SMALL CAP REVIEW- Helloworld Limited (ASX: HLO) – January 2014

Speculative Buy

Welcome to the first edition of **Small Cap Review Newsletter** for 2014. It's time we took more notice of many small cap companies out there and the future of the Australian market, so we bring you the following look of a company we consider worthy of consideration. First, let's take a quick look at the past month; the markets rallied late December, with a number of our suggestions still continuing to perform well; Ramsay Health Care, Invocare, Northern Star, Beadell, APA Group, the Big Four Banks and the Retail Sector. The XJO currently sits around 5300 after a lackluster start to the year and volumes continue to slowly pick up as participants return from holidays. Speaking of holidays, the latest company we reviewed makes its money in the travel industry and we think its prospects look bright.

Formerly Jetset Travel World, **Helloworld Limited (ASX Code: HLO)** is an integrated travel business operating wholesale travel, franchise-based and affiliate retail agency networks, air ticket consolidation, airline representation and travel management services. Its new focus under the consumer brand 'Helloworld' sees the integration of a new digital platform provided through a long term agreement with travel mammoth Orbitz Worldwide (market cap of US$754 million) listed on the New York Stock Exchange. The recent name change consolidates the large number of brands and agencies the company operates and has recently acquired in Australia, New Zealand, USA, Asia, UK and South Africa. In total Helloworld Limited operate 29 brands including:

- Jetset Travel
- Travelworld
- Travelscene American Express
- Harvey World Travel
- Concorde agency Network (Australia)
- Ready Rooms.com.au
- Qantas Holidays
- Travel Indochina

The company currently trades at $0.38 cents per share with a market capitalization of $167 million. Drawn from the 2013 Annual Report released in August 2013, Net Profit after tax was $16.5 million or $0.037 cents per share. This result today is a PE ratio of approx 10.11x, compared to peers:

- Webjet (ASX code: WEB) PE: 33.07x, Net Profit 2013: $6.5 million ,
- Flight Centre (ASX Code: FLT) PE: 18.79x, Net Profit 2013: $246 million,
- Wotif (ASX Code: WTF) PE: 10.66x, Net Profit 2013: $51 million and
- Corporate Travel Management (ASX Code: CTD) PE: 34.05x, Net Profit 2013: $12.3 million

In terms of share turnover this company is not the most liquid stock we have seen. However, if you take a look at its Share Registry you begin to understand why, of the 439,953,581 shares on issue:

- 94.31% of the issued capital is held by the Top 20,
- 97.26% of the shares on issue is held by parties with 100,001 shares or more ($40k investment or more) and,
- The top 4 hold 86.01%.

The top four include:

- QH Tours Limited (subsidiary of Qantas Airways Limited) holds 28.9%
- Europe Voyager NV holds 26.8% (Belgium Entity)
- UBS Australia Holdings holds 17.9%
- Sintack Pty Limited holds 12.3% (Spiros Alysandratos**)**

What is the significance of this? Well with 94.31% being held by the Top 20 this leaves a meager 25 million shares available to new shareholders. Additionally, making an assumption that a person who holds 100,001 shares or more is not in the stock for a short term trade, the number available for new investors becomes even less sitting at 12 million shares. Given that one-year rolling volume traded sits at 13.3 million shares, it poses a challenge for those looking to enter and/or accumulate holdings in this company. However, it's not an impossible task, but it does require a good deal of patience. Low liquidity can be a double edged sword. Greater demand for the stock against a backdrop of low volume on sale will likely lead to higher prices and fast, but it can also work in reverse. If bad news presents itself, a lack of liquidity can result in lower prices just as quickly. Overall, the stock has been well supported at around $0.38 cents since May 2013 as shown below in **Figure 1**.

Figure 1

The 5 year weekly chart isn't the prettiest we have seen, however, many mergers do result in an initial loss in value for shareholders due to incompatibilities between the two businesses and the costs involved to integrate, not to mention the common premium paid for the target company to entice the sale of their assets. The idea of course is to prove to shareholders the merger will create value in the longer-term. The strategic review implemented in 2012 was a well timed initiative launched by the company's new CEO Rob Gurney (Ex Qantas).

As mentioned the annual report for FY2013 revealed a net profit after tax of approx $16.5 million, up 88% on FYE2012, despite being reduced by a one off 'abnormal' expense of $12.5 million, associated with the strategic review. However, the financial performance was on par with its performance pre-merger, proving to shareholders the company is on the right path to increasing shareholder value. The review is not completely finished, expiring in FY2014 and so will add additional 'abnormal' or 'one off' costs expected to be in the vicinity of $35 to $40 million. In saying this, to date the company's strategic review has delivered cost savings amounting to more than $50 million to the FYE13 period and is expected to achieve further cost reductions.

