will simply be the directing of spend from the household (e.g. new couch), to local holiday within Australia until overseas travel becomes viable in early 2022 (Wilsons estimate).

The Wilsons Australian Equity Focus list recently added Sydney Airports (SYD) in order to gain exposure to services-based spending. Last week's SYD's February traffic numbers showed the second-best month for domestic traffic volumes since COVID-19 hit. Despite the small improvement over January, domestic passenger volumes vs pre-COVID-19 levels are down -70%, while international passenger volumes are down -98%. This implies a strong runway for reopening newsflow in our view.

Focus List also has exposure to Aristocrat Leisure (ALL) which will benefit from the economic reopening as ALL's traditional land-based gaming machine sales, which sales fell -45%.

Exhibit 1: Goods exposed companies have seen almost $A40bn market cap added



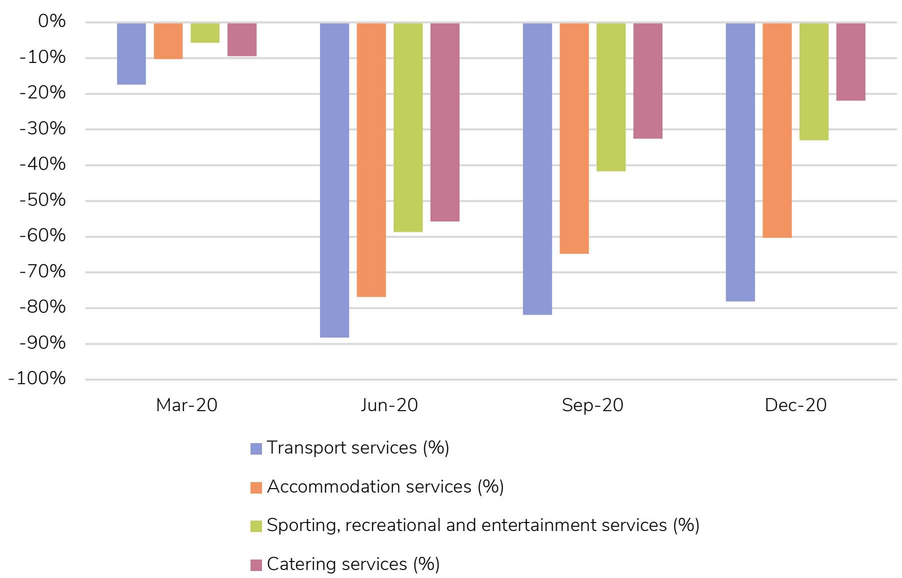
Source: Goods companies from Consumer Discretionary, Consumer Staples and Industrials. 1 Jan 2020 vs 23 Mar 2021.

Sizing up the Service Decline

National accounts data shows that >50% COVID-19 revenue declines have impacted many services-based industries. While there has been some easing of mobility restrictions, services activity remains depressed compared to pre-COVID levels.

Industries focused on social interaction, Transport Services (airlines, rental cars) and Accommodation (CBD hotels), have been most exposed to the revenue declines. Overall services-based spending is currently ~95% of pre-COVID levels, after bottoming out at 80% in mid-2020.

Exhibit 2: Many services-based businesses have seen >50% declines in revenue from COVID-19 lockdowns



Source: Source: ABS, Refinitiv, Wilsons. ABS measures of expenditure from the quarterly national accounts.

In contrast, goods consumption has benefited and is now running +6-7% ahead of pre-COVID levels. While some of this additional spending is likely to remain in place well after restrictions have eased further, the relative growth rates between goods and services spending will likely change. Goods consumption growth is expected to soften (potentially will go negative), and services spending is expected to accelerate. We think 2QCY21 is when we will start to see evidence of this emerge from ASX listed companies. This could present a challenge for goods focused companies which have seen strong price performance.

For more see [The Australian Economy: Room to Grow]

In the US, where mobility restrictions were looser than in Australia, recent data could provide a template on how to open up Australian businesses. Operating conditions in the US for services-based businesses are already starting to improve materially. Blackstone's (NYSE: BX) hotels in Las Vegas reported higher earnings across the New Years' and Super Bowl weekend periods than in the year prior.

Market estimates Goods vs Services

The revenue profile for S&P/ASX 200 service companies already anticipates a strong improvement in operating conditions across FY22E and FY23E. Much of this is the 'rubber band' effect post-lockdown as consumers resume services-based expenditure.

We find it interesting that consensus assumes only a very modest improvement in FY19 revenues levels by FY23E. Given the level of pent up demand, household savings and stimulus in the system, there is risk in our view that Services spending is cum-upgrade across FY22E and FY23E.

Exhibit 3: S&P/ASX 200 service companies offer much stronger revenue growth profile vs goods

Source: Refinitiv, Wilsons. Pre-covid mcap 1 Jan 2020 vs 23 March 2021. Earnings indexed to 2019 levels.

