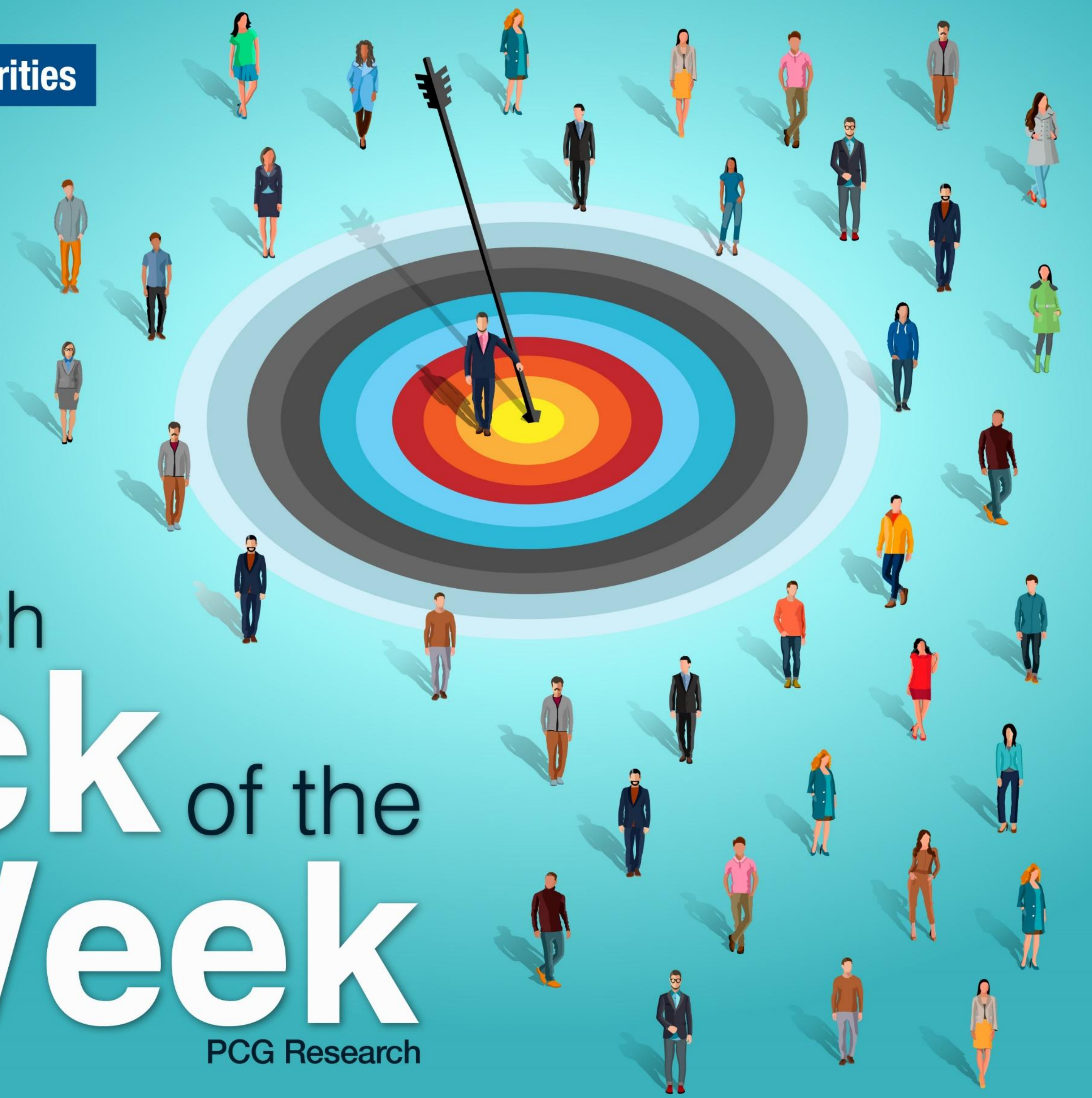
HDFC securities

Equity Research
Pick of the Week



PCG Research

DATE 28 May 2018

Thomas Cook

- Quess Corp to be key growth driver
- Strong cash flow generation
- Turnaround in Holiday Resort Business
- Robust earnings cagr over FY17-20E

INDUSTRY	CMP	Recommend	Add on Dips to	Target	Time Horizon
Travel Support Services	Rs. 277	Buy at CMP and add on declines	Rs. 260-277	Rs.340	4 Quarters

