

September 9, 2020

TRAVELZOO (NCM: TZOO)

Founded in 1998, Travelzoo is a global Internet media company with more than 30 million members worldwide. Travelzoo publishes offers from more than 5,000 travel, entertainment and local-event companies, and aggregates deals on its technology platforms to enhance members' experiences.

COMPANY HIGHLIGHTS

- * TZOO: Bridging Global Travel Suppliers and Customers
- * Travelzoo has built a robust network of global travel and entertainment suppliers and a strong technology platform that aggregates travel deals for customers. We believe this positions the company to capitalize on favorable long-term industry trends.
- * While 2020 has been an extremely challenging year for Travelzoo due to the coronavirus pandemic, which has led to sharp cuts in airline travel and hotel closures, we are encouraged by management's efforts to discontinue unprofitable operations in the Asia Pacific region, increase the use of vouchers to enhance near-term cash flow, and implement cost reductions across the business.
- * We believe that the company continues to have strong long-term prospects, supported by acquisitions (such as the purchase of a majority stake in Jack's Flight Club in January 2020). We also expect acquisitions to facilitate a shift towards a subscription-based operating model that will provide a more stable revenue and gross margin base going forward.
- * At June 30, 2020, Travelzoo had \$27 million in cash, up from \$19.5 million at the end of 2019. Based on this cash and recent cost reductions, we believe that Travelzoo is capitalized adequately to manage through the pandemic and return to growth in 2021 and beyond.
- * Year-to-date, TZOO shares have declined at a much steeper pace than the broader market, reflecting the substantial impact of the coronavirus on travel and entertainment spending. However, the company's core North American and European business delivered EPS of \$1.01 in 2019, and has been strengthened by the acquisition of Jack's Flight Club.
- * Applying a multiple of 25 (below the average forward P/E of 30 for the S&P Small Cap 600 and the Russell 2000 benchmarks) to our 2021 EPS estimate of \$0.52, we arrive at a fair value for TZOO of \$13 per share, well above current levels.

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KEY STATISTICS

Key Stock Statistics

Recent price (9/8/20)	\$8.27
52 week high/low	\$13.80-\$3.04
Shares outstanding (M)	11.3
Market cap (M)	\$93.0
Dividend	Nil
Yield	Nil

Sector Overview

Sector	Consumer Discretionary
Sector % of S&P 500	11.4%

Financials (\$M)

Cash & Mkt Securities	27.0
Debt	5.4
Working Capital (\$M)	-14.8
Current Ratio	0.7
Total Debt/Equity (%)	NA
Payout ratio	NM
Revenue (M) TTM	83.0
Net Income (M) TTM	NM
Net Margin	NM

Risk

Beta	1.8
Inst. ownership	30%

Valuation

P/E forward EPS	NA
Price/Sales (TTM)	NA
Price/Book (TTM)	NA

Top Holders

Renaissance Technologies
Dimensional Fund Advisors
Acadian Asset Managers

Management

CEO	Mr. Holger Bartel
Chairman	Mr. Ralph Bartel
CFO	Mr. Wayne Lee
Company website	www.travelzoo.com

PRICE CHART



COMPANY SPONSORED REPORT. SEE LAST PAGE FOR DISCLOSURES.

INVESTMENT THESIS

For more than 20 years, Travelzoo has worked in partnership with top travel suppliers to aggregate insider travel, entertainment, and lifestyle deals to a member base that has grown to more than 30 million. Travelzoo has more than 20 offices worldwide, which allows it to develop relationships with local suppliers and content contributors, and provide enhanced deals and experiences to its members.

The company's core strategy has been to build a travel and lifestyle brand with a large user base in the travel, entertainment and local-event markets. Travelzoo's supplier partner base consists of more than 5,000 companies, including airlines, hotel chains, cruise line operators, and tourism organizations around the world. Travelzoo generates most of its revenue by selling advertising rather than by taking a percentage of the transaction value. This enables Travelzoo to lower costs and helps its suppliers to maintain higher returns on invested capital. Prominent publications and products are published in 11 countries and include Local Deals and Getaways, which allow members to purchase vouchers for deals from local businesses such as spas, hotels, and restaurants, and from which Travelzoo receives a percentage of the transaction value.

For Local Deals and Getaways, the company earns a fee for acting as an agent for voucher sales with third-party merchants. Such transactions have historically accounted for approximately one-third of revenue, and had been declining before this year. However, in 2020, vouchers have been more attractive to Travelzoo as a source of up-front cash to support operating cash flow. The vouchers are recorded as accounts payable only when redeemed, and given that many are unlikely to be redeemed before 2021 or even 2022 due to the pandemic, the near-term economics are favorable. Merchant accounts payable were \$20.8 million as of June 30, 2020, compared to \$6.1 million on December 31, 2019.

