In this edition we give an overview of emerging and frontier markets over the second quarter of 2018 before exploring investment opportunities in travel and tourism.

Travel and Tourism has grown at an astonishing rate over the last century. It creates jobs, drives exports and is a key beneficiary of disposable income growth and increased connectivity in the emerging world.

The Team

John Malloy and James Johnstone co-manage the RWC emerging and frontier markets strategies. The team is composed of a further 15 analysts, economists and strategists based in Miami and Singapore, many of whom have worked together for over twenty years. The team joined RWC Partners in 2015 and now manages c. $6bn for its clients.

Emerging and frontier markets represent the fastest growing countries in the world. The RWC team believes the continued growth in these markets represents opportunities across a range of industries.

The highly experienced and dedicated team takes an index-agnostic, opportunistic approach which allows it to explore investment opportunities that are often off the beaten track.
Review of Q2 2018

Emerging and frontier market equities suffered significantly during the second quarter of 2018. The RWC Emerging Market Equity Fund returned -8.1% vs. the MSCI Emerging Markets Index’s return of -7.8%. Frontier markets also fell, with the RWC Frontier Markets Equity Fund down -14.3% vs the MSCI Frontier Markets Index’s return of -15.1%. Trade tensions, rising US yields and a counter trend rally in the US dollar outweighed the positives of robust global growth, strong earnings potential and compelling valuations. The oil price rose +13.1% to $79 per barrel due to declining inventory data, collapsing exploration activity, increasing demand and Middle Eastern tensions. Whilst OPEC elected to ramp up production by 1 million barrels per day in the second half of 2018, the oil price will likely remain supported in the near to medium term.

Asian markets fell during the quarter, led by China as trade tensions dominated market direction. Nonetheless, macroeconomic data remains encouraging. Chinese and South Korean export growth remains robust and inflation is muted. The PBOC’s RRR cuts will release further liquidity into the system which should alleviate some of the market’s concerns. Continued market liberalization is also an encouraging sign with QFII rules further relaxed during the month. Latin America fell as political uncertainty in Brazil and a truckers’ union strike due to higher oil prices heavily impacted sentiment causing the real to depreciate from 3.3:USD to 3.9:USD. Brazilian consumption and capital expenditures remain strong, as evidenced by the first quarter GDP growth number. Private bank lending and industrial production continue to see a recovery. EMEA saw declines during the quarter led by Turkey and South Africa. The Turkish Lira fell -18% to 4.6:USD as the country negotiates a challenging macroeconomic environment. Additional sanctions impacted Russia but the equity market staged a comeback during the second half of the quarter as higher oil prices continue to benefit the country’s economy.

In frontier markets, Vietnamese equity markets declined during the quarter as retail margin pressure was exacerbated by fears over the local currency, the dong, as investors looked to the fall in the Chinese yuan and feared that Vietnam would be forced into a sharp devaluation. This led to falls in recent IPO stocks which was compounded by foreign ownership restrictions. Despite these concerns, the macroeconomic environment remains attractive with stable inflation, a robust currency and a strong manufacturing export base. A sharp fall in the Argentine peso from 18:USD to 28:USD caused the central bank to raise the policy rate from 27.5% to 40% to stem capital outflows. The IMF has granted the country a $50 billion package over 36 months which includes a significant fiscal deficit reduction but with some provisions for social security spending. The EMEA region performed relatively well with higher oil prices benefiting economies such as Saudi Arabia.

The outlook for emerging and frontier market equities remains positive despite rising geopolitical and trade tensions. Global growth remains intact and export growth continues to grow at around 15% year-on-year. Our portfolios have very little direct exposure to the US and so we would say that the current conditions present a buying opportunity. Macroeconomic risks remain such as a protracted period of USD strength and the prospect of a full-blown trade war. Nonetheless, the increased differentiation in emerging and frontier market growth that we have seen, and will likely see in the coming quarters, will hopefully favor our rigorous and thorough approach. The fundamental investment theses for our current holdings remain intact and our research suggests that specific themes such as urbanization, disposable income growth and financial inclusion remain unaffected by the current conditions over the long term.

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Emerging Travel and Tourism

Introduction

The growth of tourism and travel across the world over the last century is astonishing. The United Nations World Tourism Organization (UNWTO) estimates that in 1950 there were just 25 million tourist arrivals internationally. 67 years later, destinations worldwide welcomed 1.3 billion international tourist arrivals. 2017 was a record year for tourism with arrivals growing for an eighth consecutive year, a sequence of uninterrupted growth not recorded since the 1960s. Every day, more than 3.6 million tourists cross international borders, causing significant changes in transport methods. Travel time and costs have been reduced, information and communications technology has been revolutionised and tourism has become a central pillar for economic development in some countries. The total contribution of travel and tourism to GDP is estimated to be $8.8 trillion in 2018 which is 10.4% of global GDP and is forecast to rise to $12.4 trillion by 20281.