HDFC Scrip Code	THOCOO
BSE Code	500413
NSE Code	THOMASCOOK
Bloomberg	TC IN
CMP May 25 2018	Rs. 277
Equity Capital (cr)	36.7
Face Value (Rs)	1
Eq- Share O/S (cr)	36.7
Market Cap(Rs cr)	10280
Book Value (Rs)	49
Avg. 52 Wk Volume	528389
52 Week High	303
52 Week Low	202

Shareholding Pattern % (Mar 31, 18)	
Promoters	67
Institutions	21
Non Institutions	12
Total	100.0

PCG Risk Rating*	Yellow

ANALYST

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Company Profile:

Thomas Cook (India) Ltd (TCIL) is the leading integrated travel and travel related financial services company in the country offering a broad spectrum of services that include Foreign Exchange, Corporate Travel, MICE (Meetings, Incentives, Conferences, Events), Leisure Travel, Insurance, Visa & Passport services and E-Business. The company set up its first office in India in 1881. Company has presence in four different verticals namely Travels & Corporate Services, Human Resource Services, Financial Services (Foreign Exchange) and Vacation Ownership (Sterling Holiday). Company derives 53% revenues from HR Services, 43% from Travels & related services, 3% from Holiday Resorts and 2% from Financial Services.

Investment Theme:

Thomas Cook is one of the renowned names in the Travels & related services in India and abroad. Company holds majority stake in Quess Corp, which is one of the largest Staffing firm in India having presence across the four verticals. Over FY16-9M FY18 its Travels business has posted 51% revenue cagr led by acquisition of Kuoni Travels (SOTC). The Indian Tourism industry is at nascent stage and has a lot of scope to grow fast led by Indian demographics and rising income. Thus such dynamics help players like Thomas Cook. Quess Corp has posted 44% revenue and 50% EBITDA cagr over FY13-18. Strong revenue growth and margin expansion led by several acquisitions and that has resulted into 79% PAT cagr over the same period. PAT margin has also surged from 1.7% to 5% in FY18.

Recently, Board has approved restructuring exercise; the main aim behind the same is that company can focus on its travels and foreign exchange business. Management has indicated that they would spin off shareholding of Quess Corp in Thomas Cook. As a part of it, Thomas Cook shareholders would receive 1,889 shares for every 10,000 shares held in the company (i.e. 1 equity share of Quess for every 5.3 shares held). Thus, this would waive off holding company discount and shareholders would get full value in Quess. The rationale of the exercise is to reduce complexities in the organisation given separate line of businesses, different cost structures. The whole process may take approximately three months for completion.

Concerns:

- Pressure on Thomas Cook's market share, if competition from online travel operators or unorganized low-cost travel agents increases sharply.
- Any slow-down in economy will lead to lower consumer spending in travel & tourism.
- Safety Concerns for foreign tourists amidst local events and incidents to affect the FTA figures.
- Lack of government support and implementation of marketing and promoting schemes of the government in the election year with more focus given to the latter.

View and valuation:

For 9M FY18, company has posted 32% revenue growth led by 29% increase in Human Resource (Quess) and 39% growth from Travels segment. EBITDA increased 35% yoy to Rs 440cr. EBITDA margin marginally increased to 5.1%. For FY17 EBITDA margin was at 3.7%. PAT surged 1.5x to Rs 216cr on the back of tax write back of Rs 32cr vs. Rs 85cr tax paid for 9M FY17. Other Income increased 25% to Rs 74cr. We estimate revenue to see 20% cagr over FY17-20E led by strong performance from HR services and robust growth momentum from Travels segment. We expect EBITDA to post 28% cagr led by turn around in Sterling Business and strong show from Travels. EBITDA margin may expand 140bps over FY17-20E. Strong revenues and robust operating performance would drive 75% PAT cagr over the same period. We recommend Thomas Cook as a BUY at CMP of Rs. 277 and add on declines to Rs.260 with TP of Rs 340. We have valued Thomas Cook (India) on Sum-Of-The-Parts (SOTP) basis to arrive at the target price of Rs 340.