Travelzoo's technology delivery platforms include a website, an app, and an e-mail alert service. According to management, Travelzoo's website is visited by 8.3-10.9 million unique visitors each month, and supplements its audience reach with website networks that syndicate deal content. In addition, the company has over 4.2 million followers on Facebook and Twitter, and its mobile applications have been downloaded 6.6 million times. To keep pace with the migration of consumers to digital and mobile platforms, Travelzoo has made its content available on both mobile devices and hotel booking platforms.

Historically, the company has been a counter-cyclical business, as travel-related customer traffic and deals have been highest when occupancy rates of travel suppliers are decreasing and resulting in more aggressive discounting. During these periods, Travelzoo provides

more compelling deals for its members, and travel suppliers see higher occupancy rates. Although Travelzoo has an affluent customer base, its customers are still price-sensitive and are known to respond to and seek out discounts on travel-related products and services.

In recent years, Travelzoo has had three operating segments based on geographic regions: North America, which consists of Canada and the United States; Europe, which includes France, Germany, Spain, and the United Kingdom; and Asia Pacific, which includes Australia, China, Hong Kong, Japan, and Southeast Asia. In 2019, Travelzoo reported revenue of \$111 million, which was flat with 2018, as lower revenue and operational losses in Asia Pacific offset modest revenue growth in the profitable North American and European markets, which had 18% and 12% operating margins, respectively, in 2019. We note that Europe's operating margin of 12% was below the 14% generated in 2018. We believe that this was a key factor in Travelzoo's acquisition of a majority stake in Jack's Flight Club, a travel deal aggregator that has traditionally generated strong operating margins and whose member base is primarily in the UK.

Although Travelzoo had expected to achieve a sustainable business in Asia Pacific by 2020, it announced in March 2020 that it would exit that business. In our view, the decision to exit Asia Pacific was prudent given the disruption from the COVID-19 pandemic, the longstanding drag of the segment on earnings, and the region's modest 6% contribution to total revenue in 2019. The Asia Pacific region generated a loss of \$0.67 per share in 2019, compared to earnings of \$1.01 per share in the core North American and European units. In addition, Asia Pacific also saw declines in both revenue per member and employee in 2019 (down 18% and 14%, respectively, despite growth in both mobile application downloads and social media followers). Despite the significant disruption from the pandemic, Travelzoo management said that business began to recover around midyear, boosted by travel deals with longer redemption periods. We note that during previous periods of industry disruption, such as 9/11 and the financial crisis of 2008-2009, leisure travel recovered more quickly than business travel. We expect suppliers to take aggressive measures to spur a recovery by offering enhanced discounts to customers.

Travelzoo has realigned its cost structure to position itself for a return to profitability post-pandemic. With streamlined operations, Travelzoo should be able to better integrate Jack's Flight Club, a travel-related subscription service based in the UK. (Travelzoo acquired a 60% stake in Jack's in January 2020 for \$12 million, and has the option to acquire the remainder of the company in 2021 or 2022. In June 2020, several acquisition terms were modified, including a price reduction of \$1.5 million.)

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PEER COMPARISON

Company	Ticker	Recent Price (\$)	52-Week High (\$)	52-Week Low (\$)	Mkt. Cap (\$MIL)	1-yr Price Change (%)	1-yr Rev Growth (%)	1 YR EPS Growth (%)	P/E Ratio	Beta	Yield (%)
TRAVELZOO	TZOO	8.27	13.80	3.04	93	-38	0	-12	14.3	2.04	NA
Expedia	EXPE	103	139.88	40.76	1454	-23	9	NA	NA	1.54	1.0
Trip Advisor	TRIP	23.7	42.96	31.87	3187	-39	-3	10	26.6	1.33	NA
Booking Holdings	BKND	1949	2904	1107.29	7980	-2	4	34	17.4	1.04	NA

Jack's Flight Club offers a free subscription, as well as a premium service for which members pay \$40-\$60 annually. Jack's has generated \$1.6 million in revenues for Travelzoo since the closing and had 1.7 million subscribers as of June 30. We believe that Travelzoo is well positioned to expand its business by cross-promoting offers between Jack's Flight Club and Travelzoo members. In addition, we believe that the Jack's acquisition will help Travelzoo to move its core customer base to a subscription model over time.

In April 2018, Travelzoo entered into an agreement with German start-up company weekend.com, which uses technology to promote vacation packages. Travelzoo invested \$3 million in weekend.com for a 25% ownership stake. Subsequent investments of \$1.7 million have raised this stake to 33.7%.

RECENT DEVELOPMENTS

Year-to-date, Travelzoo stock has fallen 23%, versus a 3% advance for the S&P 500.

