

Thomas Cook (India)

5 November 2018

Reuters: THOM.NS; Bloomberg: TC IN

Moving in the Right Direction; Retain Buy

Thomas Cook (India) or TCIL reported a mixed performance in 2QFY19 with the travel and forex business showing good revenue growth, while margins and Sterling's performance was disappointing. On like-to-like basis, consolidated revenues increased 13.8% YoY to Rs15.9bn and were in line with our estimate. EBIT improved to Rs61mn profit vs. a loss of Rs177mn in the same period last year. PBT improved from a loss of Rs399mn to a profit of Rs112mn. The reported numbers are not comparable YoY. While the company beat our revenue expectations, we were disappointed by slower-than-expected recovery in travel margin. TCIL posted operational performance in a seasonally lean September quarter which was also affected by floods in Kerala and Manali. The company increased each of its businesses and we hope margins will follow suit. As of now, we have revised our travel business and Sterling margins down to a much conservative level. There remains seasonality in the business with April-June and October-December quarters being the peak season, while the remaining quarters are lean. We continue to like TCIL for its strong business growth, retail focus in forex, cash flow generation and a solid balance sheet. We have retained Buy rating on TCIL with a reduced target price of Rs300, representing 41% upside from the current market price.

2Q is seasonally weak quarter for the travel business: The overall segment's revenues increased 15% YoY to Rs14.7bn and EBIT rose to Rs187mn as compared to Rs21mn YoY. EBIT margin improved to 1.3% vs. 0.2% YoY. YoY, outbound revenues increased 19%, MICE increased 53%, inbound increased 12%, corporate travel increased 16% and DMS increased 10%. Our EBIT margin estimate for the travel business in 2QFY19 was much above the reported results, but still marked a good improvement YoY. Our miss largely came from slower-than-expected recovery in the online and DMS business. Thus, we have reduced our EBIT margin estimates for the travel business by 50bps each for FY19 and FY20, which now stand at 2.7% and 2.9%, respectively, as compared to 2.7% in FY18. However, both domestic and DMS businesses continue to move in the right direction. DMS business improved its gross margin by 200bps to 17% and reduced loss during 2QFY19 to Rs9mn as compared to Rs42mn YoY and Rs230mn QoQ. Loss (before tax) in online business during the quarter was Rs50mn. Forward travel bookings increased 20% YoY. 3Q remains seasonally strong for the company while 4Q is again a lean period.

Forex business shines: Revenues increased 15.8% YoY to Rs729.6mn and were 9.4% above our estimate. EBIT increased 41% YoY to Rs.238mn and were 6.7% above our estimate. EBIT margin during the quarter improved to 32.6% vs. 26.7% YoY. Retail business revenues increased 11% YoY on a comparable basis as Borderless card sales increased 12% YoY. We continue to focus on the company's growth in forex business as it yields a better spread and creates float. Also, the wholesale business remains difficult to predict, both in terms of volume and margins.

Sterling struggles with accounting problems: Revenues decreased 5.6% YoY to Rs520mn and were 24.7% below our estimate (which were not adjusted for accounting changes). Adjusting for accounting changes, Sterling's revenues increased 5.4% to Rs.584mn, but were still down 15.5% as compared to our estimate because of Kerala and Manali floods. Thus, the business posted a loss of Rs232.8mn as compared to our expectation of a loss of Rs66mn (which was not adjusted for accounting changes). We have now updated our numbers for Sterling, which has lowered TCIL's consolidated results as well. We now expect Sterling to post Rs720mn EBIT loss in FY19 as compared to Rs390mn in our old estimates.

BUY

Sector: Travel & Tourism

CMP: Rs212

Target Price: Rs300

Upside: 41%

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Key Data

Current Shares O/S (mn)	370.5
Mkt Cap (Rsbn/US\$bn)	78.6/1.1
52 Wk H / L (Rs)	303/193
Daily Vol. (3M NSE Avg.)	506,653

Price Performance (%)