Key Highlights

- **Thomas Cook is one of the leading travels and travel related financial services company which also runs Leisure, Travel and holiday resorts (Sterling Holiday) and Quess Corp (Staffing Company).**
- **Thomas Cook holds 49% stake in Quess Corp which is valued at ~Rs 8000cr. Thomas' Mcap stands at ~Rs 10200cr which is ~75% of its Market Cap.**
- **For 9M FY18, Kuoni Travels (SOTC) accounted for 46% while Quess (HR services) at 49%. Sterling Holiday (Vacation Ownership) Business is also turning around. Over FY16-9M FY18 its Travels business has posted 51% revenue cagr led by acquisition of Kuoni Travels (SOTC).**
- **Indian Tourism industry is at nascent stage and has a lot of scope to grow fast led by Indian demographics and rising income. Thus such dynamics help players like Thomas Cook.**
- **We expect 17% revenue and 53% PAT cagr over FY17-20E.**

(Rs cr)	FY17	FY18	FY19E	FY20E
Net Sales	8,746	11,648	13,218	15,039
EBITDA	420	614	744	876
APAT	88	303	378	477
EPS (Rs)	2.4	7.9	9.3	11.8
P/E (x)	115	34	29	23
EV / EBITDA (x)	30	19	15	13
RoE (%)	6.3	17.5	18	19

Source: Company, HDFC sec Research

Company Details & Restructuring Highlights

Thomas Cook (India) is the largest integrated travel and travel related financial services company in India. The company offers a range of services that include foreign exchange, corporate travel, leisure travel, and insurance. Their subsidiaries include Travel Corporation (India) Ltd, Thomas Cook Insurance Services (India) Ltd, Thomas Cook Tours Ltd, Indian Horizon Travel & Tours and Thomas Cook (Mauritius) Holding Company Ltd. The company has overseas operations in Sri Lanka which is a branch of TCIL and Mauritius which is a subsidiary of Thomas Cook (India) Ltd. The company along with their subsidiaries has their presence in 166 locations in India and seven countries outside of India.

The company operates in two segments, namely foreign exchange and financial services, and travel and related services. Foreign Exchange and Financial Services deals with providing travel related foreign exchange & payment solutions. The company also offers credit cards and financial services relating to travel insurance. Travel and Related Services include consumer leisure travel retailing, travel management services, leisure inbound service and general sales agency business.

Thomas Cook (India) was incorporated as Thomas Cook (India) Pvt. Ltd on October 21, 1978. The name of the company was changed to Thomas Cook (India) Ltd on March 07, 1979. The company was originally promoted by Thomas Cook Group Ltd, the history of which can be traced back to the founder Thomas Cook. He commenced business in the United Kingdom in 1841 which included organizing group tours called Cook's Tours. In accordance with the permission granted by RBI, Thomas Cook Overseas Ltd transferred their business in India to the company as a going concern with effect from November 01, 1978.

Thomas Cook India is promoted by Fairfax Financial Holdings Through its wholly-owned subsidiary, Fairbrigde Capital (Mauritius). Fairfax through Thomas Cook India owns 49% of Quess Corp and 100% of Sterling Holiday Resorts.

Company has presence in four different verticals namely Travels & Corporate Services, Human Resource Services, Financial Services (Foreign Exchange) and Vacation Ownership (Sterling Holiday). Company derives 53% revenues from HR Services, 43% from Travels & related services and 3% from Holiday Resort and 2% from Financial Services.

Post the Quess Corp spin-off, the company can focus on their core business and increasing efficiencies and profit margins while expanding organically in the industry. Company has also recently refurbished all the rooms for Sterling Holidays, an entity which was making losses prior to its acquisition by the Company. It is turnaround story which is now reporting operating profits. The company has also entered into partnerships with Airbnb and OYO rooms in the past, giving it an access to a larger customer base and providing its clients with more customized solutions. Management has proven their ability to lead the business resulting in the company being a market leader in the sector. They have focused on performance centric marketing in the last few years with an effort to bring in efficiencies and reduce of cost of acquisition across all B2C businesses and it has resulted in additional usage of digital medium to acquire customers at lower cost per lead.

Board has approved restructuring exercise. As a part of which, Thomas Cook's shareholders would receive 1,889 shares for every 10,000 shares held in the company (i.e. 1 equity share of Quess for every 5.3 shares held). The rationale of the exercise is to reduce complexities in the organisation given separate line of businesses, different cost structures and methods of revenue recognition. The whole process may take around three months.

BUSINESS BACKGROUND:

Quess Corp: Quess Corp is one of India's leading integrated business services providers operating in 4 broad segments: a) Global Technology Solutions, b) People and Services, c) Integrated Facility management (IFM) and d) Industrial Assets Management (IAM). Headquartered in Bengaluru, it has pan India presence with 50 offices across 25+ cities as well as operations in North America, the Middle East and South Asia. Company derives ~53% of revenue from Quess.

