



- 00:23** **Cameron Webster** On this episode, we speak with institutional portfolio manager Rob Campbell. Fresh off a flight from Toronto, Rob and I dive into what might be considered high quality business models in the travel industry. We guide you on the journey and stop at some of our holdings, including Amadeus, Intercontinental Hotels Group, and Sika. Thanks for listening!
- 01:20** **Cameron Webster** We do travel as a research team—extensively. We think there's high value in travelling, meeting companies, meeting management teams. We thought we'd tie the two together and investigate what kind of stocks we own in the travel industry, given we all spend a lot of time traveling.
- 01:37** **Rob Campbell** Definitely. Air travel globally is on the rise. People have more disposable income; they're interested in travelling. (Clearly for work I do quite bit of that too). There are definitely ways to make money in the travel industry. But it's not everywhere.
- 01:55** **Cameron Webster** I forgot my flight attendant: “welcome to the flight, Rob.” Welcome to the podcast, Rob.
- 01:45** **Rob Campbell** [laughs] Keep all limbs inside the vehicle.
- 01:47** **Cameron Webster** Thanks for that opening insight, that's good.
- 01:48** **Rob Campbell** Seat trays up!
- 01:49** **Cameron Webster** When I was thinking about mapping this conversation out, I thought, well, what was my last trip and how many different business models did I encounter throughout the trip?
- For instance, you have to book somewhere. Then you have to get to an airport. Then you gotta go through an airport. Then you gotta get on the aircraft. Then you gotta rely on the aircraft to get you to where you're going. Then you have to do it all over again pretty much on the other side.

- L 02:35 **Rob Campbell** There's security, there's escalators—all kinds of different things. Building materials...all that type of thing.
- L 02:39 **Cameron Webster** Let's talk, Rob, first about: within that value chain of taking a flight, of travelling, what would we characterize as “good” businesses, and what would we characterize as “not-so-good” businesses?
- L 02:53 **Rob Campbell** I think for us a lot of it comes down to, as you said, business model: what are [some] companies or types of businesses that have durable competitive advantages; where are the revenues going to be a little bit more recurring; where is competition going to be a little bit more benign? And maybe an interesting place to start is, just where that isn't.
- L 03:13 **Rob Campbell** I think the travel industry is interesting because we do find these good businesses, but there are also a lot of areas where we don't. Just because [either] travel for work, but also, I think more importantly, (and I think people can relate to this a little bit more), from a leisure perspective—it's pretty discretionary. So when times are tough and the economy isn't doing as well, maybe you don't take that trip to Hawaii ... maybe you do something a little bit closer to home, or you drive—or whatever.
- L 03:38 **Rob Campbell** So there is a cyclical inherent in these more discretionary business models, and that's where companies who have a lot of fixed costs, or don't pay very good attention to their balance sheet, or whose margin's revenues are really influenced by the cyclical of that business—they can get into trouble. And that's where we start to doubt the durability of those business models.
- L 03:57 **Rob Campbell** I think one area that we've tended to stay away from is—you think of travel, you think of airlines. And there's a lot of data that says that, over the last 70 years that passenger airlines have been in existence...there's been a lot of capital and wealth that's been destroyed in those businesses! [laughs] It's...kind of obvious because the way that they started, at least, was these state-owned entities where profitability just wasn't a concern.
- It was this rising business—there was almost a pride in terms of “American Airlines, we're gonna be the airline of the United States,” or Air France, or whatever it was. Profitability just wasn't a concern, it was just about having

routes, running the routes, getting the contracts for those passenger miles.