	1 M	6 M	1 Yr
Thomas Cook (India)	(7.6)	(25.5)	(15.3)
Nifty Index	(4.1)	(1.5)	1.2

Source: Bloomberg

Cons. Summary (as reported) Rs mn	2QFY19	2QFY18 (Incl. Quess)	1QFY19	YoY (%)	QoQ (%)
Net Sales	15,999	26,756	20,845	(40.2)	(23.2)
Cost of sales & service	(12,377)	(11,036)	(16,428)	12.2	(24.7)
Operating and other expenses	(3,504)	(15,055)	(3,589)	(76.7)	(2.4)
EBITDA	118	666	828	(82.2)	(85.7)
EBITDA Margin (%)	0.7	2.5	4.0	(180bps)	(330bps)
Depreciation	(166)	(251)	(162)	(33.8)	2.6
EBIT	(48)	414	666	(111.5)	(107.2)
EBIT Margin (%)	(0.3)	1.5	3.2	(180bps)	(350bps)
Net Interest Cost (Income)	(71)	(373)	(9)	(81.0)	722.2
Other Income & Exceptional	0	150	0	NA	NA
PBT	(119)	191	657	(162.0)	(118.1)
Tax Expense	(27)	549	(10)	(105.0)	182.2
Core PAT	(146)	740	648	(119.7)	(122.5)
Core PAT Margin (%)	-0.9	2.8	3.1	(370bps)	(400bps)
Income from Associate - Quess	84	0	49	NA	NA
Consolidated PAT	(85)	244	706	(134.7)	(112.0)
Consolidated EPS	(0.23)	0.66	1.90	(134.3)	(112.0)

Source: Company, Nirmal Bang Institutional Equities Research

Our take on TCIL's 2QFY19 earnings

TCIL posted stellar revenue growth in all its businesses. As compared to last year, earnings growth was also good, but we were much ahead in our estimate. Thus, from the profitability point of view, we were a bit disappointed. But we like to highlight that it was a seasonally lean quarter for the company as 'Durga Puja' and 'Dussehra' holidays were in October this year. Additionally, the business was affected by floods in Kerala during the monsoon season. It is the peak season for this destination, which is an important contributor to the company's inbound and domestic business. Having said that, TCIL continues to post much improvement in margins YoY and the business is moving in the right direction.

Reasons behind reduction in our estimates and target price

Our estimates and target price stand reduced, but we continue to like the stock as we previously did. We like to urge the investors to add on in the current weakness. The company is making the right move in the right direction, and even with a disrupted peak season it reported very good revenue growth. Our estimates have largely been reduced on two counts. Firstly, change in accounting policy for Sterling. This will affect the reported margins for the business, but cash flow remains the same. Lastly, as the inbound business was affected by floods, which is a high-margin business, we have reduced our margin estimates slightly for the travel business as well. Our target price has been reduced largely because of the recent price drop in Qess Corporation. As we value TCIL on cash flows, Sterling's accounting change has no effect on our target price.

Our thesis on the stock

Our thesis on TCIL remains the same. We like the stock for the following reasons:

- Growth in travel business: TCIL continues to deliver growth in core travel business. Very few businesses are currently able to deliver 15% plus revenue growth in India. TCIL's growth is broad-based, indicating that the company is able to beat competition and increase its scale very well organically. We believe that as the scale of operations increase, there will be much better fixed-cost absorption (as gross margin remains intact with a positive bias) and, therefore, we will eventually see margins recovering. Thus, the most important criteria is organic growth which will drive margins upwards.
- Growth in retail forex business - Wholesale forex is witnessing shrinking margins and it is also difficult to predict volume in that business. TCIL's focus on retail forex is yielding good results. The company is able to expand its spread and create a larger float at the same time. After posting a decline in revenues for four consecutive quarters, TCIL posted solid 16% revenue growth (10.4% organically) in 2QFY19. Margins have also recovered sharply.
- Efficiency in Operations - TCIL has increased its investment in technology multi-fold as compared to a few years ago. The results are now showing in revenue growth. The company is constantly introducing leaner and faster processes for its sales and customer relations teams to improve holiday package-buying experience of the customer. It is also mining the huge data collected using analytics which helps to improve sales lead conversion.
- Our little experience with the company teaches us that quarterly earnings will remain volatile and not comparable YoY. This is because of the fact that Indian holidays shift dates each year unlike in Western countries where Christmas remains on a fixed date. We should focus more on full-year margins and organic revenue growth.
- TCIL is an industry-leading B2C branded business. The company is debt-free on a standalone basis. On consolidated basis, it has Rs3,210mn in net cash. It has Rs5,500mn float (mainly arising from retail forex business) which reduces working capital requirement. Finally, the company operates its core travel and forex business with almost no capital employed.

