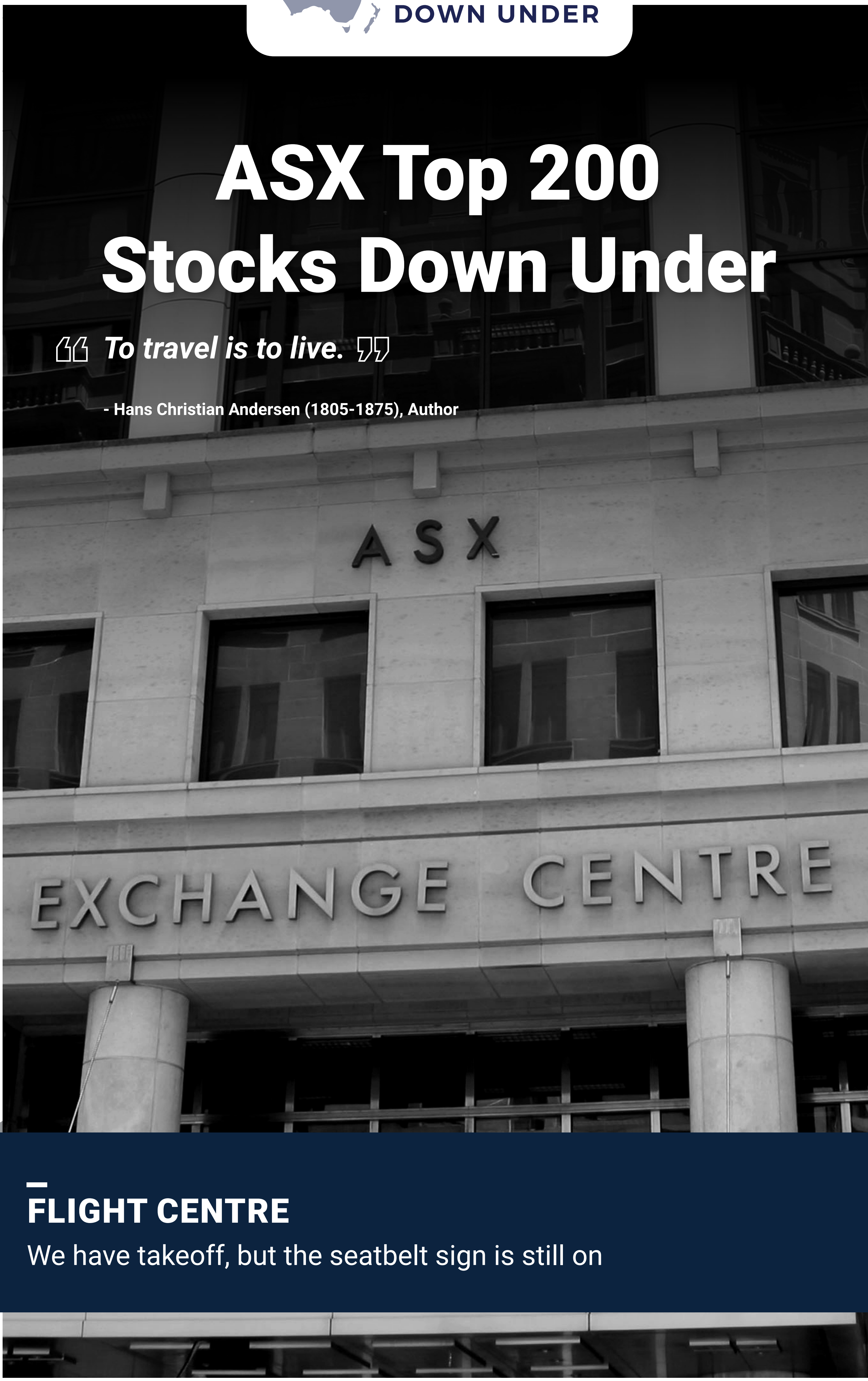
STOCKS DOWN UNDER

7 MARCH 2022

ASX Top 200 Stocks Down Under

> *To travel is to live.*

- Hans Christian Andersen (1805-1875), Author



FLIGHT CENTRE

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Stocks Down Under rating: ★ ★ ★ ★

ASX: FLT
Market cap: A$3.5BN

52-week range: A$13.67 / A$25.28
Share price: A$17.79

It's only been six months since we last covered travel agent Flight Centre (ASX: FLT). Since then, the company's shares have moved from $16.86 to $17.79. The lack of movement would suggest very little happened in the last 6 months, but things were more complicated with the Omicron strain, the Ukraine crisis and a major market correction, all taking the gloss off the rebound in demand for travel. We think the recovery of the travel sector to pre-COVID levels is on track for 2024, but there'll be more turbulence for Flight Centre shareholders before then.