- ⌚ 04:41 **Rob Campbell** A lot of those businesses did destroy a lot of wealth, A) because they weren't focused on profitability, and B) because there just wasn't a lot of competition.
- ⌚ 04:47 **Cameron Webster** You mentioned fixed cost too—in terms of the business model. You look at all these really expensive aircrafts, [and] yes, you want to have them around for a long time, but those are expensive tickets to finance, to purchase.
- ⌚ 04:59 **Rob Campbell** They're fixed costs. And it's all about asset utilization, so, as much as we complain about this—it's about having as many people in the airplane as possible—making sure you're not running flights that are not at capacity. You got to have every seat booked; booking all those revenue miles. In downturns, that doesn't necessarily tend to be the case.
- ⌚ 05:16 **Cameron Webster** So airlines, maybe not so much.
- ⌚ 05:19 **Rob Campbell** But if we could stay on airlines for a second—you roll through to the 80s and all of a sudden, there was this wave of liberalization—or deregulation—in the airline industry. You had the emergence of players like Southwest [Airlines]. There are all of a sudden these low-cost carriers. So these big, state-owned entities—they just lost a lot of money, needed recapitalization.
- ⌚ 05:39 **Rob Campbell** And alongside that, you still had that cyclical. You had these unions who became pretty powerful; these pension liabilities that got really, really large...lots of write-offs, a lot of wealth destroyed for shareholders along the way. It's been really not a nice “boring” airplane ride, but more of a rollercoaster ride [laugh]—the types of landings that you expect in the middle of a blizzard.
- ⌚ 05:55 **Rob Campbell** We haven't tended to find as many airline ideas. I say “tended” because if we found an operator that was really focused on being very low-cost, or at least exposed to a market that was growing at a pretty good rate, I think we might be interested in that case. But I think we'd be cognizant of the other risks that are just inherent in that business model. So we just haven't tended to invest a lot in that area.

- L 06:18 **Cameron Webster** Okay, so airlines ... subject to cyclical, probably a highly leveraged balance sheet—markers that we wouldn't necessarily attribute to a high-quality company, or a high-quality business model.
- So, let's flip it a little bit, Rob. Give me an example of a high-quality business model that we have in one of the portfolios now.
- L 06:39 **Rob Campbell** Sure. Maybe if I could go back to the history of airlines but take it from the perspective of: you're booking a flight. If it was 1965 and you wanted to book a flight from—
- L 06:44 **Cameron Webster** Careful, you're going date me. Careful!
- L 06:46 **Rob Campbell** [Laughs]—from Calgary to Toronto, (it's definitely before I was born), but you'd essentially have to go to your rotary phone and dial up the airline. That was the way that you booked your flight. Where we are today in terms of going on to Expedia or one of these sites—that just didn't exist. You'd literally have to call the airline. You think about that, it's pretty inefficient.
- L 07:09 **Rob Campbell** So, what a couple of the airlines had to develop were these systems, essentially, to manage their bookings. If you're an airline and you have two people booking at once, but they're speaking to two different operators, how did you know that they both didn't book the same seat?
- L 07:23 **Rob Campbell** It was American Airlines, actually, who developed what is now known as a “global distribution system.” That was essentially a way to manage their bookings, and really be the infrastructure that allowed people to be able to book flights and for airlines to be able to manage those.
- L 07:37 **Cameron Webster** So it was the standard for the entire industry—
- L 07:40 **Rob Campbell** No, when it started it was really for American Airlines. And United had their own entity that did that, and then airlines in Europe as well. I think what came out of that was, these things were spun out. The one at American Airlines was spun out of Sabre—it's a publicly listed company in the U.S.—Air France and Lufthansa had a similar thing that got spun out as Amadeus, which is a company that we actually hold in the portfolio.