Sterling Holiday Resorts: Sterling Holiday Resorts, a pioneer in vacation ownership and Leisure Hospitality Company in India, was incorporated in 1986 with the vision of deleveraging great history experiment to Indian Families. Currently, it has a total inventory of 2124 rooms spread across a network of 32 resorts in India. Last year they completed the refurbishment of all its resorts and they are now the best in class.

Forex: Company is one of India's largest foreign exchange dealers in both the wholesale and retail segments of the market, by virtue of its extensive network as well as sales, and one of the few non-banking institutions to have been granted an AD-II license by the Reserve Bank of India (RBI).

Insurance Business: The Company offers both overseas as well as domestic travel insurance. It also conducts regular training programs and deeper interactions with all the other lines of businesses like Leisure Travel, Foreign Exchange, MICE, Corporate Travel, Visa, etc. to offer the products to their specific set of customers. This has helped in improving the penetration of insurance in every business, garnering higher share of customer wallet and building customer loyalty.

SOTC Travel Services: SOTC Travel Services (Formerly "Kuoni Travel (India) Pvt. Ltd.") is a step-down subsidiary of Fairfax Financial Holdings Group. SOTC is leading travel and tourism company having presence across various travel segments including Leisure Travel, Incentive Travel, Business Travel, Destination management Services and Distribution Visa Marketing Services. It contributes ~43% of revenues to the company.

Real Estate Properties: Thomas Cook owns a number of valuable real estate assets like number of branches and corporate offices. In addition Sterling Holidays owns several resorts and also has an unused land bank also. This will provide additional cushion to valuations. Our target price does not include value from these assets.

Travel & Tourism Industry Outlook

The Travel and Tourism industry is a diversity of businesses, services, organizations and communities encompassing domestic, inbound, and outbound travel for business, leisure, MICE, visiting friends and relatives, spiritual or business leisure and hence its stakeholders include businesses, governmental agencies, educational institutions, communities, and citizens across the globe. The contribution of the industry to each country is significant, comprising both economic and social development; opening up business, trade and capital investment, creating jobs and an entrepreneurial workforce and protecting heritage and culture. Today, tourism is a major source of income for many countries, impacting the economy of both the source and host countries. Tourism has grown faster than world trade over the past four years. As a worldwide export category, tourism ranks third (after fuels and chemicals and ahead of food and automotive products). In many developing countries, tourism ranks as the leading export sector.

Developments in technology and infrastructure, the entry of low-cost airlines, eVisas, etc. have made tourism more affordable with a rise in disposable income and brag-worthiness of travel fuelling demand. The WHO estimated that there are around half a million people on board aircraft at any given time. There have also been changes in lifestyle, tastes, rising household incomes, which has been a positive effect and boost to the industry. Further the industry is supported by e-commerce and m-commerce of various services, which makes it easy, accessible and convenient for customers, offering them greater choice at competitive rates. Asia has become the epicenter of growth for business travel. The region is already the world's largest market. Travel and tourism is one of the largest service industries in India and has tremendous potential as one of the key contributors to the growth of the nation. India has emerged as the world's fastest–growing outbound market and in absolute numbers it is second only to China. India is en-route to becoming the world's fastest growing e-commerce market with the second largest number of internet users in the world and holiday e-commerce sales are likely to grow at a phenomenal rate. Retail inflation has softened due to declining oil prices and weak domestic demand. Easing inflationary pressures strengthened the impact of reasonable liquidity conditions on market interest rates. "Athiti Devo Bhava", (our guest is equivalent to our god), is the ethos of Indian culture and the catch-line of the Ministry of Tourism's Incredible India campaign. The recently released data from the ministry shows a healthy rise in foreign tourists arriving in India. Tourism is a major component of India's foreign exchange earnings.

Electronic tourist authorisations, known as E – Tourist Visa, launched by the Government of India have resulted in increase in number of tourist visa issued in the country, with arrivals through e-visa increasing 57.2 percent to 1.7 million during 2017. During CY2018 (up to February) arrivals through e-visa has increased 60.7 percent yoy to 516,000. India has been ranked 3rd among 184 countries in terms of travel & tourism's total contribution to GDP in 2016. India's foreign exchange earnings (FEEs) from tourism increased 20 percent during CY2017 to reach US$ 27.7 bn. During CY18 (up to February) FEEs from tourism increased 16.3 percent year-on-year to US$ 5.49 bn. In India, the sector's direct contribution to GDP is expected to grow by 7.9 percent per annum during 2016–26. The sector in India accounted for 9.3 percent of the total employment opportunities generated in the country in 2016, providing employment to around 4cr people during the same year. The number is expected to rise 2 percent annum to 46.4 million jobs by 2026. Travel & tourism's contribution to capital investment is projected to grow 6.3 percent per annum during 2016–26, higher than the global average of 4.5 percent. Contribution of visitor exports to total exports is estimated to increase 7.2 percent per annum during 2016–2026 compared to the world average of 4.3 percent.

