EDISON

Tourism Holdings

The return of ROCE

Company AGM

General industrials

Tourism Holdings (THL) continues to deliver on its commitment to reduce capital employed, cut costs and rein in debt. FY15 NPAT forecasts have been upgraded from more than NZ$15m to more than NZ$16m, which is 44% more than FY14. Restoration of acceptable ROCE (defined by the board as 14%) is well underway with all divisions except NZ set to achieve this target by the end of FY15. We have therefore unwound part of our execution discount to the market and the peer group and increased our valuation from NZ$1.65 to NZ$2.00.

Year end	Revenue (NZ$m)	PBT* (NZ$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
06/13	224.6	7.3	3.4	4.0	49.1	2.4
06/14	226.7	19.8	9.5	11.0	17.6	6.6
06/15e	248.0	26.5	15.2	12.0	11.0	7.2
06/16e	260.3	31.8	18.3	14.4	9.1	8.6

Note: *PBT and EPS (fully diluted) are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Crucial year FY15 shaping up well

The focus of the board and management is on restoring ROCE to acceptable long-term sustainable levels. The company stated at its AGM on 26 November 2014 that the Australian business would lift its return from 4.6% in FY14 to a run rate of close to 14% by the end of FY15 and that the ROCE of the NZ business would reach the target in FY16 (ROCE in FY14 was 7.3%). Improved ROCE is being achieved through a combination of reduced capital employed, cost reduction and revenue increases. Using the company's formula of untaxed EBITA and year-end funds employed, ROCE at end of FY15 should be between 11.7% and 12.9% using an NPAT range of NZ$16-18m.

Strong RV aftermarket

The company has adopted a conservative depreciation policy, which sets the assumed realisable value of recreation vehicles (RVs) at NZ$3,000 to NZ$5,000 less than the expected price. This buffer means that THL's earnings include profit on sale of RVs, which is the amount of depreciation over-provided during the useful life of the RV. As a result of this conservative policy THL's earnings have included profit on sale of RVs in each of the last nine years.

Valuation: Upgrade from NZ$1.65 to NZ$2.00

There is an increased level of confidence in the company's ability to restore ROCE and to maintain capital discipline. It has a logical strategy of remaining an RV-centric business and using capital-light opportunities to move up the value chain and sell experiences rather than just providing a vehicle. THL is ticking the boxes by showing that it can deliver on its promises. Return restoration is happening, tourist market fundamentals remain strong and growth options are under consideration. For these reasons we have reduced the discount applied to peers and the market from 15% to 12.5% and we increase our valuation from NZ$1.65 to NZ$2.00.

1 December 2014

Price	**NZ$1.67**
Market cap	**NZ$188m**

Net debt (NZ$m) as at end FY14	78.7
Shares in issue	112.3m
Free float	78%
Code	THL
Primary exchange	NZX
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	14.4	17.6	70.4
Rel (local)	13.1	16.1	57.8
52-week high/low		NZ$1.8	NZ$0.9

Business description

Tourism Holdings listed on the NZX in 1986. It is the largest motorhome rental operator in the world with a fleet of 3,900 motorhomes designed to meet the needs of the free independent traveller (FIT) market.

Next event

H115	Late February 2015

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Edison profile page

Tourism Holdings is a research client of Edison Investment Research Limited

Earnings upgrades and ROCE

At its AGM on 26 November 2014 THL upgraded guidance for FY15 by 6.7% to more than NZ$16m and issued guidance for the first half of 2015.

Exhibit 1: THL – Guidance provided 26 November 2014

NZ$m	Current	Previous	Actual	Variance
	2015e	2015e	2014	y-o-y
NPAT	>16	>15	11.1	44.1%
Net debt	80	80	79	1.3%
	Current	Previous	Actual	Variance
	Dec-14	Dec-13	Dec-13	y-o-y
EBIT	>9	N/P	7.2	25.0%
NPAT	>4	N/P	2.5	60.0%
Net debt	85	N/P	97	-12.4%

Source: Company data. Note: N/P = not provided.

Edison forecasts for FY15 of NPAT of NZ$18m remain unchanged.

The upgraded guidance shows that the ROCE restoration journey is well underway. The company uses untaxed EBITA and year end funds employed to calculate ROCE. The table below shows that using Edison's balance sheet assumptions, the company's ROCE target (as calculated by THL) is achieved in FY16. If we use the company's minimum guidance for FY15 of NZ$16m PAT, the ROCE for FY15 reduces from 12.9% to 11.7%.

