Langton
Capital Limited

31July 2014

THOMAS COOK (TCG): 121.5p
Margin pressure becoming an issue?

Company reports 'group is a stronger & more resilient business' and is 'more able to withstand shocks'

Year to end-Sep	PBT (£m)	EPS (p)	PER (x)	DPS (p)	Yield (%)
2013 (A)	NA	5.0	NA	Nil	Nil
2014 (E)	200.0	10.7	11.4	Nil	Nil
2015 (E)	302.0	16.2	7.5	2.9	2.4

Source: Company & Broker Estimates

Group updates on Q3 trading:

Following its Q3 trading update this morning, Thomas Cook hosted a conference call for analysts and our comments are set out below:

Overall:

- Cost cutting is 'really developing well' – group is 'confident of delivering more than £400m in Wave II by FY18
- Run-rate savings are currently around £360m p.a.
- Profits from UK are 2x those of this stage last year
- Says airline is continuing to perform well despite 'problems caused by additional capacity'
- France is still tough, Russia, however, is 'very encouraging'

Current Trading:

- Trading is 'in line with expectations'
- Average selling prices in UK are down 4% (same in Germany – 'impacted by increase in market capacity')
- Cost inflation is currently benign
- Data given goes to 19 July and 'nothing significant' has changed since that date
- Says it has taken share in the Nordic market
- What do you need to do in Q4 to hit targets? Need underlying £25m up-turn.
- Has Egypt now annualised? Yes, broadly speaking.

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Market Cap: £1.8bn
12m range 117p 189p

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- Just how difficult is the Lates market? Airline capacity is the issue. The reaction is branding, online sales, becoming more relevant to customers

More on Capacity and General Market Developments:

- Overall capacity has risen by 6% on short haul and by 10% on some routes
- Working capital movements are negatively impacted 'by the later booking pattern this year' (World Cup etc.)
- There are 'less chances to put up prices in short haul due to over-capacity in that market'
- Group however says it sources 45% of flights ('lift') from external airlines & can therefore 'benefit from overcapacity' – really?

Outlook:

- The group reiterates that it is confident it will hit targets but considers that this will be more dependent on cost cutting etc. than had previously been expected
- There is real progress being made on web penetration, shop upgrades, unique product offering etc.

Langton Comment: Thomas Cook's shares rose briefly this morning and then gave back most of their gains. The damage, arguably, was done by the group's comment that 'there is continuing pricing softness due to higher levels of market capacity'.

The group goes on to say 'we are confident that the acceleration of our cost out and profit improvement programme will mitigate market pressures in order to achieve our FY14 gross margin target improvements' but concerns remain that this will prove tough to deliver.

The conference call covered little new ground and, at the time of writing, the shares, having fallen by more than 35%, are up by a little over a half of one percent. Q4 is upon us and TUI Travel will update further on the industry next Friday.

As witnessed by the shares' reluctance to bounce materially, we would suggest that shareholders have grounds for concern and delivery in Q4 will be key. We somewhat disagree with the company when it says that overcapacity in 'lift' is a positive and see risks to delivery this year. With that in mind, we would be minded to lighten holdings further at these levels.

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