Exhibit 4: S&P/ASX 200 service companies expected to show rapid improvement in earnings from a low base

Source: Refinitiv, Wilsons. Pre-covid mcap 1 Jan 2020 vs 23 March 2021. Earnings indexed to 2019 levels.

Wilsons Australian Equity Focus List

The 'service reopening' thematic is likely to gather more investor attention through 2021. Based on our estimates, goods-based businesses have witnessed a ~40% increase in value, while service-based businesses are currently trading on enterprise value ~5% below that of pre-COVID levels. This disconnect is likely to narrow.

We have increased the Focus List's exposure to services with the recent addition of SYD (3% weighting).

See Acting with Conviction

We suspect we'll increase services exposure as our conviction levels increase (valuations notwithstanding).

Three key events are likely to be important in underpinning a further rerate of services-based companies;

1. A vaccine-led domestic opening to international travel in 2021 and 2022
2. Services-based companies begin to report an acceleration of activity levels
3. Goods-based companies report a slowing of demand, particularly a sequential, or month-on-month slowing of demand.

We have elected not to play travel companies like Flight Centre (FLT), Corporate Travel (CTD), QANTAS (QAN), and Webjet (WEB). Valuations look to have more than captured the potential improvement in activity.

There remains a high degree of uncertainty as to when international travel can resume – which is critical to profitability for all operators with the exception of QAN (who is more domestically exposed). With enterprise valuations above pre-COVID levels for these companies, our assessment is that the margin of safety has become too small.

Whilst SYD's profitability is also heavily exposed to international travel – a lower enterprise value vs. pre-COVID suggests a much larger 'margin of safety', which should better protect investors if the reopening was delayed. SYD still contains significant operating leverage - with the airport currently operating at 30% of pre-COVID capacity.

While ALL's (3.5% weighting) position in the Focus List is predicated on the structural growth in online social gaming (which we think will earn more than traditional land-based gaming by 2025), it does offer cyclical exposure to the resumption of gaming activity across pubs/clubs and casinos.

More importantly, CAPEX spending is likely to resume post the COVID-19 spending freezes. This can help underpin earnings over the next three years. ALL is expected to report earnings in late May, 2021.

The Focus List's key goods exposures is to Reliance Worldwide (RWC) and Super Retail Group (SUL). We think both companies are likely to see another round of earnings upgrades driven by buoyant activity levels relative to expectations, which is currently not captured in the share price.

Goods and Services Baskets

We have split the S&P/ASX 200 Consumer Discretionary, Consumer Staples and Industrial sectors into Goods and Services baskets. We show the change in enterprise value along with an assessment of where current operating conditions are and the market's assessment of future growth rates.

From a Focus List perspective, service-based companies Atlas Arteria (ALX), Skycity Entertainment (SKC) both look interesting from the "service reopening" thematic – depressed earnings and valuations in line or below pre-COVID levels.

While not a 'reopening' beneficiary per se, Dominos (DMP) growth rates over the next few years are likely to be well supported with the added benefit of a stronger balance sheet to support new geographic growth.

Exhibt 5: S&P/ASX 200 Goods exposed companies

Company	Enterprise Value 1 Jan 2020 ($Abn)	Enterprise Value 23 Mar 2021 ($Abn)	Enterprise Value % Change	Revenue (FY21/FY19)	EPS (FY22/FY19)	EPS (FY23/FY19)	Wilsons Comment
Travel							
Corporate Travel Management	2.2	2.7	25%	-55%	-42%	7%	EV distorted by US acquisition in 2020
Webjet	1.8	2.0	13%	-81%	-81%	-40%	Higher EV than pre-COVID. EPS diluted by >80% due to equity raising. Substantially leveraged to international travel.
Qantas Airways	15.3	16.0	4%	-67%	-37%	-8%	Higher EV than pre-COVID, less share dilution vs FLT. The market is also factoring in market share gains.
Flight Centre Travel Group	3.4	3.5	2%	-81%	-88%	-63%	Higher EV than pre-COVID, given equity dilution EPS expected to be just ~40% of FY19A by FY23E.
Transport							
Auckland International Airport	12.8	12.5	-2%	-64%	-67%	-36%	Greater EPS dilution vs SYD. Highly leveraged to international traffic numbers.
Transurban Group	58.7	51.8	-12%	3%	-68%	-2%	Revenue almost back to pre-COVID levels. Investors are overlooking TCL in favour of companies with greater reopening operating leverage.
Sydney Airport Holdings	28.9	24.2	-16%	-49%	-50%	-12%	Airport operating <30% of capacity. 2 phased recovery: 1) CY21 domestic travel; 2) CY22 international.
Atlas Arteria Group	8.9	6.9	-22%	-34%	52%	56%	Longer and more aggressive EU and US lockdowns have had a greater impact on revenue, delaying a potential distribution step up.
Entertainment							
Event Hospitality and Entertainment	2.5	3.2	29%	-51%	-53%	-17%	Market pricing in strong domestic reopening recovery across key properties, despite lagged earnings recovery.
Crown Resorts	8.1	9.2	13%	-49%	-36%	-3%	Significant COVID-19 earnings impact. M&A activity is now a larger focus.
Skycity Entertainment Group	3.2	3.2	1%	-33%	-37%	-24%	Benefitted from NZ COVID-19 elimination strategy. Still needs international travel for full utilisation. Forecast to be at ~70% capacity in FY21.
Tabcorp Holdings	12.8	12.9	1%	1%	1%	8%	Valuation broadly unchanged supported by Lotteries.
Aristocrat Leisure	23.7	23.6	0%	1%	10%	24%	COVID-19 paused ALL's growth profile. Reopening beneficiary with land-based gaming.
Star Entertainment Group	5.3	5.0	-5%	-26%	-22%	0%	Valuation getting some benefit from M&A in the sector, despite significant impact on earnings.
Other							
Domino's Pizza Enterprises	5.1	9.5	88%	53%	53%	78%	Significant rerating in market cap. Global growth profile remains strong (perhaps even improved vs pre-COVID)
IDP Education	4.4	6.9	58%	-4%	54%	112%	English learning testing business has recovered quickly after COVID-19. Student placement component still struggling with lack of international students globally.
Ramsay Health Care	20.2	23.4	15%	13%	-8%	0%	Equity raising of 2020 reduces the EPS leverage, despite revenue surpassing FY19 in FY21E.
Collins Foods	1.6	1.8	13%	19%	40%	61%	Market ignoring the earnings growth. EU biz could be a source of + earnings surprise.
InvoCare	2.0	1.9	-5%	4%	-21%	-11%	Less earnings due to COVID restrictions. Should be a winner from reopening.
G8 Education	2.0	1.6	-19%	-6%	-48%	-37%	Lagged revenue recovery, with earnings recovery held back given equity raising in 2020