- L 08:00 **Rob Campbell** And I think the interesting thing is that globally, Amadeus, Sabre, and Travelport, between the three of them—they have a 95% market share globally.
- There are, in effect, only three players in the world who serve as the pipes that actually connect people who are booking travel with the actual airlines.
- L 08:20 **Rob Campbell** If you think about that from a business model perspective, they're the bottleneck. You've got to go through their systems—whether you're booking through a travel agent or if you're going onto Expedia or something like that.
- It's sort of like Visa, in the sense that transactions just go through their software. That is a business model that we can get excited about. Because all of a sudden you have significant barriers to entry. I think it's incredible. And by the way, this isn't—
- L 08:43 **Cameron Webster** So what's the barriers to entry?
- L 08:45 **Rob Campbell** Just the network effect and the scale that they've got built up. Think of how many travel agents there are in the world! They've got existing relationships with all those travel agents. Think of the number of airlines in the world. And think of how much value that brings to their customers—that someone can basically, in effect, book a flight anywhere. Connecting flights, hotels, rental cars...that all go through this one set of pipes, essentially.
- L 09:07 **Rob Campbell** So they serve, essentially, as a tax on airplane bookings. But I don't say “tax” from a negative perspective because it's really adding a lot of value to both their suppliers and their customers in terms of being able to enable people to book travel.
- L 09:18 **Cameron Webster** Right, it's more like a utility.
- L 09:20 **Rob Campbell** Yeah, essentially. A utility that has tremendous barriers to entry.
- L 09:24 **Rob Campbell** An example of that would be Amadeus, which we hold. [It] was essentially formed in the late 80s, and over the past 30 years, there have been no new entrants and no exits from that industry. That's how strong the barriers to entry are. It's just got that kind of scale that it's virtually impossible to come

in and replicate the networks that they have set up.

- ⌚ 09:50

Rob Campbell

And the nice thing is—as shareholders at least—the competition between them seems to be quite rational. They're not trying to severely undercut one another. That nice, oligopolistic type of market is one that we can get excited about.
- ⌚ 10:00

Cameron Webster

So that gets us a little bit more into the digital age. We went from the analog age of operators at airlines trying to not book the same seat at the same time. What else in the electronic space, in the digital ecommerce space within the travel industry, would be an attractive business model for us?
- ⌚ 10:19

Rob Campbell

I mentioned Expedia, but at least one of the stocks that we hold in our U.S. portfolio is Booking.com, or you may be more familiar with it as Priceline. ... The strength of that business model is very similar, it's a network effect. They have a tremendous amount of sales and relationship staff on the ground in terms of the numbers of hotels that they're affiliated with.
- ⌚ 10:45

Rob Campbell

If you go onto Booking.com or Kayak, which is another one of their brands, you can pretty much see all the hotels that are in a particular country or region. And you can see all kinds of details about them, you can see maps...those types of other services that have really increased. But it really makes it easy for the customer to go on and book travel that way.
- ⌚ 11:03

Rob Campbell

So maybe just to connect the dots with what we were talking about Amadeus, the way that I would book a flight would be to go onto Priceline or Booking.com (or a hotel, I'd use their software to screen things out that way). Booking.com gets a pretty good cut in terms of the price of the hotel room that I would book, and then the actual mechanism through which the transaction would take place would go through Amadeus' infrastructure.
- ⌚ 11:29

Cameron Webster

On Bookings, what I want to understand is, how do they generate revenue? You mentioned they get a cut, but who's actually paying Booking? Is it me, the customer booking? Where is the revenue stream in that business model?
- ⌚ 11:43

Rob Campbell

Essentially I'm booking a hotel room, ultimately as the customer I'm paying for it. Expedia will get about 20% of the cost of the hotel room, just as a

cut. Amadeus or somebody like that, (Amadeus is more focused on flights), will take about a 2% tax on that, essentially. And the rest will go to the hotel. But 20% of hotel bookings—that's pretty substantial.