Exhibit 1: Result-2QFY19 consolidated (on comparable basis)

	Comparable			Reported	
Particulars (Rs. mn)	Q2 FY19	Q2 FY18	Shift (%)	Q2 FY19	Q2 FY18
Revenue from Operations	15,951.5	14,020.8	13.8%	15,998.8	27,973.3
Other Income	107.2	(17.6)	-	112.7	150.6
Total Income from Operations	16,058.7	14,003.2	14.7%	16,111.5	28,123.9
Total Costs	15,833.7	14,019.5	12.9%	15,880.5	27,183.0
EBITDA	225.0	(16.2)	-	231.0	940.9
Depreciation / Amortization	164.2	161.2	1.9%	166.2	321.1
EBIT	60.8	(177.5)	-	64.9	619.7
Interest and Finance cost	172.9	221.2	(21.8)%	183.5	377.9
PBT	(112.1)	(398.7)	-	(118.6)	241.9

Source: Company reports, Nirmal Bang Institutional Equities Research

Exhibit 2: Result-1HFY19 consolidated (on comparable basis)

	Comparable			Reported	
Particulars (Rs. mn)	H1 FY19	H1 FY18	Shift (%)	H1 FY19	H1 FY18
Revenue from Operations	29,426.0	25,983.2	13.2%	36,844.0	56,704.7
Other Income	268.7	192.3	39.8%	271.6	363.1
Total Income from Operations	29,694.7	26,175.5	13.4%	37,115.6	57,067.8
Total Costs	28,453.5	25,090.7	13.4%	35,897.8	54,262.5
EBITDA	1,241.2	1,084.8	14.4%	1,217.7	2,805.3
Depreciation / Amortization	275.2	265.2	3.8%	328.1	600.8
EBIT	966.0	819.5	17.9%	889.6	2,204.5
Interest and Finance cost	309.1	400.5	(22.8)%	351.0	739.5
PBT	656.9	419.0	56.8%	538.6	1,465.0

Note : The comparable numbers in the table above are post exclusion of Qess Corp and acquisitions made in the previous year (DMS, TC Forex & TC Travel)

Source: Company reports, Nirmal Bang Institutional Equities Research

Key takeaways from 2QFY19 conference call

Travel business:

- DMS business (acquired in July last year) continues to post improvement. During 2QFY19, it improved gross margins by 200bps to 17% which led to 10% revenue improvement. Losses in the segment were reduced to Rs9mn as compared to Rs42mn YoY and Rs230mn QoQ.
- TCIL has acquired a license in the US market which has opened up corporate ticketing opportunity for the company in that country. We believe this could be a significant contributor to the overall business of TCIL, as the US constitutes the biggest pie of Indian exports.

Exhibit 3: Travel segment's gross operating margins

Segment	Q2 FY19	Avg full year margins
Outbound	15%	14%
Inbound	39%	21%
MICE	8%	8%
Domestic	19%	17%
Corporate Travel	6%	7%
DMS	17%	16%

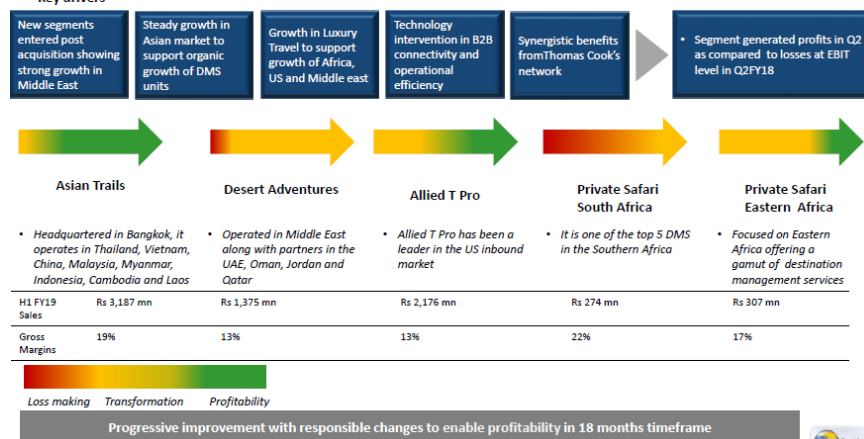
Source: Company reports, Nirmal Bang Institutional Equities Research

- TCIL acquired a strategic 24% stake in Bengaluru-based Ithaka – a chat-based mobile application during the quarter.