Key	Focus List Member

Source: Refinitiv, Wilsons.

Exhibt 6: S&P/ASX 200 Service exposed companies

Name	Enterprise Value 1 Jan 2020	Enterprise Value 23 Mar 2021	Enterprise Value % Change	Revenue (FY21/FY19)	EPS (FY22/FY19)	EPS (FY23/FY19)	Wilsons Comment
Autos							
ARB Corp	1.5	2.8	87%	26%	48%	67%	Valuation almost doubled given demand profile, and geographic expansion
Eagers Automotive	3.8	6.0	59%	59%	120%	138%	Improved demand profile and acquisitions.
Bapcor	2.2	2.8	30%	32%	14%	24%	Improved demand profile and acquisitions.
GUD Holdings	1.1	1.4	24%	23%	9%	17%	Improved demand profile and acquisitions.
Discretionary Goods							
Kogan.com	0.7	1.4	97%	79%	225%	287%	Valuation has risen dramatically given bring forward of market share gains.
Breville Group	2.3	3.7	63%	53%	52%	74%	Valuation risen dramatically given demand profile, and geographic expansion.
Harvey Norman Holdings	5.7	8.5	48%	21%	21%	22%	Improved demand profile and earnings which the market expects to be maintained.
JB Hi-Fi	4.6	6.1	32%	25%	40%	39%	Improved demand profile and earnings which the market expects to be maintained.
Super Retail Group	2.4	3.1	31%	23%	14%	15%	Improved demand profile and earnings. We think earnings risks remain to the upside.
Premier Investments	3.0	3.7	25%	9%	44%	51%	Improved demand profile and earnings which the market expects to be maintained.
Staple Goods							
Coles Group	20.3	30.2	49%	2%	10%	18%	Improved demand and earnings profile, durability of elevated spending levels could be tested later in 2021.
Costa Group Holdings	1.6	2.3	43%	23%	150%	171%	FY19 was trough year for earnings pre-COVID 19. Earnings recovery in-play pre-COVID.
Woolworths Group	48.0	66.3	38%	12%	24%	30%	Improved demand and earnings profile, durability of elevated spending levels could be tested later in 2021.
Metcash	3.3	4.3	29%	16%	2%	7%	Improved demand and earnings profile, durability of elevated spending levels could be tested later in 2021.
Coca-Cola Amatil	10.2	11.5	13%	-2%	11%	19%	Market pricing in domestic reopening recovery in drink volumes
Brambles	12.8	13.5	5%	12%	31%	43%	Market focused on short term earnings with COVID-19 impacted. Strong growth in FY23.
Housing							
Reece	7.9	12.3	56%	13%	17%	30%	Improved demand and earnings profile driven by housing spend.
Wesfarmers	49.2	64.5	31%	19%	19%	23%	Improved demand and earnings - particularly from Bunnings.
Reliance Worldwide Corporation	3.6	3.7	3%	14%	17%	26%	Improved demand and earnings profile, market more sceptical on durability of demand.

Key	Focus List Member

Source: Refinitiv, Wilsons.

Disclaimer and Disclosures

Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures

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