10 July 2014

THOMAS COOK (TCG): 126p
Margin pressure becoming an issue?

Comments from ABTA & warnings from DART Group, Air France, Lufthansa etc. have focussed attention on capacity…

Year to end-Sep	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2013 (A)	NA	5.0	NA	Nil	Nil
2014 (E)	202.0	10.8	11.7	Nil	Nil
2015 (E)	302.0	16.3	7.7	3.0	2.3

Source: Company & Broker Estimates

Capacity issues cloud horizon:

Thomas Cook's shares collapsed from above 300p to below 10p. The company underwent emergency surgery and diluted existing shareholders via a Rights Issue before rallying to recent highs of 189p.

Recently, capacity concerns have begun to grow and we consider the situation below:

Capacity:

Capacity remains an issue: Putting on capacity into an Egyptian revolution and ahead of the World Cup was perhaps not the best of ideas. Everyone wanted to get a jump on the economic recovery.

That's understandable – but it will arguably lead to lower margins & we have had warnings from Air France, Lufthansa, DART Group etc.

Re the tour operators, Thomas Cook updates on 31 July and TUI Travel follows suit on 8 August.

- ABTA said recently that capacity was a problem. Bigger than the weather & World Cup. See - ABTA & overcapacity summer 2014 (if you have a PDF version of this note, please email us for links).
- ABTA chair Noel Josephides said on 26 June *'there is gross overcapacity…and margins are going to be affected. Everyone has to sell cheaply. It's classic travel industry behaviour…we're back to the prices of five-six years ago – £89, £99 for bookings in four to five days…Forget the weather, forget the World Cup – they are excuses. It is simply too much capacity.'* Within a fortnight, it would appear that he is being proven right.

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Market Cap: £1.9bn
12m range 127p 189p

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Discounting:

Thomas Cook offers 7 day summer holidays for £148pp: So when is a discount not a discount? Well when it's an 'offer' or a 'promotion' of course because Tour Operators don't want to 'discount' as it sends the wrong signal.

But Thomas Cook is nonetheless going to be 'promoting' and 'offer' of four-person, seven-day holidays to Majorca for only £899 from tomorrow (Fri 11 July) and we would make a number of points:

- It's hard to make money at £225pp – but the only thing worse than a marginally loss-making seat to Palma, is an empty one.
- EasyJet is offering mid-August flights to Palma from Gatwick to Palma for between £181 (bad flight times) and £335 return.
- EasyJet is offering flights from Luton to Palma for between £216 (ghastly take-off times & Fri to Fri rather than Sat to Sat) and £434.
- Thomas Cook is offering free in-flight meals, accommodation & in-resort kids club on top of the flights. See Thomas Cook offer (if you have a PDF version of this note, please email us for links).
- Travel Weekly is a trade rather than a B2C journal and comment #2 below the article referred to above is interesting – it wasn't written by Langton and reads *"In other words......"We have a shed load still to sell in high season as we overcooked our prices, so now please help"*
- Interestingly the offer ends 25 July and TCG updates on trading on 31 July. It would not be surprising to hear the co therefore say 'bookings have been sluggish year to date but have picked up in recent weeks'. Well they would, wouldn't they? Margins will be key.
- Caveats: we don't know the scale of this offer – it could be a few hundred holidays or it could be thousands.

So what are the implications for Thomas Cook:

Advice to those not long out of surgery? Don't fall off your bike: We would suggest that Thomas Cook 'is recovering' rather than 'has recovered'.

It will have to deliver more than just cost cuts. Sound bites and presentation have their role to play – but they will only go so far and TCG will have to change more than just its logo.

So a tough market isn't what the doctor would have ordered – but do you buy the shares because they have fallen? Or do you sell them because they have further to go?

We accept that share prices are down but, with a sticky summer to come, we would be minded to take further profits. Summer 2014 could and probably will give us an insight as to how the new-look Thomas Cook deals with difficult markets (Egypt, a relatively marginal issue, caused problems earlier in the year) and observers will be in a better position to value the company on a ten-year view once they have seen it perform through thick markets and thin. Charts below:

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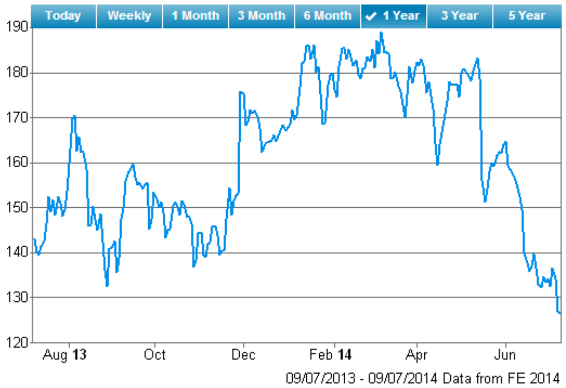
TCG – One Year – Source: Barclays



TCG – Three Year – Source: Barclays

Langton Comment: Thomas Cook has survived its near-death experience has restructured. It won't be revisiting the dark days of 2012 in a hurry but we believe that:

1. Estimates are falling and,

2. Recovery is being pushed out to the right.

This is maybe unavoidable but, whilst the management of TCG has little choice but to tough it out, shareholders can vote with their feet and we would suggest that they consider doing so.

In a recovery situation, the only thing you can say about the two-year forecast PE ratio is that it's wrong. This can be for one of two diametrically opposed reasons and, with 2014 set to be tough, we hope we've made clear what we think. Over to you.

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