Exhibit 4: Transformation in international DMS entities

- TCIL acquired this business in June 2017, and has since then been committed to increasing volumes and containing losses.

Key drivers



Source: Company reports, Nirmal Bang Institutional Equities Research

Exhibit 5: Continuing segments

Continuing Segments (as reported)	2QFY19	2QFY18	1QFY19	YoY (%)	QoQ (%)
Financial Services	730	630	730	16	0
Travel & Related Services	14,738	12,803	19,383	15	(24)
Vacation Ownership	520	551	725	(6)	(28)
Total Segment Revenue	15,988	13,984	20,838	14	(23)
EBIT					
Financial Services	238	169	242	41	(2)
Margin (%)	32.6	26.7	33.2	590bps	(60bps)
Travel & Related Services	187	21	774	811	(76)
Margin (%)	1.3	0.2	4.0	110bps	(270bps)
Vacation Ownership	(233)	(161)	(59)	44	297
Margin (%)	(44.8)	(29.3)	(8.1)	NA	NA

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Segments Revenues and EBIT

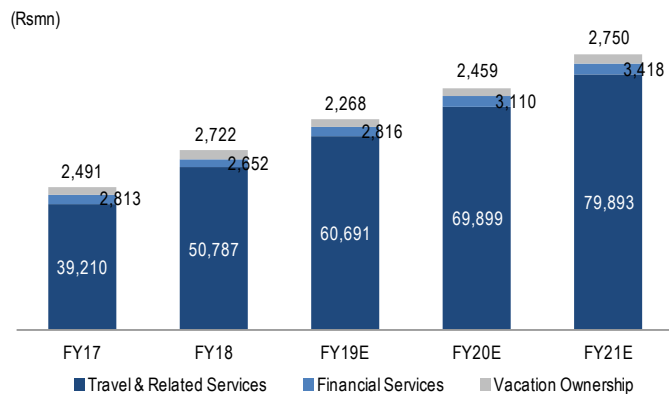
Revenues (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Financial services	2,813	2,652	2,816	3,110	3,418
YoY (%)	2.4	(5.7)	6.2	10.4	9.9
Travel & related services	39,210	50,787	60,691	69,899	79,893
YoY(%)	80	29.5	19.5	15.2	14.3
Vacation ownership	2,491	2,722	2,268	2,459	2,750
YoY (%)	21.1	9.3	-16.7	8.4	11.9
Others	-	-	44	48	53
YoY (%)	-	-	-	10	10
Total segment revenues	44,514	56,161	65,818	75,515	86,114
YoY(%)	67.4	26.2	17.2	14.7	14
EBIT (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Financial services	1,031	703	935	1,070	1,192
Margin (%)	36.7	26.5	33.2	34.4	34.9
Travel & related services	1,258	1,366	1,644	2,014	2,362
Margin (%)	3.2	2.7	2.7	2.9	3
Vacation ownership	(501)	(182)	(720)	(860)	(825)
Margin (%)	(20.1)	(6.7)	(31.8)	(35)	(30)
Corporate-level expenses	(812)	(856)	(523)	(600)	(685)
% of Total revenues	1.8	1.5	0.8	0.8	0.8
Total segment EBIT	976	1,031	1,336	1,623	2,044
Blended margin (%)	2.2	1.8	2	2.1	2.4