Exhibit 2: THL – ROCE

	2013	2014	2015e	2016e	2017e
ROCE (average FE)	3.8%	6.3%	8.7%	10.2%	10.9%
ROCE (year end FE)	3.7%	6.9%	8.8%	10.1%	10.8%
ROCE on EBITA (untaxed, average FE)	5.4%	9.8%	12.8%	15.0%	16.1%
ROCE on EBITA (untaxed, year end FE)	5.2%	10.7%	12.9%	14.9%	15.8%
ROCE target (EBITA untaxed year end FE)	14.0%	14.0%	14.0%	14.0%	14.0%

Source: Company data, Edison Investment Research estimates

Growth strategy

THL's plan is to continue with the business re-structure particularly in the NZ market, which has 52% of the motor homes and is not expected to meet its ROCE target until FY16. The company believes that change must be ongoing and that THL needs to be positioned to achieve "long run returns regardless of cyclical issues which meet reasonable investor expectations" (chairman's address, AGM, 26 November 2014). The business needs to be able to withstand global shocks or sudden changes in demand, to be more flexible with a reduced fixed-cost base.

The THL strategy for growth is to:

- continue to leverage the expected increase in demand for free independent travel (FIT) to improve and grow the RV market, which only accounts for 1% of the world travel market.
- add capital light incremental businesses that provide more services to the existing customers.
- change the focus from product and price to the provision of valuable experiences.
- maintain investment discipline and only invest when there is a high degree of confidence that the investment can achieve as a minimum benchmark a long-run average ROCE before tax of more than 14%.

At this stage the company is not considering any particular investment or initiative.

FY15 commitments

As evidence of growing confidence, the company has provided guidance for H115 EBIT, NPAT and net debt and for FY15 NPAT and net debt (see Exhibit 2 above). It has also provided operational guidance per segment, stating that the Australian business through cost management and revenue improvement will restore ROCE to acceptable levels by the end of FY15, that the NZ business will show improvement In ROFE, that there will be a continuation of strong ROCE in the US RV business and the NZ-based tourism businesses, and that the manufacturing joint venture will produce excess cash, which will be used to reduce THL's loan to the joint venture.

Build, rent, sell model

One of the hallmarks of the THL business model is the build, rent, sell model used to manage RVs. In Australia and New Zealand the RV product is manufactured by its 50% owned joint venture, which gives THL complete product control and the ability to right-size the fleet. In the US the product is bought from third parties but THL does have input to the design and exclusive use of the design for a period of 12 months.

When THL buys an RV the purchase is recorded as a non-current asset and depreciated. The depreciation rate is set by taking into account the expected sale price and the timing of the disposal. The Statement of Accounting Policies in the FY14 Annual Financial Statements states that the estimated useful life of motor homes for the purpose of providing for depreciation is between one and six years. In the US, because of the market size, it is possible to sell motor homes after about 12 months and the company's marketing material states that the product is to be two years old or less. In Australia, because of the distances travelled, the average useful life of an RV is around four years, and in New Zealand RVs are held for around six years. When the motor home has reached the end of its useful life, the written down value is transferred to a current asset and when sold the difference between the written down value (which becomes the cost of goods sold) and the sale value is recorded in the income statement as a gross profit or loss.

Accounting for rental assets provides opportunities to 'massage' profits by under-estimating or over-estimating realisable values. THL has a conservative approach and sets the realisable value at between NZ$3,000 and NZ$5,000 less than the expected price in order to provide a buffer for any market fluctuations. It is only when there is certainty on resale values that THL reduces the depreciation rate. In each of the last nine years, THL has recorded a profit on sale of RVs as part of annual income, which provides evidence of the conservative nature of the depreciation policy. The result is a reduction in near-term profits.