FIGURE 1:
Tourism is growing in absolute terms…

FIGURE 2:
…and as a % of global GDP

FIGURE 3:
Visitor exports are increasing

FIGURE 4:
Impacting more jobs and investment


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Chinese Outbound Tourism

Chinese outbound travel is a transformational phenomenon driving structural growth across different countries and industries worldwide. The country’s international tourism spend has more than tripled over the last six years. Spending reached $258 billion in 2017 from only $73 billion in 2011. The World Travel & Tourism Council (WTTC) forecast growth of 12.4% CAGR over the next five years to $462 billion by 2022. Growing disposable incomes, infrastructure development and a relaxation in visa requirements are partially responsible for this increase. The Chinese government has recently further simplified the application process. Previously, multiple visits to the visa office were needed to verify personal details. The new method requires only one trip and most regions are now allowing online submissions which further eases the application process. The growth in Chinese outbound tourism is also partially responsible for the recent declines in the country’s current account.

An important reason for the increased ease of international travel for Chinese citizens is the growing use of the Chinese passport. According to Chinese travel service provider, Ctrip, only 8% of the Chinese population have passports, compared to 46% in the United States of America. Nielsen calculate that the number of Chinese passports could double from 120 million today to 240 million by 2020 given the relaxation in the visa application process. Chinese tourists are prepared to spend considerable amounts of money on their travels. Regardless of destination country or region, Chinese tourists tend to always spend the largest portion of total travel expenses on shopping. Estimates suggest they spend an average of $762 per person on shopping compared to $486 per person for non-Chinese tourists.

Source: CLSA, UNWTO, RWC Partners 2000-2022E

Source: CLSA, RWC Partners 2017-2021E
Key Beneficiaries

The secular growth of Chinese outbound tourism will have a considerable impact on the surrounding Asian countries. In Thailand, Chinese tourists have grown at 29% per annum from 2012 to 2017 outpacing overall Chinese tourist growth of 5.5% per annum. In 2017, Thailand received over 35 million international arrivals of which c.10 million were from China. Partially responsible was the release of the film 'Lost in Thailand'. The film is a comedy concerning the travels of three Chinese men in Thailand. At the time of its release, it was the highest grossing movie of all time in the country earning over RMB 1 billion. Unsurprisingly, in the first quarter of 2013 the number of tourists to Thailand soared 93% to 1.2 million.
FIGURE 10: Thai arrivals lead the ASEAN region

FIGURE 11: Chinese Tourists have grown substantially

Source: CEIC, RWC Partners 2017

Source: CLSA, WTTC, RWC Partners 2006-2017

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Other countries in the region are also benefiting from increased Chinese travel. In 2017, Malaysia had 25.9 million tourist arrivals of which 2.3 million were Chinese. This will likely continue to rise as the country’s share of China’s outbound tourists is still small at only 1.8%. The Philippines and Indonesia may also benefit. The latter is ranked fourth in terms of tourist arrivals with 14 million during 2017 behind Thailand, Malaysia and Singapore. However, with the upcoming Asian games and various infrastructure projects, we expect the tourism sector to be one of the key beneficiaries. Rising star destinations such as Manado in North Sulawesi and Lombok in West Nusa Tenggara are now rivalling legacy destinations such as Bali and Jakarta.

**FIGURE 12:**
Chinese arrivals are increasing in absolute terms…

**FIGURE 13:**
…and relatively

**FIGURE 14:**
ASEAN tourism has potential to grow

**FIGURE 15:**
Manado Tua Volcano in Indonesia

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Investment Opportunities

CTRIP

Ctrip is China’s leading online travel agency with 60% market share. The company provides travel services for hotel accommodations, transportation ticketing services, packaged tours and corporate travel management. Online travel penetration in China is low at c.18% compared to 40% penetration in the United States of America. Overall travelling booking demand remains robust and the company’s growth outlook remains strong with our estimates suggesting 41% 5 year CAGR growth in earnings per share.