Source: Company reports, Nirmal Bang Institutional Equities Research

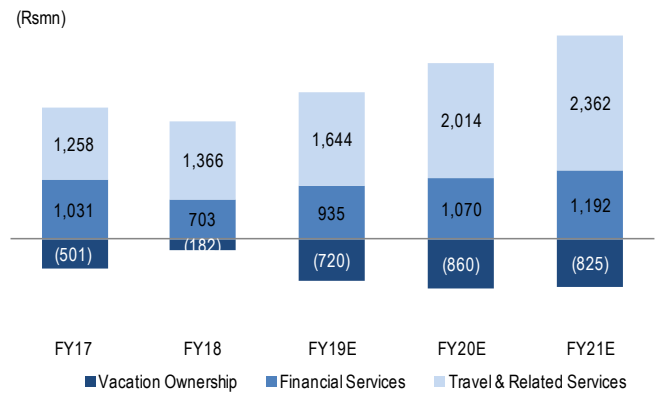
Exhibit 7: TCIL's valuation

Thomas Cook's Valuation		Value (Rs mn)	Value per share
Core Business	@ 3.5% FCF Yield on Sept. FY20E FCF of Rs. 2,124mn	60,678	163
Net cash	as on Sept. 2018	3,210	9
Value of continuing Business		63,888	172
49% Stake in Quess	@10% discount to market value	48,510	131
Total Value		112,398	303

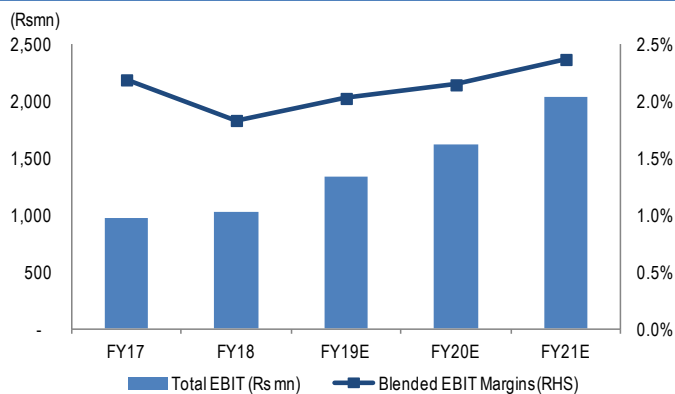
Source: Company reports, Nirmal Bang Institutional Equities Research

Exhibit 8: TCIL's revenue break-up


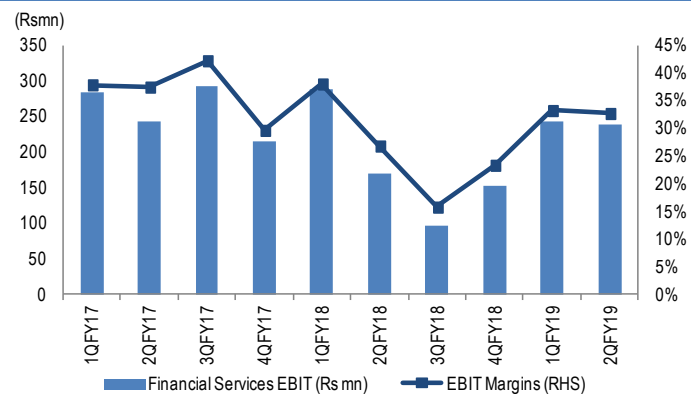
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: TCIL's EBIT break-up


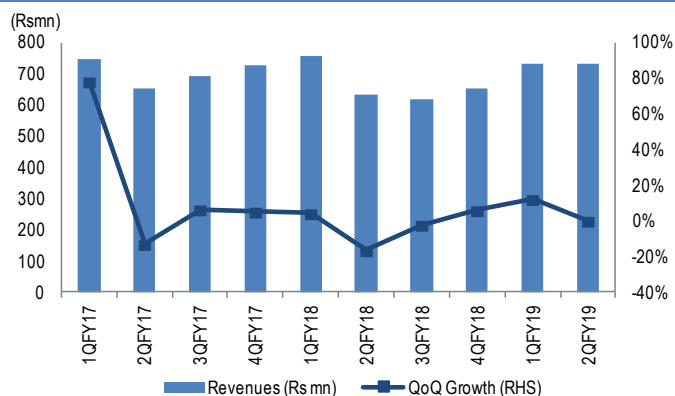
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: TCIL's EBIT and margins


