

## Why we own Thomas Cook India Limited?



### Company Snapshot

**CMP: Rs 246.50**

**Market Cap: Rs 9057.22 Crores**

**52 Weeks High/Low: Rs 256 / 178**

**Promoter Ownership: 67.65% (Fairfax Financial Holdings Limited)**

INR: Cr

THOMAS COOK (INDIA) LTD	Mar-15	Mar-16	Mar-17
Sales	3244.28	6093.93	8588
EBIT	242.2	93.07	322.39
EBIT Margin	7.47%	1.53%	3.75%
EBITDA	283.63	153.66	407.02
EBITDA Margin	8.74%	2.52%	4.74%
Profit After Tax	90.15	-77.89	38.18
PAT Margin	2.78%	-1.28%	0.44%
Operating Cash Flow	131.43	383.25	285.5

Source: Screener.in

## Business Introduction

Thomas Cook India Limited (TCIL) is India's largest, fully integrated and highly profitable Foreign Exchange and Travel Operator with current market capitalization of ~ Rs. 9057 crores. Prem Watsa founded Toronto-based financial services firm Fairfax Financial Holdings bought controlling stake in TCIL from distressed British parent in 2012 and continues acquisitions in India through TCIL (Quess, Sterling Resorts). Fairfax is following the same business strategy as Berkshire Hathaway and since inception Fairfax has compounded its book value at ~19.4% CAGR.

TCIL has been operating in India for last 136 years. Since it went public about 34 years ago, TCIL has suffered annual loss only once and experienced revenue decline in only 3 years. It is a dominant player in Outbound and Inbound Travel in India. It owns 98% stake in Sterling Holiday Resorts Limited (Sterling Holidays) which is a leading holiday lifestyle company in India and the pioneer of Vacation Ownership in India, with a current inventory of 2124 rooms spread across 32 resorts in India.

There are huge intra-group synergies between Travel, Financial Services, and Travel Related Services with the ability to cross sell multi products to the same client. For example, ~70% of travel customers also buy Forex from TCIL. Both the Forex and Travel business have enduring competitive advantages and synergies which enable TCIL to deliver ample Free Cash Flow for the parent holding company.

Prem Watsa announced that TCIL will be Fairfax's investment vehicle in India to acquire other businesses. In 2013, TCIL bought India's most profitable HR solutions and services company – Quess Corp.



Source: Company Presentation

## Quess Corp

TCIL acquired Quess Corp in 2013 for Rs. 259 crores for 74% stake. Under leadership of Mr. Ajit Issac it evolved from a 1 Room Operation in 2007 to 90,000 employees in 2014. Below is current overview of its various lines of businesses:

Business Vertical	Revenue	Headcount	Vertical Details
People & Services	Rs. 2,345 cr (20% Y-o-Y Growth)	~1,10,000	<ul style="list-style-type: none"> <li>General Staffing &amp; Retail Solutions</li> <li>Search, Recruitment, and Recruitment Process Outsourcing</li> <li>Skill Development</li> <li>Digital Compliance</li> <li>Logistics</li> </ul>
Global Technology Solutions	Rs. 1,183 cr (28% Y-o-Y Growth)	10,000+ Tech Professionals	<ul style="list-style-type: none"> <li>IT Staff Augmentation</li> <li>System Integration</li> <li>IIoT and Mobility Solutions</li> </ul>
Integrated Facilities Management	Rs. 405 cr (10% Y-o-Y Growth)	~22,300	<ul style="list-style-type: none"> <li>Integrated Facility Management</li> <li>Catering Services</li> <li>Integrated Security Solutions</li> </ul>
Industrials	Rs. 224 cr (5% Y-o-Y Growth)	~3900	<ul style="list-style-type: none"> <li>Industrials</li> <li>Managed Services</li> <li>Engineering Solutions and Services</li> </ul>

Quess went public on July 12, 2016, completing India's most successful IPO by over subscription rate (147 times) in the past 5 years. Post acquisition revenue has grown from 1000cr (FY13) to ~4173cr (FY17). During the same period Profit after Tax has grown from 17.8cr to 113.46cr. It has business presence across the globe including India, North America, the Middle East and South-East Asia powered by a team of ~1,89,200 people. TCIL's market capitalization is ~9057cr, whereas Quess Corp alone has market capitalization of ~11,400cr.

Below bullets (from latest Annual Report) would give you an idea of Quess' industry dynamics and long run-way of growth potential ahead of it:

- The temporary staffing market grew 19% in 2016 to around Rs. 54,000cr and the sector is expected to grow by 20% annually to Rs. 92,000cr by 2019.
- The working age population (15-54 years) accounted for **58.9%** of the 1.26 billion population in 2016 and it is expected to increase to **65.9%** of the population (891 million) in 2022.
- The IT staffing market in the US grew 6% in 2016 to USD 123 billion and is expected to grow at 18% over the next five years. Quess has traditionally stayed away from the 'H1B' model and has focused on staffing of local IT talent, who are not under the 'H1B' regime. The current shift towards protectionism is not expected to impact a player like Quess that has traditionally focused on staffing local IT talent.
- India's security services market is likely to grow at a rate of **20%** between FY 2014-15 and FY 2019-20 and achieve market revenues around Rs. 97,040 crores by FY 2019-20.
- It is forecasted that industrials market will grow at a CAGR of 10-11% per annum from Rs. 4,800 crores in 2016 to an expected Rs. 6,700 crores by 2019.

