Wizz Air: Having a Good Crisis

This week, Gareth Brown, Co-Portfolio Manager on the International Shares Fund, is joined by Chloe Stokes, Analyst on the International Shares Fund, as they discuss a new position in the Fund, the low-cost airline known as Wizz Air. Gareth explains how, as contrarians, we are always on the look out for businesses who are able to use crises to their advantage.

https://youtu.be/gj7cHuoe2x0

Transcript:

Gareth

Hi, I'm Gareth Brown, one of the Portfolio Managers here at the Forager International Shares Fund. Welcome to one of our Friday short videos I'm joined today by Analyst, Chloe Stokes. Today we're going to talk about a fairly new position in the Fund. Consider this a teaser for the September quarterly report when it comes out next month. Back in early May, the world found out that Warren Buffett sold all his US airline stocks in the teeth of the COVID-19 panic. We're contrarians, later that month, we acquired an airline stock in Europe. Chloe, tell us a little bit about the business of WizzAir.

Chloe

Wizz is a low cost airline with a focus on central and Eastern Europe. They keep costs down by operating a young and optimized fleet of aircraft flying to secondary airports and including only basic services in standard fares and charging add-on fees for any additional items. Wizz has grown market share quickly within Europe by selling cheap plane tickets and jamming passengers onto the plane.

I'm not sure if you've been on a Ryanair flight before, but seating is pretty tight. To try and illustrate how they keep costs so low, investor relations at Wizz were recently explaining that they'll cram almost 20% more seats than even Ryanair onto a comparable aircraft.

Gareth

Airlines as a group have a really notorious reputation for bad economics but as my good mate Nathan Bell once said, 'if you blindly gave someone the financial statements for one of these well-run low cost carriers, and we're asked to judge the business without knowing that you were looking at an airline stock, you'd swear, it was a really high quality business'. Good margins, good return on capital good cash flow and a lot of them actually returned cashflow each year to the shareholders via dividends and buybacks. Does Wizz Air belong in that same bucket as Ryanair or Southwest?

Chloe

Yes, but a more niche version. As I mentioned before, in order to keep costs down Wizz aircrafts flies largely between secondary airports. Currently around 60% of its capacity operates between cities where Wizz is the sole airline.

That doesn't mean competition can't or won't come along but it's a nice advantage for now. Another difference is that much of the customer base are flying between work in Western Europe and visiting friends and family in Eastern Europe, which is generally less discretionary than holiday or even business travel.

This helps to reduce cyclicality for Wizz. So far, the model is resulting in high margins and a solid return on equity. Cash isn't being returned to shareholders just yet though, Wizz is using it to buy more planes so they can continue to grow.

Gareth

So it's been a pretty good few years but COVID-19 has been a shock to the system like none we've seen since the dawn of the jet age. One of the things we're always looking out for in these situations is who's having a good crisis. These are the times that great companies accelerate their edge over the rest of the peer group and when I looked down at the press release from Wizz over the past few months, not only are they reopening flights, but they're starting new bases and they're opening new routes. They seem to be having a good crisis.

Chloe

Yes. We've seen them open up new bases like Milan Malpensa, Gatwick and Tirana in Albania, places that have been on their wishlist for years, but where landing slots were either unavailable or too expensive. Wizz was too small to capitalize much on the Global Financial Crisis, but they have the balance sheet and the right long-term focus now to come out of the current environment as a much stronger business.

Gareth

I can't remember the specifics, but Ryanair and EasyJet apparently picked up something like 20 million incremental passengers in the 2008 crisis and the European crisis that followed it because they were able to hit the accelerator when other airlines were trenching. We recently had a call with Wizz Air investor relations and probed them on which of their competitors were similarly expanding into this downturn and it sounds like it's been a very subdued response. Any insight into why that is?

Chloe

I don't know for sure but the only explanations that make sense that they're either too nervous or they don't have enough planes. As an example, Ryanair has a large outstanding order for Boeing 737 max planes. The has been significantly delayed due to the aircraft being grounded back in March, 2019 after two fatal crashes.

With less available aircraft than originally planned. They're not exactly in an ideal position to sweep up opportunities as they arise from the current crisis and as for all the non low cost carriers, the economics of the routes that Wizz Air is pursuing, probably just don't make sense

with their higher cost base.

Gareth

You mentioned Gatwick and Milan Malpensa as two big airports where was this taking the battle to the bigger players, but would it be fair to say that the real focus of this business is on that under served Eastern European market? The other day, I saw that Wizz opened a new route between what must be pronounced, Pardubice and Lviv.

From one town in the Czech Republic that you've never heard of to another town in the Ukraine that you've never heard of and that's three flights a week. It didn't make an immediate sense why that would be, but it starts to make sense when you realize that there are 200,000 Ukrainians living in the Czech Republic.

Chloe

That's right. They're providing a service to price sensitive Europeans that's cost competitive versus the train or the bus while dramatically more time efficient for customers and that's how they end up with around 60% of their routes as monopolies, because they can make it profitable where other airlines couldn't. It's the way to build a moat in an industry notorious for its lack of moats.

Gareth

That's a great spot to end the discussion. Thanks, Chloe. The thesis here is that we own a good business but one that's priced pretty much like any other airline, despite the recent re-emergence of COVID concerns in Europe and in the travel market in Europe over the past four to six weeks.

We’re up a little on our initial investment and hope to make much more in the years ahead as life slowly gets back to normal. Thanks for joining us, we hope to see you again soon.