We have discussed earnings yield in previous reports and with the recent turnaround in profit for 2013 this meant a higher earnings yield for HLO which currently sits at 9.4% (**Figure 1**), higher than the average fixed interest rate you'll achieve at your bank 3.84% (1 year) to 4.34% (5 year). On comparison HLO would be a better choice purely on a yield basis, but it comes with a higher element of risk. Bear in mind this is not your return on investment, rather it's your claim on the company's earnings as a portion of your investment at current prices. Your share of the earnings is the distribution of profits in the form of the dividend. The dividend yield is 3.95%, not including the franking credit which increases the yield to 5.64% if included, still higher than the average term deposit rate over a 5 year period. The company has a dividend policy of distributing between 40-60% of Net Profit (where the recent dividend represents 50% of earnings) so there is potential upside to a higher dividend payment if the balance sheet allows.

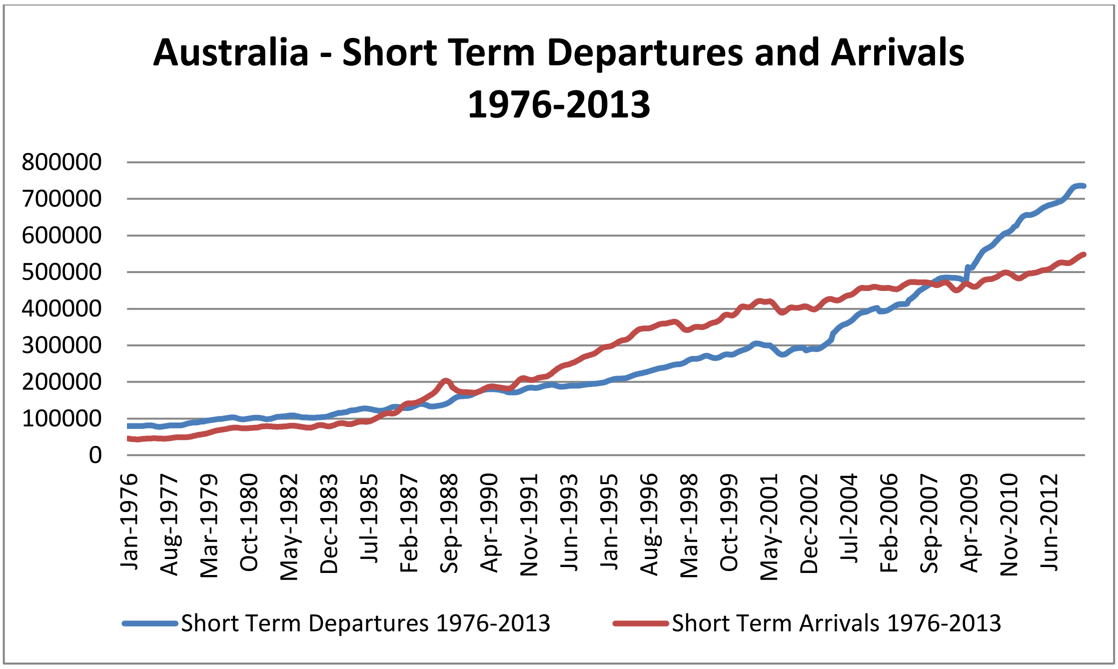

Figure 2

Figure 2 reflects 37 years of data reflecting short term (less than 12 months) departures from Australia by residents and visitors from 1976 to 2013. What we can observe from this chart is the strong trend in the number of people travelling overseas. Noticeably, the chart depicts the strong relationship between our currency and our travel plans, where a higher currency leads to a greater number of people travelling overseas. We can see an example of this in 2009 where the trend of residents departing exceeds that of visitors, coinciding with our currency rising from $0.66 cents in early 2009 to a high of $1.10 in July 2011. Today the Australian dollar sits at $0.88 cents against the USD with support around $0.87 cents, so naturally you can expect growth in the trend to slow over time. We don't see a risk of this trend reversing anytime soon; hence the company is well placed to continue to capture its piece of the growing trend.

In summary, Helloworld is a travel services business for the retail and wholesale markets with store presence in Australia, New Zealand, USA, Asia, UK and South Africa. The strategic review implemented by the new CEO, Rob Gurney was a well timed decision and is achieving efficiencies and cost reductions from its merger with Stella Travel Services. The rebranding achieves a stronger worldwide presence in store (in the countries mentioned above) and online (worldwide) to compete with the likes of Flight centre, Webjet and Wotif. The share price has held steadily at $0.40 cents per share, currently trading at $0.38 cents per share. We believe investors are slow to react on the improving fundamentals and prospects for further growth derived from its strategic review are not being factored in. Along with the tight register we believe early buyers will benefit prior to the quarterly report, due for release in early March which we speculate will reflect a continuation of the improving fundamentals. We suggest some exposure to this company for a speculative longer term hold.