In July 2020, Travelzoo posted a 2Q20 net loss from continuing operations of \$0.32 per share, as revenues dropped 73%, to \$7 million, due to the pandemic.

In June 2020, Travelzoo sold its Japan-based Asia/Pacific subsidiary, and entered into a licensing agreement, under which it retained ownership of the existing regional member base. It will receive quarterly royalties on revenues over an initial five-year period.

In March 2020, Travelzoo announced that it would discontinue operations in the Asia Pacific region to focus on its core North American and European markets.

In November 2019, Travelzoo was named "Best Online Travel Deals Provider" by the British Travel Awards organization for the eighth consecutive year.

In May 2019, the company announced a one million-share stock buyback program. It repurchased more than 600,000 shares for \$10.8 million in 2019, and 169,000 shares for \$1.2 million in the first half of 2020.

EARNINGS & GROWTH ANALYSIS

We forecast revenues of \$54 million in 2020 and \$72.5 million in 2021, representing a 52% decline in 2020, but 35% growth in 2021. We expect 2020 revenues to be limited by a slowdown in advertising insertion orders on Travelzoo's network, partly offset by contributions from Jack's Flight Club. Similarly, we expect a modest top-line impact from the exit from the Asia Pacific region, which accounted for approximately 6% of 2019 revenues. However, we expect this exit to result in higher margins in the core business and stronger EPS growth over time, especially if the company is able to move customers to a subscription model.

In 2019, Travelzoo generated operating margins of 8%, reflecting 15% margins in North America and Europe and a substantial loss in the Asia Pacific business. We expect an operating loss in 2020 due to the pandemic, but look for a return to growth next year with margins of 12%. We forecast a net loss of \$1.04 per share in 2020 and EPS of \$0.52 in 2021.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Travelzoo is Medium. As of June 30, 2020, the company had cash, cash equivalents and restricted cash of \$27 million, compared to \$19.5 million at the end of 2019. Prior to the pandemic, the company had an established a business model that had generated positive net income since 2016, despite negative returns in the Asia Pacific region.

In April/May 2020, Travelzoo received \$3.6 million in federally backed loans under the Paycheck Protection Program and the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). It plans to use the funds for employee compensation and benefits, and rent, and will apply to have the loans forgiven in keeping with the provisions of these programs.

Net cash provided by operating activities in 2019 was \$9.4 million, compared to \$5.3 million in 2018. Net cash used in investing activities in 2019 was \$124,000, compared to \$86,000 in 2018. Net cash used in financing activities was \$9.1 million, primarily due to \$10.8 million for stock buybacks, up from \$5.3 million in 2018.

As of June 30, 2020, Travelzoo had negative working capital of \$14.8 million, though prior to the pandemic, it had maintained a current ratio above 1.0 since 2015. With the discontinuation of Asia Pacific operations and prospects for stronger business conditions in 2021 and beyond, we expect Travelzoo's core business to generate enhanced cash flows and liquidity. As such, we view the company as being capitalized sufficiently for the foreseeable future.

Travelzoo does not pay a dividend, and we do not expect one to be initiated in the near term, as the company focuses on integrating the Jack's acquisition and expanding its global footprint.

MANAGEMENT & RISKS

Ralph Bartel founded Travelzoo in May 1998. He has been a member of the board since inception and chairman since May 2017. Mr. Bartel served as CEO from 2008 to 2010, and currently serves as Travelzoo's chief talent officer. Mr. Bartel holds a Ph.D. in Communications from the University of Mainz, Germany; a master's degree in journalism from the University of Eichstaett, Germany; and a Ph.D. in Economics and an MBA in finance and accounting from the University of St. Gallen, Switzerland.

Holger Bartel, has been Travelzoo's CEO since January 2016, and previously held the post in 1999-2007 and 2008-2010. Mr. Bartel also served as chairman between 2007 and 2009. Prior to joining Travelzoo, he was an engagement manager at McKinsey & Company. Mr. Bartel was a research fellow at Harvard Business School and holds a Ph.D. in Economics and an MBA in finance and accounting from the University of St. Gallen, Switzerland.

Travelzoo's board has five members. The board includes three independent directors, one of whom, Mary Reilly, chairs the audit, compensation and nominating committees. Ms. Reilly has been a member of the board since 2013 and was previously a partner at Deloitte LLP.

Risks to the company include its status as a "controlled company," as Chairman Ralph Bartel, via investment vehicle Azzuro Capital

(Travelzoo's largest shareholder), holds 39.9% of the voting power. In addition, Chairman Ralph Bartel and CEO Holger Bartel are brothers.