The domestic tourist visits (DTV) saw 15.6% rise in 2016 compared to the previous year. The aviation industry is also seeing growth in both the domestic as well as the international sectors India's domestic RPK which measures actual passenger traffic rose by over 27.9 percent in March 2018 compared to the corresponding month of the previous year. India posted the highest load factor of all domestic markets (87.8 per cent), 6.7 percentage points higher than in March 2017. The Foreign Tourist Arrival for 2016 stood at 8.8 million, 9.7% higher than the previous year. With the various government initiatives and marketing campaigns, the rising medical tourism industry, corporate travel industry, etc. all growing, puts Thomas Cook in a very sweet spot as it offers end to end solutions in the sector along with its subsidiaries.

The Booming Indian Tourism Industry

Indian tourism business is still at nascent stage and has tremendous opportunity to grow in future because of the Indian demographics and rising economy. 66% of the population in India is below 35 years, with the median age of 27 years driving consumption. Younger consumers have high spending power and are open to experiment with newer places and forms of entertainment.

As per government report, the domestic tourist visits (DTV) saw 15.6% rise in 2016 compared to the previous year. The aviation industry is also seeing a growth in both the domestic as well as the international sectors. As per official data, India's domestic RPK which measures actual passenger traffic rose by over 27.9 per cent in March 2018 compared to the corresponding month of the previous year. The domestic India market posted double-digit annual growth for the 43rd consecutive month (27.9 percent, up from 22.9 per cent in February), with passenger demand continuing to be supported by a combination of strong economic and network growth. India posted the highest load factor of all domestic markets (87.8 percent), 6.7 percentage points higher than in March 2017. India's domestic passenger traffic growth was followed by that of China at 15 percent and Russian Federation at 5.9 percent.

The direct contribution of Travel & Tourism to GDP in 2017 was Rs 5,943.3bn (3.7% of GDP). This is forecast to rise 7.6% to Rs 6,392.7bn in 2018. This primarily reflects the economic activity generated by industries such as hotels, travel agents, airlines and other passenger transportation. The direct contribution of Travel & Tourism to GDP is expected to grow by 7.1% per annum to Rs 12,677.9bn (3.9% of GDP) by 2028.

The total contribution of Travel & Tourism to GDP (including wider effects from investment, the supply chain and induced income impacts, was Rs 15,239 bn in 2017 (9.4% of GDP) and is expected to grow 7.5% to Rs 16,385bn (9.4% of GDP) in 2018. It is forecast to rise at 6.9% cagr to Rs 32,053 bn by 2028 (9.9% of GDP). Hotel occupancy in the country's top two markets, Delhi and Mumbai, has hit ~80 percent in January-March 2018, after over a decade.

Travel & Tourism generated 2.61cr jobs directly in 2017 (5% of total employment) and this is forecast to grow by 2.8% in 2018 to 2.68cr (excluding commuter services). It also includes, for example, the activities of the restaurant and leisure industries directly supported by tourists. By 2028, Travel & Tourism will account for 3.32cr jobs directly, an increase of 2.1% per annum over the next ten years.

We see tremendous potential of growth in some of the sectors like the North East where now, with the growing infrastructures and an increase in air routes and frequency, the area is more accessible. There is also an increase in the demand for medical tourism. Supported by the Government and the meager expenses, this is rapidly growing industry in India.

Special Government Initiatives

Tourism & Hospitality sector has been the harbinger of 'more inclusive growth' in India by promoting other industries in the economy through backward and forward linkages and generating employment in various sectors such as hospitality, travel, and entertainment, wellness and other sectors. A series of promotional activities have been undertaken by Ministry of Tourism (MoT) in important and potential markets overseas through India Tourism offices abroad with the objective of showcasing India's tourist potential to foreign tourists. The aspect of 'seasonality' in Inbound tourism is a challenge and The MoT has taken the initiative of identifying, diversifying, developing and promoting niche products of the country, including Cruise, Adventure, Medical, Wellness, Golf, Polo, Meetings Incentives Conferences & Events (MICE), Ecotourism, Film Tourism and Sustainable Tourism. The North East region of India is being promoted by the MoT through several media campaigns. The region is also being promoted through the annual International Tourism Mart.