- ⌚ 12:05 **Rob Campbell** And it's not just hotels, by the way. You can go onto Booking.com and literally they have things—it's not quite Airbnb, but it's similar—you can book a tree house.
- ⌚ 12:15 **Cameron Webster** Is that right? [laughs]
- ⌚ 12:15 **Rob Campbell** The extent of that network, and the number of things that they have signed up—just think of how difficult that is to replicate. Here's the other thing about—
- ⌚ 12:22 **Cameron Webster** So treehouse.com.
- ⌚ 12:23 **Rob Campbell** Treehouse.com [laughs].
- ⌚ 12:24 **Cameron Webster** Book a tree house anywhere!
- ⌚ 12:25 **Rob Campbell** Yeah, not for me, but maybe for somebody. Here's the other thing that I find is really interesting about it. So, I'm terrible at booking flights, and I'm terrible because I get so nervous that I'm going to book things the wrong way. I remember there was a Christmas where, instead of flying from Toronto to Montreal, I booked it backwards and it was just this massive problem. So I get really nervous, when it goes to click “Purchase” that I've done everything right.
- ⌚ 12:47 **Rob Campbell** One of the nice things about something like a Bookings is, they save all your information. So I don't have to type in my address, my credit card, all that stuff again—it's just saved there. It's got my passport information. When you think about the search cost associated with going outside of that—it's just a lot easier to do that all in one place. And that's another part of the stickiness of having a network effect and having repeat customers. They're making things really easy for a traveller to be able to purchase travel.
- ⌚ 13:13 **Cameron Webster** Right. So, what would be the risk in that model? We've got sticky end users

and we've got pricing that's dependent on how much revenue they're sharing with the ultimate place you're booking: hotel or airline or tree house.

- L 13:27 **Rob Campbell** I think there are a couple of risks. The biggest one is just the cyclical nature around it. Revenues are growing very strongly—double digits, year over year, at the moment. But that can turn. That's one risk is just, you're maybe overpaying for what you assume will be growth in revenues, over the near future, or the medium-term at least, that just don't happen.
- L 13:46 **Cameron Webster** So, Amadeus in the structure of the industry they're competing...you mentioned it's highly consolidated, there haven't been any new entrants—sounds great. But what are some of the risks in that business model? Regardless of how concentrated and domineering, or “dominating” it sounds like it is?
- L 14:04 **Rob Campbell** You get worried as an investor when you have trouble coming up with a list of significant risks. When you book travel, if you go to a corporate travel agent or an online travel agent, like an Expedia, those transactions—the actual way that those take place—will go through a global distribution system like the one that Amadeus offers.
- L 14:21 **Rob Campbell** But if you go directly to the airline, you bypass that. And airlines like that because it's more profitable for them. They get a better sense of their end customer and they don't have to pay that tax, essentially. So airlines, and I think rewards programs play into this, are trying to get you to basically book directly with them. So the risk is that that happens a lot more.
- L 14:40 **Rob Campbell** Another risk is, if you go back to Michael Porter's “Five Forces” and the bargaining power of their customers, all of a sudden—if you think back 20 or 30 years ago, most of the business was this very fragmented set of corporate travel agents. Someone on the street corner who was booking a flight for a couple customers. They have essentially no bargaining power; they have to take what Amadeus says.
- L 15:01 **Rob Campbell** But if their customers really start to concentrate, and I'm thinking more about the online travel agents—all of a sudden they have more bargaining power. They can say, “gosh, we're sending you all kinds of business, I don't want to

pay that 2% tax, let's make it a little bit lower." And that's another risk.

15:14 Rob Campbell They're great business models—and I like to call them the “toll road” business model because it doesn't matter if you book a flight on Air Canada or WestJet or United or whatever it is—everyone's still using the global distribution system. It's like a toll road.

15:59 Rob Campbell I had a client meeting recently that was in the western suburbs of Toronto, and then later that day I had a meeting that was on the complete opposite side of Toronto. And just thinking of sitting on the 401 and the risk of missing that meeting—well, for sure I was going to take the 407, which is the toll road that you pay whatever it is and you get to bypass all that traffic.

The risk was such that they could have charged me whatever they wanted, I was going to take that toll road. It's very similar with Booking. But the risk is somebody gets around that.