Other risks include a protracted disruption from the COVID-19 pandemic, which has had a significant negative impact on the global travel and entertainment industries. In addition, Travelzoo operates in a very competitive environment. Competitors include large internet portal sites, search engines, and travel search agents such as Kayak, Expedia, Groupon, and TripAdvisor. This competition has kept pressure on advertising rates. In addition, competitors may make strategic acquisitions or establish cooperative relationships to expand their businesses or to offer more comprehensive solutions. Travelzoo and its peers also face high customer acquisition costs.

COMPANY DESCRIPTION

Travelzoo is a global Internet media company that publishes offers from more than 5,000 travel and entertainment companies. It also provides commentary on target locations to more than 30 million customers worldwide.

VALUATION

Travelzoo's current market capitalization of \$73 million reflects disruptions in the travel and entertainment industries due to the pandemic. However, we believe that the year-to-date decline of 38% in the TZOO share price does not fairly value Travelzoo's core business, which has more than 30 million members, and had profitable operations in North America and Europe prior to the pandemic. These markets generated EPS of \$1.01 in 2019.

While 2020 will be extremely challenging, we believe that the acquisition of a majority stake in Jack's Flight Club will help Travelzoo shift its business towards a subscription model, which we think will provide a more stable and profitable revenue base. We expect stronger industry conditions in 2021, and look for Jack's to be an important driver of long-term growth.

Based on these dynamics, we apply a multiple of 25 (below the average forward P/E of 30 for the S&P Small Cap 600 and the Russell 2000 benchmarks) to our 2021 EPS estimate of \$0.52 to arrive at a fair value estimate of \$13 per share.

Steve Silver,
Argus Analyst

INCOME STATEMENT

Growth Analysis (\$MIL)	2015	2016	2017	2018	2019	Q1 2020	Q2 2020	Q3 2020E	Q4 2020E	2020E	2021E
Revenue	141.7	128.6	106.5	111.3	111.4	20.3	7.0	12.5	14.0	53.8	72.5
Gross Profit	122.9	114.2	93.6	99.0	99.5					45.4	64.5
SG&A	103.1	93.7	79.9	81.8	83.2					54.5	52.0
Product Development	12.5	9.4	9.2	9.0	6.9					3.6	4.0
Operating Income	7.1	11.1	4.5	8.2	9.4					-15.6	8.5
Interest Expense	NA	NA	NA	NA	NA					-0.8	-0.6
Pretax Income	5.9	10.9	4.7	8.3	8.9					-16.4	7.9
Tax Rate (%)	NA	39	66	44.0	54.0					NA	32.0
Net income	10.9	6.6	3.5	4.6	4.1					-11.6	5.9
Diluted Shares	14.7	14.0	12.9	12.5	12.0					11.3	11.4
EPS	0.74	0.47	0.27	0.37	0.34	-0.32	-0.48	-0.15	-0.09	-1.04	0.52
Dividend	NA	NA	NA	NA	NA					NA	NA
Growth Rates (%)											
Revenue	NA	-9	-17	5	0					-52	35
Operating Income	NA	56%	-59%	82%	15%					NA	NA
Net Income	NA	-39%	-47%	31%	-11%					NA	NA
EPS	NA	-36%	-43%	37%	-8%					NA	NA
Valuation Analysis											
Price (\$): High	14.29	13.27	11.25	21.15	22.85						
Price (\$): Low	7.54	6.63	5.75	5.95	8.72						
PE: High	NA	17.9	23.9	78.3	61.8						
PE: Low	NA	9.0	12.2	22.0	23.6						
PS: High	NA	1.3	1.1	2.5	2.5						
PS: Low	NA	0.7	0.6	0.7	0.9						
Yield: High	NA	NA	NA	NA	NA						
Yield: Low	NA	NA	NA	NA	NA						
Financial & Risk Analysis (\$MIL)											
Cash/Restricted Cash	36.5	28.0	24.0	19.5	20.8					NA	NA
Working Capital	16.0	14.6	7.6	6.4	1.1					NA	NA
Current Ratio	1.4	1.5	1.3	1.2	1.0					NA	NA
LTDebt/Equity (%)	NA	NA	NA	NA	NA					NA	NA
Total Debt/Equity (%)	NA	NA	NA	NA	NA					NA	NA
Ratio Analysis											
Gross Profit Margin	87%	89%	88%	89%	89%					84%	89%
Operating Margin	5%	9%	4%	7%	8%					NA	12%
Net Margin	8%	5%	3%	4%	4%					NA	8%
Return on Assets (%)	16	12	8	11	7					NA	NA
Return on Equity (%)	51	37	27	33	37					NA	NA
Op Inc/Int Exp	NA	NA	NA	NA	NA					NA	NA
Div Payout	NA	NA	NA	NA	NA					NA	NA

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