FIGURE 16:
Transportation revenue has seen impressive growth

Source: Ctrip, RWC Partners 2010-2020E

The company’s domestic airline ticketing business has been impacted by unbundling regulations in Q4 2017 and the first quarter of 2018 which has impacted the share price. Ctrip’s air ticketing business has seen rapid volume growth. Encouragingly, international air ticketing has accounted for over 40% of its total air ticketing revenues as of the first quarter of 2018, with a stable take rate of about 4%. Management expects international air ticketing to sustain its strong growth momentum largely due to Skyscanner and Trip.com which now account for 10% of revenues. The stock trades at 21.4x 2019 earnings on our estimates with 3 year average revenue growth of 25%. Risks to the investment thesis include disruptions in the travel industry such as new technologies, diseases and political unrest, in addition to a significant deterioration in China’s macroeconomic environment.

FIGURE 17:
Ctrip’s market share continues to grow

Source: Ctrip, CLSA, RWC Partners 2015-2020E

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Sands China develops, owns and operates casinos in Macau. The company currently operates five casinos (Venetian Macau, Parisian Macau, Plaza at the Four Seasons, Sands Cotai Central and Sands Macau). These casinos have more than 1,600 tables and 5,500 slot machines. Furthermore, Sands China operates over 12,000 hotel rooms, almost one third of Macau's total hotel inventory. We expect VIP gross revenues, mass revenues and slot revenues to grow at a 7%, 14% and 10% CAGR, respectively. The company continues to recover from sharp falls in revenues during 2015 when President Xi Jinping’s crackdown on corruption in the region negatively impacted margins.

**FIGURE 19:**
Gaming market continues to recover

**FIGURE 20:**
Led by a recovery in VIP segment

Chinese tourist arrivals to Macau are growing substantially. *Mainland Chinese tourist arrivals account for nearly 70% of total tourist arrivals in Macau and during 2017, this number increased to 32 million.* With more visitors staying overnight, the average length of stay of Chinese visitors has increased from 1.04 days in 2014 to 1.28 days in 2017. This is partly due to ease of access as visitors from China are exempt from entry-permits and visas. They can enter Macau by holding a Two-Way Exit Permit issued by the People’s Republic of China.

With 62% of Sands China’s gaming revenue coming from the mass segment, Sands will benefit from any upswing in China’s tourist arrivals. The company trades on 19.6x 2019 earnings on our estimates with 9% 3 year average revenue growth. We forecast +37.5% upside to the stock. On the other hand, we acknowledge certain risks to our thesis such as the deceleration of Macau’s gross gaming revenue especially within the VIP segment.
Minor International

Minor International is one of the largest hospitality and leisure companies in the Asia Pacific Region, operating over 160 hotels and resorts, 2,100 restaurants and 400 retail trading outlets in Thailand and in 39 other countries. The company has demonstrated solid top-line performance in the last 17 years, growing revenues at a 23% CAGR from 2000 to 2017. Minor will undoubtedly be a beneficiary of increased outbound tourism due to its international presence. Furthermore, despite some big acquisitions and expansions the company has managed to maintain a Return on Invested Capital of c.17% showing Minor’s long-term execution power.

Minor International has recently acquired a 34.7% stake in NH Hotel Group for 192 million euros in order to grow its global footprint. While Minor’s Hotels are reputable in Asia, Australia, the Middle East, NH Hotel Group brands are strong in Europe and the Americas. We believe management expertise and brand synergies will allow the company to transform into one of the largest hoteliers globally. The stock trades on 15.8x 2019 earnings on our estimates and we forecast c. 40% upside to the current share price.

There are certain risks to our opinions on Minor International, such as the possibility of the company being unable to execute on growth due to new launches, changes in consumer preferences and a variety of factors affecting global tourism such as geopolitical unrest, disease and natural disasters.
**FIGURE 24:**
NH Group and Minor hotels will become the world’s 19th largest hotel platform by number of rooms

![Graph showing hotel platform by ownership](image)

Source: Minor International, NH Group 2018E

**Turkish Airlines**

Turkish Airlines operates a network of domestic and regional services throughout Turkey and the Middle East as well as international services to Europe, Africa, North America, South America and Asia. **The company currently operates c.180 billion available seat kilometres in capacity (ASKs) with roughly 2% of global market share. With c.85% of revenues generated in EUR or USD and a large proportion of costs in local currency, the company is a net beneficiary of a weaker Lira.** Following the broader market sell-off in Turkey, the company is trading at 4.9x 2019 EV/EBITDA, a discount to global peers. Conversely, the company is exposed to the macroeconomic dynamics of Turkey which may impact demand for air travel and cargo transportation.