## Quess Corp. Performance Snapshot

### Analysis of Business Performance

#### Revenue Performance (in ₹ crores)

	FY 2016-17	FY 2015-16	Growth
<b>Business Segment</b>			
People & Services (P&S)	2,345.41	1,949.85	20.3%
Global Technology Services (GTS)	1,182.97	921.12	28.4%
Integrated Facility Management (IFM)	404.61	371.87	8.8%
Industrials	224.37	192.17	16.8%
<b>TOTAL</b>	<b>4,157.36</b>	<b>3,435.01</b>	<b>21.0%</b>

#### Segment Results (in ₹ crores)

	FY 2016-17		FY 2015-16	
	EBIT	EBIT Margin	EBIT	EBIT Margin
P&S	108.9	4.6%	72.4	3.7%
GTS	83.4	7.0%	60.5	6.6%
IFM	20.3	5.0%	17.2	4.6%
Industrials	17.1	7.6%	17.1	8.9%
Unallocated Expenses	(33.3)		(30.4)	
<b>TOTAL</b>	<b>196.4</b>	<b>4.7%</b>	<b>136.7</b>	<b>4.0%</b>

*Source: Company FY16-17 Annual Report*

**Interesting Fact:** Quess Corp recruited 1 person every 5 minutes through general staffing business.

Below Youtube Video to understand Quess and its Intelligent Fanatic Mr. Ajit Issac:

<https://www.youtube.com/watch?v=Bp7xYfAfMIY&list=PL5rAd0gCa7MBMiI5SO0xZy9VaAJujLTcY>

<https://www.youtube.com/watch?v=AHzpJlgvp0Y>

## Understanding Business Economics

- **Travel & FOREX:**

- Outbound Leisure tourists pay in advance but payments to hotels and airlines is made later by TCIL creating negative working capital. However, this negative working capital benefit from Travel business is negated by elevated working capital requirement in FOREX business.
  - It's Holiday Saving Account and Gift Cards create float for the business where money is received in advance and services are provided much later.
- TCIL is India's largest buyer of international travel components like airline seats, hotel rooms etc. It has the pricing negotiating power and gets discounted prices when compared to its competitors.
- Asset-light business model allows TCIL to expand with less intensive capital investment requirement.
- Strong "Thomas Cook" brand gives pricing power and strong Pan India distribution network.
- Ability to sell travel and tour packages and FOREX in both online and offline form. Difficult for online competitors to provide offline services like bus tours, local guides, etc.
- It can utilize Sterling Holiday Resorts with current inventory of 2124 rooms spread across 32 resorts to sell to its inbound customers. Per my understanding – there is no debt on Sterling Resorts, making this asset-heavy business into one-time fixed cost plus maintenance only type of model.
- Weak rupee helps inbound tourism while stronger rupee helps outbound making business model less vulnerable to currency movements.

- **Quess:**

- Quess is in the business of buying people's time and selling it to its customers. It collects pay from its customers and shares it with its contractors after taking a spread. It converts customer's fixed cost into variable cost by providing the solution to India's complex Labor rules which allows the client to focus on its core competencies.
- Overall asset-light business model which can be scaled without much need for capital to grow and expand. However, tight working capital management will be key as headcount increases and company forays into new verticals.
- Close to recession proof business model within its Integrated Facility Management and Industrial vertical. It provides hard and soft services to 2 international airports, 17 hospitals, and 6 universities. Even in slowdown environment – businesses would still have to keep their premises clean and hygienic. Big industrial plants would still need to be monitored and maintained for uninterrupted functioning all year round.

## Business Valuation

Novice investor would pass investing in such business like TCIL given current Price to Earnings multiple of ~108. For TCIL, reported accounting earnings materially understate economic earnings. As you can notice in below table, its Profit after Tax may not be very impressive but it has been consistently generating good cash from its operations and it deploys Free Cash to buy other businesses after supporting its own capital and working capital needs. On top of this we have Mr. Prem Watsa with proven track record of excellent capital allocation skills that will ensure each rupee is being allocated optimally.

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Source: Screener.in

Fairfax paid 10x Free Cash Flow for 75% stake in TCIL in 2012 (after adjusting for undervalued Real Estate). Also, senior management's compensation structure is tied to Free Cash Flow (FCF) and not accounting earnings. Valuing this company based on FCF parameter than accounting earnings makes more sense.

Businesses that are run by intelligent fanatics like Mr. Madhav Menon (Chairman TCIL), Mr. Ajit Isaac and monitored by Mr. Prem Watsa, it becomes very important to visualize what the earnings or FCF of various businesses can be like a decade from now.

