

PUBLIC NOTE

The Long Arc of Leisure Demand

Peter Lewis
peter@plraresearch.com



There are a number of capital-intensive leisure businesses in the US that we associate with Baby Boomers: cruise ships, timeshare resorts, enclosed malls, regional casinos, golf courses, multiplex theaters, ski mountains, and so on. Are there any common elements in how investors should approach them?

The oldest millennials are nearly forty, and it's probably time to admit that on average we're not quite as into these experiences as our parents — just as they've been less interested than their own parents in drive-in theaters, road trip vacations, bowling alleys, and a cocktail before dinner.

At the same time, these are hardly fads like pet rocks or Beanie Babies; many are tastes that people retain for a lifetime, and the slope of those preferences along the age curve may be as little as one or two percent per year. That curve can also be bent by other factors for years at a time; for example, Tiger Woods got a younger crowd interested in golf for a while, and the snowboarding craze got them onto ski mountains.

There are temporary offsets on the input side too: cheap timeshare inventory from busted condo projects after the financial crisis, or lower fuel costs for cruise lines after the collapse in oil prices a few years ago. There's also consolidation and changes in market share: large hotel-brand timeshare companies have been crowding out smaller ones for decades, and small movie theaters have struggled to afford digital projection equipment. You can benefit from a contraction in supply, as we've seen with malls. And you can market to more foreign tourists, or cruise ships can even be moved outright from the Caribbean to Asia.

The most consistent offsetting factor is that as your core US customer base gets older, some of them have more time and money. They can spend more on each

trip to the mall; you can sell them premium cabins on your cruise ship, an extra timeshare week, or second homes at the base of your ski mountain.

So when you combine all that with the greater absolute number of Boomers, it shouldn't be a surprise that some of these businesses have performed well as they've approached and entered their retirement years, even as these activities have slipped further from the zeitgeist.

But for any business where the median dollar of profit is driven by an older customer every year, there's still a long-term problem. And when they target this demographic problem head on, they often wind up pushing it around and making it more difficult to measure.

For example, you may be able to get younger people into your casino with more poker tables or better restaurants, but those are lower margin businesses than slot machines. Maybe you can sell them timeshare or vacation packages at the same price, but only by spending more on marketing or inventory — or maybe the initial margin will be the same, but they'll buy fewer upgrades. You can get them back into your mall with an Apple store, but they'll do less cross-shopping at other stores.

What we're really talking about is an underlying propensity to spend your free time in certain ways. And for all the armchair sociology about different generational values, and the particular narratives that crop up in each sector, a lot of it may be as simple as just not wanting to do what your parents did. Which is a tough thing to fight.

It seems like investors and management in these sectors go through multi-year mood swings in terms of how seriously they take this demographic problem, and it often has to do with how their business is doing at the moment. But that's largely driven by broader consumer spending (these are all cyclical businesses, of course) and some of those medium-term headwinds or tailwinds specific to each sector.

The underlying age curve is hard to separate from all these other trends, but it's also hard to assess many current business strategies without it. Let's take subscription pricing as an example — here's an interesting comparison from Adam Aron of AMC theaters on their last earnings call. The question was about the new flat monthly pricing that every theater chain is adopting:

I was in the ski resort business and when I got to Vail, we sold 5,000 season passes a year. When I left ten years later, we were selling 160,000 season passes a year.

I had a couple years' stint as the CEO of the [76ers]. And we doubled season ticket sales in one year and drove the biggest attendance increase of all 30 teams in the NBA, and the biggest ticket revenue increase...

And long before there was a MoviePass, we have been working on a subscription product within AMC... I am not surprised by the price elasticity. I think there is room for us at some point in the future to go up further...

That was a weird NBA season (2011-12) but we won't argue about basketball. The point is that he's not invoking the "subscription" model as a self-contained experiment, but as a tool in a larger strategy of price discrimination and customer segmentation.

Cheaper season passes at ski resorts have been accompanied by much higher walk-up lift ticket prices, with a complex range of options in between. You can't talk about season ticket sales in pro sports without considering the enormous secondary market where so many of those seats wind up. (Even when they weren't sold to brokers to begin with.) And since movie theaters are another industry that's been offsetting falling attendance with rising prices for a long time now, it makes sense they'd be looking for better ways to segment their product.

Of course there are plenty of differences. For example, movie theaters have a major variable cost in studio royalties that the other two businesses don't. And the insurance value of advance sales is more important for skiing and sports arenas, since the risk of poor snowfall or a losing season is greater than the risk of a weak film calendar.

But they're all responding to an aging audience (albeit the NBA much less than other sports) with increased segmenting and targeting of their existing customers. Which isn't to say they're not also pursuing new ones, but that's a more difficult goal and they're often in tension with each other.

There are two key points to take from this. First, comparing pricing strategies between startups and legacy businesses can be misleading in both directions. It's not just a question of MoviePass having the "wrong" price point at \$10/month and theaters finding the "right" one at \$20 or \$25. Their economics and incentives are different from the ground up. (If it's too hard to take MoviePass seriously, think of ClassPass and gyms.) And similarly, you can imagine a fashion subscription box startup succeeding with a product / price point where a legacy fashion brand would lose money, or vice versa.

Secondly, it's becoming difficult to value the legacy businesses without more demographic data than public shareholders are getting. Even a full age distribution wouldn't really be enough. Are older customers staying longer, spending more, choosing higher-margin products/services, driving younger customers' purchase decisions (e.g. by organizing family vacations), generating more referrals, using their loyalty points differently, travelling further to get to you, even just taking better parking spots?

Does this focus on age sound overly simplistic? Maybe the length of the customer relationship or some other related metric is more predictive. Aging population cohorts are not the only exogenous source of changing consumer preferences or behavior over time. But at the moment they seem to be concentrating more value in fewer customers for a lot of businesses, which means that mapping them to every part of the customer relationship is more important than ever.

PLRA is a paid research publication for institutional investors, but you can share these public notes freely, and sign up at plraresearch.com to receive them directly.