Share price chart

Source: Tradingview

A 40-year old business with the same co-founders

Flight Centre was founded in 1982 by Graham Turner, Bill James and Geoff Harris, who all remain with the company today (albeit only Turner remains in a day to day capacity) and hold just over 25% of shares between them. The company is a travel agency serving both the leisure and corporate sectors out of brick-and-mortar stores and online. It has several brands and even other business ventures, including forex service Travel Money Oz and a stake in bike retailer 99 Bikes. Flight Centre has a presence in 26 countries, but remains headquartered in Brisbane. Just 33% of its global TTV (Total Transaction Value) comes from Australia, although this should increase as borders re-open.

Flight Centre shareholders have endured a rough few years. After reaching an all-time high of $68 a share in mid-2018, it initially dropped after allegations of anti-competitive practices prior to the pandemic and then of course the shutdown of the global travel industry due to the pandemic. The company undertook a $700m capital raising to survive, retrenched 4000 workers and closed dozens of stores. But similar to Qantas (ASX: QAN), these decisions meant not only that it would survive the lean times, but it would thrive in the post-COVID world with a substantially lower cost base.

Flight Centre's exposure to international markets meant it hasn't been all doom and gloom over the past couple of years. The company benefited from an uptick in demand in certain Northern Hemisphere markets such as the USA and Europe in 2021, because vaccination programs advanced faster than in Australia. However, the business is yet to fully recover from its pre-COVID highs. In FY19, the company reached TTV of $23.7bn and a profit of $343.1m. FY20 and FY21 saw back-to-back underlying losses of just over $500m, and TTV fell to just under $4bn in FY21.

Recovery still a work in progress

In releasing his company's recent half-yearly results, Graham Turner told shareholders his company was now seeing the strongest indicator of a return to normalcy with restrictions easing and governments beginning to treat COVID as endemic. At the same time, the company noted uncertainty remained around future variants and government responses to them.

The company's TTV was $3.3bn for the six months to December 31, 2021 – up 113% compared to 12 months ago. Although the stock dipped 6% because it still lost $276m, the company now thinks its TTV can surpass peak FY19 monthly levels during FY23 and return to monthly profitability in corporate and leisure travel during FY22.

Consensus estimates forecast $957.6m in revenue and negative $204.1m in EBITDA in FY22. But in FY23, Flight Centre is projected to achieve $1.9bn in revenue and $328.9m in positive EBITDA, whilst in 2024, it is forecast to reach $2.4bn in revenue and $496.8m in EBITDA. Flight Centre is consequently trading at an FY24 EV/EBITDA of 8x and P/E ratio of 16x. It is behind Corporate Travel Management (ASX: CTD) that is valued at an EV/EBITDA of 11x and a P/E of 19x. Compared to Webjet (ASX: WEB), Flight Centre is behind on an EV/EBITDA basis but ahead on a P/E basis – as Webjet is at 10x and 17x, respectively, for FY24.

At Stocks Down Under, we usually don't like to look too far out when valuing a company, but FY24 is appropriate here because that is when travel will return to pre-COVID levels.

Can it rebound again?

The last time we covered Flight Centre, in August 2021, we gave it four stars based on the company's growth prospects. Since then, its share price has been volatile. The news that Australia's border would reopen sent shares as high as $25, in mid-October, but the Omicron wave and market correction in January sent shares back to $15.50. Shares briefly surpassed $20 again in February, only to fall again after the breakout of the Ukraine crisis. The company briefly addressed the Ukraine crisis, noting it had the potential to blunt the recovery in Europe for some months.

It is clear there is appetite for travel, but travel is more complex now, playing into the strengths of Flight Centre. At the same time, it will take until 2024 for travel numbers to return to pre-COVID levels and it is unpredictable about what could impede travel demand, be it future COVID variants, the situation in Ukraine worsening or other global crises making people thinking twice about travel.

No stock in the travel industry is immune from these challenges. But we like the company's broad exposure to several international markets and to both corporate and leisure travel ahead of companies that have only exposure to fewer markets or just one segment, such as Corporate Travel (ASX: CTD). Business travel is a conventionally high- margin sector, but will take longer to come back than leisure travel. We also trust the company's management team with significant skin in the game for an ASX 200 company and experience in navigating industry crises before (even though arguably none have been as long or extreme as COVID-19).

So it's four stars again, but not without a warning to expect further turbulence before the company reaches cruising altitude.

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