I have attempted to value TCIL by 1) discounting future FCF using conservative assumptions and 2) checking implied growth rate in current market price using reverse Discounted Cash Flow (DCF) to see if it is feasible to achieve that growth rate.

## FCF Valuation

### Assumptions:

- CFO grows at 20% for next 5 years and then at 15% for next 4 years. CFO grows at 5% thereafter in perpetuity.
- Fixed Capital Investment grows at 20%.
- Discount Rate of 11.5% (6.5% 10 Year Indian Treasury Bond + 5% Equity Risk Premium)

Cr.	20% Growth Rate Period in CFO						15% Growth Rate Period in CFO				
	0	1	2	3	4	5	6	7	8	9	10
	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27
Cash Flow from Operations	285.50	342.60	411.12	493.34	592.01	710.42	816.98	939.52	1080.45	1242.52	1304.65
Fixed Capital Inv (growing at 20%)	25.00	30.00	36.00	43.20	51.84	62.21	71.54	82.27	94.61	108.80	114.24
Free Cash Flow	260.50	312.60	375.12	450.14	540.17	648.21	745.44	857.25	985.84	1133.72	1190.40
Terminal Value*										18313.92	
Terminal Value + Year 9 FCF										19447.64	
Present Value		280.36	301.73	324.73	349.49	376.13	387.94	400.12	412.68	7301.18	

Value of Firm (sum of Present Values)	10134.35
Minus Debt	900.00
Equity Value	9234.35
Shares Outstanding	36.68
Equity Value Per Share	251.75

### Key:

\*How I got Terminal Value of 18313.92? :  $1190.40 / 0.115 - 0.05 = 18313.92$

## Reverse DCF

### Assumptions:

- 11.5% Discount Rate
- Period = 10 years
- Exit Price to Book Multiple of 3x

Following are the steps I followed to find implied growth rate of TCIL's book value in current market price of Rs. 245

- 1) Future Value of 245 in 10 years using 11.5% discount rate = 727.63
- 2) Use 3x exit price to book multiple I get future book value = 242.54 (727.63/3)
- 3) Discount future book value of 242.54 at 11.5% discount rate and current book value per share of 43.31, I get implied growth rate in Book Value = **18.80%**

So with this market is implying a growth rate of 18.8% in TCIL's book value at current market price of Rs. 245. Below table shows the implied growth rates of book value at various exit multiples:

Company	CMP	Trailing P/B	Exit Multiple Implied Growth Rate				Historical Book Value Growth	
			P/B 2.5x	P/B 3x	P/B 3.5x	P/B 4x	Pre Acquisition (6 Yr)	Post Acquisition (4 Yr)
TCIL	245	5.7	20.98%	18.80%	16.98%	15.43%	18.50%	42.38%

As we can see, TCIL has grown its book value at 42.38% every year in last 4 years after Fairfax acquired it. This growth rate is definitely not sustainable but it would take long time before it normalizes to a lower long term average.

### Bottom-Line

Thomas Cook qualifies in "compounder" bucket where the bet is on Intelligent Fanatics like Mr. Ajit Issac, Mr. Madhav Menon, and Mr. Prem Watsa. This business should be looked at from multi-decadal investment horizon standpoint. Excellent side-car investment opportunity with Mr. Prem Watsa to create long-term wealth.



## Risks

- 1) Fairfax launched its second investment vehicle for India in 2014, Fairfax India Holding. However Mr. Prem Watsa has assured that future acquisitions will be done fairly between both investment vehicles.

*Excerpts from Fairfax 2014 Annual Letter:*

*Last year we said that Thomas Cook India would be our vehicle for further expansion in India. For the reasons mentioned above, **we have now added Fairfax India as an investment vehicle in India**. Thomas Cook India's resources may constrain the size of deals it can do, although we expect that deals in its area of expertise will continue to be done in that company. In determining the appropriate vehicle for any investment, we will consider all of the relevant circumstances and we will be fair, as always, in order not to disadvantage one of these vehicles.*

- 2) TCIL has license to use "Thomas Cook" brand in India from Thomas Cook UK which expires approximately in 2024. Management has informed that it will go for license renewal but also working towards brand building if renewal runs into any issues.
- 3) Risk from other online competitors. Travel and Forex is very competitive business. With clients today preferring to go online to book their tours - TCIL will have to continuously innovate and improve their ability to sell its products and services online. Currently TCIL does 26% of packaged holiday sales online.

### **Sources:**

- 1) Company annual reports and presentations of TCIL and Quesco Corp.
- 2) Professor Sanjay Bakshi's write-up on TCIL on his blog:  
<https://fundooprofessor.wordpress.com/2013/12/01/why-i-bought-thomas-cook/>
- 3) Ashish Kila's presentation on TCIL in IIC2017.

### **Disclosures:**

- 1) The content of this report is only for information for the readers and not to be construed as investment advice. Please consult your Financial Advisor before acting on it.
- 2) I am personally invested in TCIL.