**FIGURE 25:**
Elewana African Experience in Kenya and Tanzania

![Image of Elewana African Experience](image)

Source: Minor International, Tivoli

**FIGURE 26:**
Capacity and Market Share continue to trend higher

![Graph showing Turkish Airlines capacity vs. global market share](image)

Source: Turkish Airlines, RWC Partners Q1 2018

**FIGURE 27:**
Diversified revenue base

![Pie chart showing revenue by geography](image)

Source: Turkish Airlines, RWC Partners Q1 2018

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Corporacion America Airports

Corporacion America Airports (CAAP) is one of the largest airport operators in the world operating 52 airports in 7 countries (Argentina, Brazil, Italy, Armenia, Uruguay, Ecuador and Peru). We forecast around 15% EBITDA growth per annum over the next three years as the company is a key beneficiary of global passenger traffic growth. Argentina, the largest single country contributor to revenues, is underpenetrated with regards to air travel. Flights per capita per annum is 0.3x in Argentina, compared to 0.5x in Brazil, 0.4x in Peru, 1.8x in the United States and 1.6x in Canada. Due to the recent sell-off in Argentine equities, the company now trades well below global peers at 4.7x EV/EBITDA. As 75-80% of revenues are dollarized and 50% of its cost base is in Argentine pesos the company is a net beneficiary of a weaker local currency. One of the threats to this investment thesis is the unlikely scenario of the Argentine concession not being extended to 2028.

Copa Holdings

Copa is a leading Latin American carrier, serving 65 destinations in 29 countries in Central America, the Caribbean, and parts of North and South America through its Panama City-based Tocumen Airport hub. Increasing traffic growth, improving yields and a high load factor should support earnings growth over the long term. As shown above, Latin America has incredibly low flight penetration per capita with potential for growth as disposable incomes rise. The company also possesses a balance sheet with Net Debt / EBITDAR at 1.6x compared to the sector average of 4.1x. The company trades on 8.8x 2019 earnings and we forecast 10% revenue growth per annum over the next 5 years with EBIT margins between 17-20%, significantly higher than regional peers. Although the company has one of the highest operating margins amongst airlines worldwide, a significant increase in demand for Copa’s routes from competitors may impact profitability.

FIGURE 28:
Flight penetration is still low in Argentina

FIGURE 29:
Copa is more profitable than Latin American peers

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Al Tayyar

Al Tayyar Group offers travel services in Saudi Arabia. The company organises vacation packages, books airline and hotel reservations and owns a car rental company. As highlighted in our last quarterly on Saudi Arabia, Al Tayyar is a key beneficiary of the Kingdom’s goal to attract 15 million religious tourists a year by 2020 and 30 million religious tourists by 2030. The company has 29% market share which is four times that of its next competitor and increased investment in local mobile applications, Tajawal and Mosafer will drive online revenue to SAR 3.7 billion ($986 million) by 2020 by our estimates. The stock is trading at 9.4x 2019 earnings and we forecast double digit earnings growth over the next few years. The company is exposed to increased competition in the online segment which could impact profitability from the company's local mobile applications Tajawal and Mosafer.

FIGURE 30:
Religious Tourists expected to double by 2030

![Graph showing Umrah Visitors from 2013 to 2030E]

Source: Vision 2030, Bloomberg, HSBC, RWC Partners 2013-2030E

FIGURE 31:
Online market share continues to grow

![Graph showing Al Tayyar's market share from 2015 to 2020E]

Source: Bloomberg, HSBC, RWC Partners 2015-2020E

Conclusion

Fundamentally, tourism and travel is a multi-decade thematic driving structural growth across the whole world. Higher disposable incomes across the emerging universe will lead to increased affordability of travel. The low proportion (8%) of the Chinese population with passports suggest we are merely at the nascent stages of this secular growth across emerging and frontier markets. The RWC Team is constantly travelling, searching for investment opportunities which will benefit from this growth potential. Travel and tourism creates jobs, drives exports and generates prosperity across the emerging and frontier market universe and we hope we will uncover more investment opportunities as these economies continue to grow and develop.
On The Road, Q2 2018

Thomas Allraum, Co-portfolio manager at a Rosneft field in East Siberia

Jaimin Shah, Analyst (Asia ex Japan) at a TOA Paints store in Thailand

Jessica Lim, Analyst (Frontier Asia) at Hoa Phat Group Headquarters in Vietnam

James Johnstone, Frontier portfolio manager at ASA Headquarters in Bangladesh

Christopher Siow, Analyst (Asia ex Japan) at Lotte Mart in Vietnam

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