Many steps have been taken over the years for the growth of India tourism industry. The recent Government has also understand the huge potential lying ahead in this sector and so it has undertaken major campaigns for promoting it like the launch of several branding and marketing initiatives by the Government of India such as Branding Incredible India! and Athiti Devo Bhava, which provides a focused impetus to growth. Apart from this, the government has also spent on campaigns and advertisements for the protection and decent treatment of the foreign tourists in the wake of various incidents of misbehavior.

Sanitation and hygiene have been identified as key concerns facing Inbound Tourism, and so the Ministry of Tourism, Government of India has hence initiated campaigns like "Campaign Clean India" and "Swacch Bharat Abhyaan" to integrate the concept of cleanliness with the underlying theme of making the tourists feel at home.

Travel Services (SOTC)

SOTC Travel Services [formerly known as Kuoni Travel (India) Pvt. Ltd.] (SOTC) is a leading travel and tourism company active across various travel segments including Leisure Travel, Business Travel and Distribution Visa Marketing Services. The key factors driving India's increased demand for outbound travel: a strong economy with a stable central government; a burgeoning middle class (estimated at almost 300 million, set to grow from the current 32% to 50% by 2030) the large diaspora and growing openness to the outside world, in particular from the younger generations. Second only to the Chinese, the number of Indian students studying abroad has risen sharply, in recent years, further stimulating travel abroad. For 9M FY18, Kuoni Travels (SOTC) accounted for 46% while Quess (HR services) at 49%. Sterling Holiday (Vacation Ownership) Business is also turning around. Over FY16-9M FY18 its Travels business has posted 51% revenue cagr led by acquisition of Kuoni Travels (SOTC). For 9M ended year FY18, business generated revenue of Rs 3,998cr with EBIT of Rs 117cr.

Company is seeing an increasing trend of corporate customers seeking to utilize our Online Booking Tool, rather than providing their booking requests offline through other means. They are realizing the benefits that the online tool can drive, which are related to policy compliance; cost savings and optimizing travel spend. With a buoyant business sentiment, corporates while exercising prudence and seeking to extract the maximum out of their travel budgets, have not put any restraints on cutting down of official travel, and trends continue to look positive. With domestic LCCs continuing to enhance their fleet strength and adding on capacity, the Average Ticket Prices continue to show a downward slide, leading to a growth in the number of passengers. The higher end front cabins on international sectors see a good demand, thereby increasing the average yield. During the holiday season, last minute travel continued to be a costly affair, with demand outpacing availability. Customers are now increasingly seeing the benefits of consolidating their travel in India for all their locations across the world. Cost saving is driving this trend. MICE (Meetings, Incentives, Conferences, Events): MICE offers a potential for high revenue earning with limited resources. Business saw an upswing and took advantage of currency stabilisation and there was a demand for new destinations with experiential product. However, stringent visa policies in destinations created a challenge. Despite intense competition amongst large and small players in the sector, MICE business has registered significant top line growth by cementing strong relationships with several corporate houses, tapping new markets and clients. Focus on Domestic market resulted in strong growth for the business.

Sterling Holidays poised for strong growth

Thomas Cook acquired Sterling Holidays in 2015. In FY15 it posted not much growth but in FY16 the Operating Income doubled however, no operating profitability was achieved. Prior to acquisition, Sterling Holidays had huge debt on its book and was making losses. It desperately needed strong leadership to guide it out from the financial turmoil. Company's operating income grew 12% to Rs 249cr in FY17; Income from resort operations grew by 39%; Occupancy grew from 57% in FY16 to 63% in FY17 on an increased available room base; Sterling expanded its room inventory to 2,124 rooms from ~2,000 rooms in FY16. The company has completed refurbishment of all its own resorts and they are now best in class.

It has expanded the number of operational rooms from 1,254 to 1,914 and also witnessed increased room occupancy to 57% during the year. Sterling Holidays has additional surplus unused land which can be used going ahead. The Group has undertaken an extensive restructuring exercise, including a series of initiatives across business lines and subsidiaries. These long term measures are key components of the Group's plan to focus on sustainable long term growth.

Sterling Holiday Resorts aims to double capacity in the next four years

- Thomas Cook Vacation ownership arm Sterling Holiday Resorts will take an asset-light route to double its room capacity to 4,500, through management contracts.