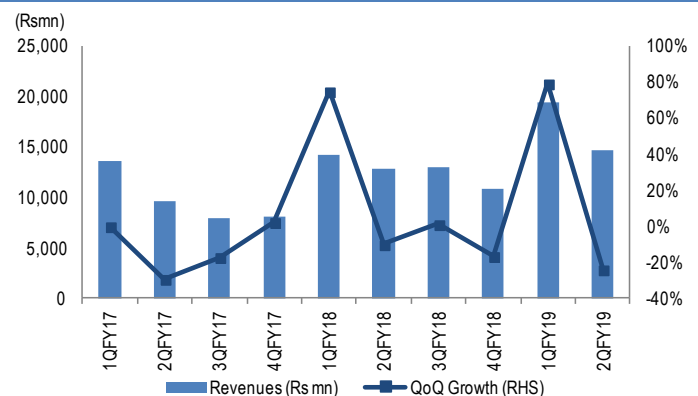
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Financial services revenues


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Financial services EBIT


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Travel & related revenues


Source: Company, Nirmal Bang Institutional Equities Research

TCIL's consolidated financials (de-consolidating Quess Corp starting FY19)

Exhibit 14: Income statement

Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
Net sales	87,624	110,178	65,818	75,515	86,114
% growth	43.8	25.7	(40.3)	14.7	14.0
Cost of sales & service	(33,957)	(43,987)	(51,086)	(58,620)	(67,157)
Staff, genral & admin costs	(41,443)	(53,022)	(6,345)	(7,076)	(7,664)
Other expenditure	(8,846)	(11,763)	(6,713)	(7,589)	(8,577)
EBITDA	3,378	1,407	1,674	2,230	2,716
% growth	83.2	(58.4)	19.0	33.3	21.8
EBITDA margin (%)	3.9	1.3	2.5	3.0	3.2
Depreciation	(915)	(1,367)	(618)	(648)	(739)
EBIT	2,464	39	1,056	1,583	1,978
% growth	99.0	(98.4)	NA	49.9	25.0
EBIT margin (%)	2.8	0.0	1.6	2.1	2.3
Interest cost	(1,322)	(1,490)	(212)	(297)	(372)
Interest/other recurring income	(1,013)	309	180	147	(26)
Non-recurring & Exceptional items	534	58,255	0	0	0
Profit before tax	1,985	58,603	1,236	1,730	1,951
% growth	NA	NA	(98)	40	13
Tax	(1,125)	406	(395)	(554)	(634)
Effective tax rate (%)	56.7	(0.7)	32.0	32.0	32.5
Minority interest	(427)	(1,634)	-	-	-
Net profit	433	57,375	973	1,176	1,317
% growth	NA	NA	(195.5)	40.0	12.0
Diluted EPS (Rs)	1.18	155.83	2.62	3.17	3.55
% growth	NA	NA	(98.3)	20.9	12.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Balance sheet

Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
Equity	366	367	370	370	370
Reserves	19,496	86,344	87,112	88,185	89,394
Net worth	19,863	86,714	87,482	88,555	89,764
Accounts payables	12,305	14,840	15,816	17,987	20,423
Other ST liabilities	15,241	12,649	12,649	12,649	12,649
Short-term loans	5,694	664	664	664	664
Total current liabilities	33,240	28,153	29,128	31,300	33,736
Long-term loans	7,376	2,310	2,310	2,310	2,310
Other LT liabilities	6,645	3,293	3,293	3,293	3,293
Minority interest	2,838	131	131	131	131
Total Equity & Liabilities	69,962	120,600	122,344	125,589	129,233
Gross block	8,661	10,684	10,948	11,250	11,594
Depreciation	(1,633)	(2,252)	(2,869)	(3,517)	(4,256)
Net block	7,028	8,433	8,078	7,733	7,338
Other LT assets + WIP	9,064	1,916	1,916	1,916	1,916
Long-term investments (Quess)	777	72,530	72,530	72,530	72,530
Inventories	89	11	56	64	74
Debtors	10,014	8,574	8,656	10,138	11,561
Cash & ST Investments	15,206	12,378	14,350	16,450	19,057
Other current assets	9,839	7,962	7,962	7,962	7,962
Total current assets	35,147	28,926	31,024	34,614	38,653
Net current assets	1,907	773	1,895	3,314	4,918
Total assets	69,962	120,600	122,344	125,589	129,233