15:58 Cameron Webster Let's progress through the value chain a little bit, Rob. We've done our booking and we used Amadeus in the background to do that, or we used Booking.com. We booked a hotel. What do we think of hotels?

16:08 Rob Campbell Very similar. Cyclical. Potentially you have these really big fixed costs. It's about capacity utilization and making sure that hotel rooms are booked every night. And that definitely introduces some risk.

We do own one hotel company in the portfolio, it's InterContinental Hotels. It's a UK-based company, but their business is really global. But they don't actually own the hotels. Really what their business model is about is franchising.

16:34 Rob Campbell If there is a link between a lot of the companies that we've talked about so far, it's that they tend to be not very capital intensive. They tend to be capital light. I think the reason that's important is because you then have the flexibility in a downturn to not have these massive fixed costs that will really impair your flexibility.

16:52 Rob Campbell So, what's the franchising model in a hotel? InterContinental Hotels Group

doesn't actually own their hotels—other people, or franchisees, will own them. And as a result, and through the benefits of the shared marketing, and the brand, and not being able to attract people to those hotels—InterContinental Hotels collects a franchising fee. That fee is essentially based off of the revenue per room, multiplied by the number of rooms in the hotel, and then multiplied by whatever the royalty rate is.

17:19 Rob Campbell The benefit to InterContinental Hotels is clear: they can be asset-light, they can focus mostly on the value of their brand, and they collect this steady stream of revenues through royalties.

The value to their customers is clear as well, in that—if I'm starting a hotel, it's pretty difficult to get distribution for it. But if I can associate myself with Holiday Inn, which is one of the InterContinental Hotel brands, all of a sudden I've got a brand name that people will recognize, that will potentially pay more for, and that's to benefit me as a franchisee.

17:47 Rob Campbell So it's an attractive business model. And by the way, we own similar business models to that in other portfolios. I think about some of the quick food service companies that we own in our Canadian Small Cap portfolio. But this is one where it really is about the value of the brand, the value of the loyalty program.

18:03 Rob Campbell I know when I book travel (typically for work), again, because of that loyalty program, I'm instinctually drawn to always going with the same player. So there's a network effect that gets created out of that, and a sense of momentum.

I am more drawn to booking through—well, for me it's Marriott, just because that happens to be the hotels that are closest to the office here in Calgary. But whenever I go other places, that's the first place I go, I look to Marriott. Am I going to be able to use my points? That's what InterContinental Hotels is able to focus on.

18:30 Cameron Webster Sounds like a toll road for the hotel business. Again, capital-light. Airlines—not so much capital-light because they own the aircraft, and if it's sitting on the tarmac, they're still paying for it.

Whereas a hotel that's being built down the street here—I don't know if they're going to fill it, but if it's affiliated with a strong brand and it's a newer hotel—it attracts people out of the get-go, and you as a loyalty customer probably get some kind of incentive. Say, “try our new hotel in Calgary.”

- ⌚ 18:59 **Rob Campbell** I think it's less of a toll road and more just—the value of brand. If you think about how to make money, generally speaking, in terms of earning a return over your cost to capital—there are really only two ways to do that.
- One is to be able to charge a price that is higher than your competitors, which is very hard to do over the long term. You think about Coke or Pepsi being able to charge a price that's higher than their competitor—a lot of that has to do with brand.
- So, if you can create a brand that people will want to pay more for—like an InterContinental Hotels brand—you have a chance of earning more than your cost to capital.
- ⌚ 19:32 **Rob Campbell** The other way to make money, by the way, is just having a lower cost structure than your competitors. But that's not as relevant in this case. It's really about the value of the brand.
- ⌚ 19:38 **Cameron Webster** Value of brands—speaking of which, [I was at] Shopper's Drug Mart last night getting ready for a trip to Peru, precaution is—well, actually Paul Moroz said this on one of the first podcasts—
- ⌚ 19:48 **Rob Campbell** Imodium.
- ⌚ 19:49 **Cameron Webster** Imodium! And I'm looking at the stuff and I'm going, “are you kidding me? Thirteen dollars for six tablets?” And he's like, “Okay, what's the alternative?” Really, there's not one.
- ⌚ 19:59 **Rob Campbell** You're putting it in your body [laughs]. You want to make sure that it's the right stuff!
- ⌚ 20:04 **Cameron Webster** From Imodium and hotels...where do we go from there, Rob [laughs]? Let's go to some of the stuff that might be in the background.