Exhibit 3: THL – depreciation and profit on sale history

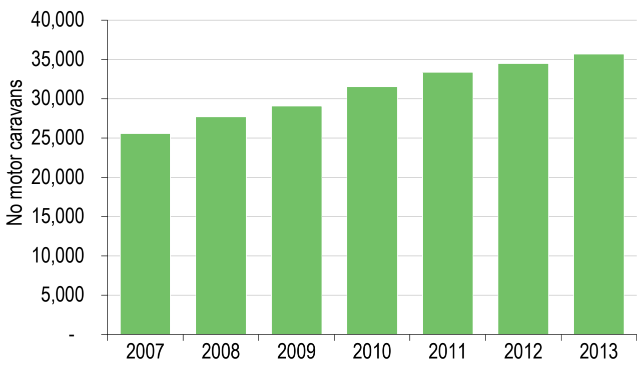
NZ$000	2006	2007	2008	2009	2010	2011	2012	2013	2014
Revenue			36,484	30,382	40,696	40,575	43,550	67,106	65,382
COGS			34,009	23,481	33,833	37,784	41,588	61,644	58,005
Gross profit	5,868	8,713	2,475	6,901	6,863	2,791	1,962	5,462	7,377
Depreciation charge – RV	20,174	21,306	24,541	31,794	31,257	36,829	39,414	39,024	33,090
Cost	178,896	175,851	190,338	215,056	206,680	300,173	323,663	312,511	288,464
Accumulated depreciation	44,971	49,123	55,204	60,731	71,453	108,025	144,389	92,875	86,403
WDV	133,925	126,728	135,134	154,325	135,227	192,148	179,274	219,636	202,061
Depreciation % of cost	11.3%	12.1%	12.9%	14.8%	15.1%	12.3%	12.2%	12.5%	11.5%

Source: Company data. Note: Gross profit on RV sales not disclosed before 2006.

In both Australia and New Zealand real depreciation rates have been falling. Real depreciation rates have been calculated as the cost of the RV less sales value divided by the vehicle life.

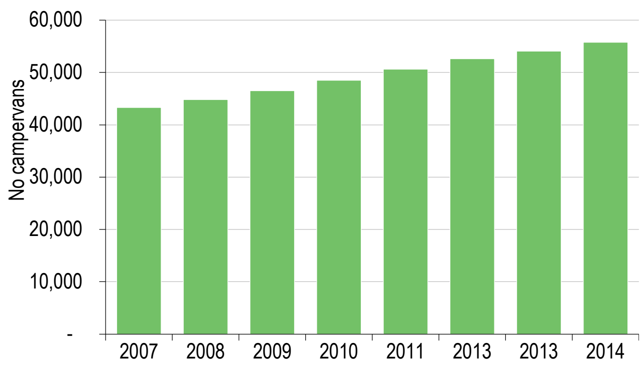
The market for RVs remains strong, with a CAGR since 2007 in New Zealand at 5.7% and in Australia 3.7%.

Exhibit 4: Registered motor caravans – NZ



Source: NZ Transport Authority

Exhibit 5: Registered campervans – Australia



Source: Australian Bureau of Statistics – vehicle census

Comparative companies

Our valuation is based on FY15 EV/EBIT multiples for the peer group. We have excluded from the peer group the airlines and the rental car companies and used a group that is more representative of tourism related exposure, albeit that companies such as Amalgamated Holdings (AHD.ASX) and Village Roadshow (VRL.ASX) have large businesses targeted solely at the local market.

Exhibit 6: THL – Valuation – Comparative companies' EV/EBIT multiples

			Yr1	Yr2	Yr3
Air NZ	AIR-NZ		6.7x	6.1x	6.6x
Qantas Airways Limited	QAN-AU		17.6x	9.7x	7.9x
Peers mean			12.2x	7.9x	7.3x
Amalgamated Hlds	AHD-AU		13.4x	12.6x	10.7x
Ardent Leisure	AAD-AU		17.7x	15.1x	12.8x
Fleetwood Corp	FWD-AU		8.9x	6.8x	5.7x
Flight Centre	FLT-AU		9.2x	8.6x	8.2x
Village Roadshow	VRL-AU		12.7x	12.1x	11.2x
Peers mean – USED IN VALUATION			12.4x	11.0x	9.7x
Peers median			12.7x	12.1x	10.7x
Car rental companies					
Avis Budget Group, Inc.	CAR-US		10.5x	6.0x	7.6x
Hertz Global Holdings, Inc.	HTZ-US		17.9x	14.1x	12.7x
Car rental company mean			14.2x	10.1x	10.2x
TOURISM HOLDINGS LIMITED	THL-NZ		8.8x	7.5x	6.7x
EV/EBIT multiple 15% discount – (NZ$)			1.94	2.35	2.28
EV/EBIT multiple 12.5% discount – (NZ$)			2.02	2.44	2.36
EV/EBIT multiple 10% discount – (NZ$)			2.10	2.52	2.45