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Cash flow

Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
PBT	1,915	60,908	1,236	1,730	1,951
(Inc.)/dec. in working capital	175	(5,193)	849	681	1,003
Depreciation	846	1,367	618	648	739
Other non-cash adjustments	(81)	(59,524)	(395)	(554)	(634)
Net cash from operations	2,855	(2,442)	2,307	2,506	3,059
Disposal of fixed assets	156	110	-	-	-
Capital expenditure (-)	(1,256)	(1,760)	(263)	(302)	(344)
Net cash after capex (FCF)	1,754	(4,092)	2,044	2,203	2,715
Other investing activities	(1,564)	651	-	-	-
Cash from investing activities	(2,664)	(999)	(263)	(302)	(344)
Inc./(dec.) in short-term borrowing	1,812	(519)	-	-	-
Inc./(dec.) in long-term borrowing	1,150	(1,583)	-	-	-
Inc./(dec.) in preference capital	-	-	-	-	-
Dividends paid	(166)	(222)	(72)	(104)	(108)
Equity issue/(buyback)	67	8,534	-	-	-
Other financing activities	(1,312)	(1,442)	-	-	-
Cash from financial activities	1,551	4,767	(72)	(104)	(108)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Key ratios

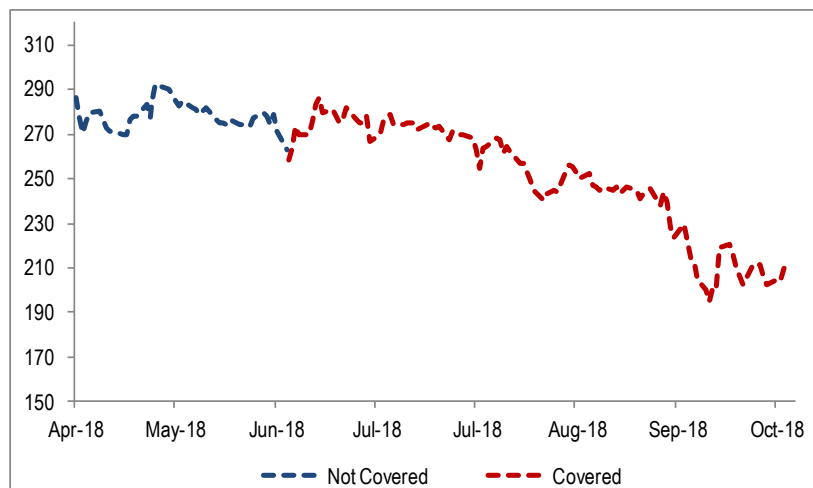
Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
Profitability & return ratios					
EBITDA margin (%)	3.9	1.3	2.5	3.0	3.2
EBIT margin (%)	2.8	0.0	1.6	2.1	2.3
Core Net profit margin (%)	(0.1)	(0.8)	1.3	1.6	1.5
Core RoE (%)	(0.6)	(1.7)	5.8	7.6	7.9
Core RoCE (%)	8.8	0.2	6.0	8.6	10.1
Core Pre-tax RoIC (%)	6.6	9.2	25.3	51.7	106.9
Cash conversion cycle	(85.0)	(81.0)	(65.0)	(63.0)	(62.0)
Leverage and FCF ratios					
Net Cash (Rsmn)	(1,327)	9,404	11,376	13,476	16,083
Net Cash Incl. Quess @ Mkt. price(Rsmn)	-	81,935	65,276	67,376	69,983
Net cash (Incl. Quess) as % of Mkt. Cap	-	104.1	82.9	85.6	88.9
Total debt/Equity (%)	0.70	0.03	0.03	0.03	0.03
FCF Yield (%)	2.1	(5.2)	2.6	2.8	3.4
FCF/Sales (%)	2.0	(3.7)	3.1	2.9	3.2
Valuation ratios					
Core EV/sales (x)	0.99	0.20	0.24	0.21	0.18
Core EV/EBITDA (x)	25.6	15.9	9.3	7.0	5.7
Core EBIT/EV (Earnings Yield)	-	6.3	10.8	14.3	17.5
P/E (x)	NA	1.8	80.9	66.9	59.8
P/BV (x)	4.27	1.20	0.90	0.89	0.88

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
4 June 2018	Buy	271.60	350
9 August 2018	Buy	261	350
22 October 2018	Buy	202	350
5 November 2018	Buy	212	300

Rating track graph



DISCLOSURES

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Stock Ratings Absolute Returns

BUY > 15%

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