- L 20:11 **Rob Campbell** Yeah, Sika is a good one. We talked about Amadeus, and the value of a company like Amadeus in terms of its business model is—I call it a “spinal replacement surgery” business model. Meaning that, to be able to go out and actually replace what they do is incredibly difficult and very painful. That's what gives it a good business model.
- L 20:30 **Rob Campbell** Sika's a different story in the sense that it's a keystone business model. Sika is ... really a specialty chemicals maker. And they make compounds that go into building materials that give those building materials specific properties.
- The actual flooring of the airport hangar, it's got to have certain properties that are really very critical to its functionality. Think about its compressive strength—these are very heavy airplanes that come in there—it's got to have a certain compressive strength. It's got to have resilience to abrasion, resistance to scratching and things like that; resistance to oil and infiltration if there are leaks. So these are very specific attributes that—
- L 21:06 **Cameron Webster** Does the floor clean itself?
- L 21:08 **Rob Campbell** I don't think they're there yet.
- L 21:09 **Cameron Webster** Oh okay, working on that one.
- L 21:11 **Rob Campbell** It's called a keystone business model because that compound is a very, very, very small proportion of the cost of building an airport hangar. But it's really critical to the functioning of it.
- We talked about brand being one way that you can charge a higher price than your competition, well things like patents and trust that your compounds are actually going to work—that are developed through reputation over the years—those are other ways to be able to have pricing power in an industry.
- L 21:36 **Rob Campbell** Sika as well—maybe a little bit cyclical in the sense that if there are more airports being built in the world, that definitely helps them. But there is a certain degree of just replacement and refurbishment that comes with their chemicals. Their business is a lot broader than just airport hangars or the

flooring in airports. They'll make chemicals that give fire-retardant type properties. So, you think about a big public space—it's good to have those chemicals in an airport.

- ⌚ 22:01 **Rob Campbell** Their business is a lot broader than just airports, but maybe a more interesting way that one of the businesses we own is tied to the travel industry.
- ⌚ 22:11 **Cameron Webster** Summing up: we like capital-light businesses overall (that seems to be a theme that, through the companies we talked about, is there). Network effects, or keystone business models—so, some reason that there's pricing power there, because if the service or the product went away, you'd somehow be in a value destruction mode as a business if you didn't have this.
- ⌚ 22:31 **Cameron Webster** A really interesting trip through the world of travel from an investing point of view. So thank you for joining us to take us on this trip. As far as “One Mawer Thought,” we'll stay on the theme!
- Given that we've had this discussion about business models, how has that affected how you travel?
- ⌚ 22:51 **Rob Campbell** I guess I'm just a little bit more aware of—even though this is a discretionary space—number one: there is some nondiscretionary aspects to it; and number two: just the value of brands. I'm coming to Calgary, I know I've got to be out of here for a meeting I have tomorrow. As a corporate traveler, I'm pretty price insensitive. I'll definitely look at Air Canada and WestJet, but that'll be a pretty cursory look. And if the prices are about the same, because I have an Aeroplan number, I'm probably going to book with Air Canada. So they've got that brand loyalty.
- I guess I'm just a little bit more aware of that, and understand why companies invest and tend to allocate capital to these types of things. Because they do result in a better business model.
- ⌚ 23:36 **Cameron Webster** Thanks for that! Thanks for joining us.
- ⌚ 23:38 **Rob Campbell** Thanks for having me.