Source: Bloomberg except Avis from Thomson Reuters

Exhibit 7: Financial summary

	NZ$000s	2012	2013	2014	2015e	2016e	2017e
Year end 30 June		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		199,962	224,621	226,668	248,001	260,310	270,726
Cost of Sales		(41,588)	(61,644)	(58,005)	(64,244)	(67,541)	(70,467)
Gross Profit		158,374	162,977	168,663	183,757	192,769	200,259
EBITDA		44,472	55,726	61,322	63,936	67,054	69,923
Operating Profit (before amort. and except.)		1,631	14,559	25,494	30,248	35,475	39,079
Intangible Amortisation		0	0	(1,637)	0	0	0
Exceptionals		0	0	0	0	0	0
Other		0	0	0	0	0	0
Operating Profit		1,631	14,559	23,857	30,248	35,475	39,079
Net Interest		(6,993)	(7,302)	(5,694)	(3,784)	(3,663)	(3,645)
Profit Before Tax (norm)		(5,362)	7,257	19,800	26,464	31,812	35,434
Profit Before Tax (FRS 3)		(5,362)	7,257	18,163	26,464	31,812	35,434
Tax		(2,814)	(2,081)	(7,047)	(8,469)	(10,180)	(11,339)
Profit After Tax (norm)		4,530	3,808	11,116	17,996	21,632	24,095
Profit After Tax (FRS 3)		(8,176)	5,176	11,116	17,996	21,632	24,095
Average Number of Shares Outstanding (m)		98.2	106.2	110.8	112.3	112.3	112.3
EPS - normalised (c)		4.6	3.6	10.0	16.0	19.3	21.5
EPS - normalised and fully diluted (c)		4.1	3.4	9.5	15.2	18.3	20.4
EPS - (IFRS) (c)		(8.3)	4.9	10.0	16.0	19.3	21.5
Dividend per share (c)		2.0	4.0	11.0	12.0	14.4	12.9
Gross Margin (%)		79.2	72.6	74.4	74.1	74.1	74.0
EBITDA Margin (%)		22.2	24.8	27.1	25.8	25.8	25.8
Operating Margin (before GW and except.) (%)		0.8	6.5	11.2	12.2	13.6	14.4
BALANCE SHEET							
Fixed Assets		238,012	275,366	256,355	239,404	233,615	231,277
Intangible Assets		23,665	22,578	20,790	20,790	20,790	20,790
Tangible Assets		205,115	244,339	228,957	212,006	206,217	203,879
Investments		9,232	8,449	6,608	6,608	6,608	6,608
Current Assets		57,075	54,444	39,180	51,289	63,580	76,525
Stocks		26,205	20,459	17,281	9,279	9,743	10,123
Debtors		17,512	19,126	15,119	16,581	17,411	18,089
Cash		4,083	5,480	3,479	12,128	13,124	15,012
Other		9,275	9,379	3,301	13,301	23,301	33,301
Current Liabilities		(47,282)	(70,887)	(61,653)	(52,312)	(53,405)	(54,375)
Creditors		(23,589)	(39,334)	(46,121)	(36,780)	(37,873)	(38,843)
Short term borrowings		(23,693)	(31,553)	(15,532)	(15,532)	(15,532)	(15,532)
Long Term Liabilities		(83,027)	(98,875)	(73,986)	(73,986)	(73,986)	(73,986)
Long term borrowings		(75,932)	(93,574)	(66,607)	(66,607)	(66,607)	(66,607)
Other long term liabilities		(7,095)	(5,301)	(7,379)	(7,379)	(7,379)	(7,379)
Net Assets		164,778	160,048	159,896	164,395	169,803	179,441
CASH FLOW							
Operating Cash Flow		29,756	52,668	53,390	51,135	56,853	59,835
Net Interest		(6,993)	(7,301)	(6,429)	(3,784)	(3,663)	(3,645)
Tax		(979)	(3,203)	(2,996)	(8,469)	(10,180)	(11,339)
Capex		(10,678)	(2,134)	0	(16,738)	(25,790)	(28,506)
Acquisitions/disposals		(1,423)	(53,083)	27	0	0	0
Financing		0	0	949	0	0	0
Dividends		(1,866)	(4,021)	(7,802)	(13,497)	(16,224)	(14,457)
Net Cash Flow		7,817	(17,074)	37,139	8,649	997	1,887
Opening net debt/(cash)		98,866	95,542	119,647	78,660	70,011	69,015
HP finance leases initiated		0	0	0	0	0	0
Other		0	0	0	0	0	0
Closing net debt/(cash)		95,542	119,647	78,660	70,011	69,015	67,127

Source: Tourism Holdings, Edison Investment Research

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