- Company is seeing multi-year high occupancy of 72 percent this year, is also expecting to be EBITDA (earnings before interest, taxes, depreciation and amortisation) positive in 2017-18.

- Sterling has 33 resorts in the country, with room strength of ~2,200. Company will expand this to 4,500 rooms in the next four years. The majority of the addition will come from management contracts. It will build own resorts but not in large numbers. Management commented that they are in talks with 8 to 10 owners to bring their asset to take under management contract. Thus, company would require less capex and the expansion will be faster. Sterling has 85,000 members and on an average adds 6,000 every year.

- More than half the 33 operational resorts are company-owned; the rest are leased. No property is under management contract. Management contracts in these leisure destinations are an untapped opportunity, as bigger global hospitality brands are not going to these locations.

- Revenue was Rs 250 crore in FY17, ~12% higher than the previous year. Sterling has land bank of 250 acres across several leisure destinations but the company does not want to incur large expenditure in setting up its own properties at all these locations. Under a management contract, the owner will share a percentage of revenue and profit with Sterling. In comparison, a committed rent is paid to an owner in leased properties.

- Sterling's properties have had an average occupancy of ~72% this year, against 63% in FY17 and 57% in FY16. Management said that company was able to increase its average room rates by 10-15 percent in the year.

- The company procures half its revenue from members (who bought vacation ownership). The rest comes from Meetings, Incentives, Conferences and Exhibitions (MICE), guests booking with online travel companies and other channels.

Quess Corp Spin Off in the shareholders’ Best Interest

Quess Corp (Quess) (formerly IKYA Human Capital Solutions) is India’s leading business services provider. Founded in 2007 and headquartered in Bengaluru, the Company has a presence in India, North America, the Middle East and South-East Asia. Powered by team of more than 2,50,000 people, Quess caters to four service lines: People & Services, Global Technology Solutions, Integrated Facility Management and Industrials. In a volatile global economic landscape, with shifting consumer preferences and far reaching technological changes, businesses are increasingly feeling the need to focus on what they do best. Quess excels in helping large and emerging companies focus on their strengths and handling the rest. Quess’ integrated service offerings across industries and geographies provide significant operating efficiencies to its clients. With operations across India and the world, Quess is acting as a force multiplier for its clients. At the same time, Quess is deeply rooted in its core values that enable it to navigate business challenges, build scale and synergies, and produce lasting results for its clients and all other stakeholders. Quess had announced six acquisitions and investments in FY16-17.

As of April 2018, Quess has 1700+ clients serviced by 2,50,000+ employees spread across 5 verticals. They are present in 10 countries and have completed 22 acquisitions. In the last 5 years, revenue has grown at CAGR of 45%, EBITDA and PAT at 50% and 69% respectively. In spite of this, we believe the company has tremendous scope to grow much more. Quess has proven its ability to grow inorganically through acquisition and turning them around in the medium term augurs well. Quess keeps on adding feathers to its cap.

Being a non-core business for Thomas Cook, board has decided to spin off Quess Corp. This will be productive for both the companies as they can now focus on only their core business. Thomas Cook currently holds 49% shares of Quess Corp and as a part of the spin-off, Thomas Cook share holders will receive 1889 equity shares of Quess for every 10000 shares owned of Thomas Cook. This gives shareholders very interesting opportunity to directly own the shares of an Indian MNC with stellar track record.

Some of the top companies under Quess are:

- Ikya: Top general staffing provider in India with over 1,50,000 associates
- Excelus: Among the largest PPP training and skill development partners with 66 centers across India
- Magna: Largest IT staff augmentation provider in India with over 10,000 associates
- Comtel: Largest IT Staffing company in Singapore. With 64% stake in Comtel, Quess attained market leadership in the Singapore IT Staffing market. In Feb'17, Quess acquired 64% in Comtel (enterprise value of ~SGD 41.9 million) with the balance stake to be acquired in a phased manner by FY 2021-22. In FY17, Comtel booked revenue of ~SGD 96 million and EBITDA of ~SGD 8 million. Company serves more than 60 clients, including marquee names in BFSI, engineering and IT sectors. Comtel has more than 1,200 associates.
- Monster: 2nd largest job portal in India , providing recruitment solutions and services to ~6.5cr registered users across India, South East Asia and the Gulf.
- MFX: Two sophisticated data centers at Ridgefield Park, New Jersey and Roanoke, Virginia which are SSAE 16 S0C1 Type II compliant facility
- Hofincons: Leading the market in Industrial Asset Management with presence across power, energy, oil & gas refining, chemicals, ferrous & non-ferrous industry segments
- Conneqt: Amongst the leading customer lifecycle management company (Tata Business Solutions). Company has signed definitive agreement with Tata Sons and Tata Capital to acquire 51 percent stake in Tata Business Support Services (TBSS) for Rs 153 crore. Tata Sons will hold the remaining 49 percent. TBSS has revenue of about Rs 700 crore and more than 130 clients including in telecom, private banks and life insurance.
- In Dec 2017, Quess has acquired 60% stake in Golden Star Facilities and Services and would invest up to Rs 5cr for 10% more equity. GSFS is a facility management company based upon Hyderabad. Company has more than 8,000 professionals and reported revenues of ~Rs 140cr.
- Quess has bought Monster Entities for USD 14mn in Jan 2018. Monster Group entities have posted revenues of Rs 180cr. It has presence in Hongkong, Vietnam, Thailand, Middle East and India. It has around 600 professionals across the all region.
- Company acquired Vedang Cellular in Oct 2017. Quess has invested Rs 40cr for 70% equity stake in Vedang. It has ~1,500 professionals and had reported revenue of Rs 78cr with PAT margin of ~5% in FY17. Vedang is in the business of Telecom Network Optimization and Installation of Telecom. Maxeed and Vedangare amongst the top 3 leading players in the Telecom Network Operations & Maintenance space in India.
- Integrated Facilities: Among the largest integrated facility management providers in India with over 30 mn+ square feet under management, 4.5 mn meals served per month and over 50,000 associates.

Opportunity Post the Spin Off

Post the Spin off Thomas Cook management can focus only on the core business of the company. Usually Parent companies trade at discount to the subsidiaries, as it is in this case too. However, since the shareholders of Thomas Cook, will receive shares of Quess Corp as per their proportionate shareholding (1889 shares of Quess Corp for 10,000 shares of Thomas Cook), means at the current market price of both the companies, an investor holding ~5.3 shares of Thomas Cook, will receive one share of Quess Corp, valuing Thomas Cook along with all of its subsidiaries at ~Rs.64 per share if we consider CMP of Thomas and Quess. This is clearly undervalued in our opinion and taking into account the tremendous growth opportunities both within the company and the sector as a whole. Company's core business includes Travel and Related Services and Financial Services. Under Travel and Related Services, the company owns and operates, Travel Circle International Limited, Hong Kong, SOTC Travel Services Pvt. Limited, Travel Corporation (India) Limited, Thomas Cook Lanka, Thomas Cook (Mauritius) Operations Company Limited and Thomas Cook (India). Under Financial Services, company is one of India's largest foreign exchange dealers in both the wholesale and retail segments of the market, by virtue of its extensive network as well as sales. The foreign exchange business has two segments:

Wholesale: Currency buying and selling services to institutions such as banks, full-fledged money changers and restricted money changers. Company consolidates the foreign currency bank notes at a central place and then physically exports them to banks in other parts of the world in exchange for credit in NOSTRO accounts maintained with them.

Retail: Foreign exchange services to individuals who to the company's outlets, airport locations, transact online or through Company's call center or transact with channel partners of the Company. These services are provided to leisure travellers who are travelling abroad or returning after travel, foreigners travelling to India, students/ film production houses, individuals who receive money from relatives staying outside India or those who remit monies outside. Apart from this, Company also services employees of corporate clients who travel on business.

Apart from this, given the broad base of Thomas Cook Customers, who rely on the Company for end to end travel services, the company also offers both overseas as well as domestic travel insurance. The Company and its management has a proven to track and is a market leader in the home country, we feel the company can now focus on their core business which is being complete travel solution provider.

Post the Spin off Scenario

As per the current scanerio, the CMP of Thomas Cook (TCIL) stands at Rs.277 whereas the CMP of Quess Corp (Quess) is Rs.1130. An equity share holder of TCIL will receive shares of Quess in the ratio of 1889 shares for every 10000 shares. Which means ~53 shares of TCIL will give 10 shares of Quess. If we calculate for post spin off hypothetical scenario, if an investor holding 53 shares of TCIL (purchased for ~Rs.14700), would now receive 10 shares of Quess which hold value of Rs.11300, then the investor has in effect purchased the 53 shares of TCIL for Rs.3400 only (or at ~Rs.64) for the core businesses of TCIL. As per our valuation, this is an excellent price for the core businesses of Thomas Cook. Also the value of Quess reflective in the CMP of Thomas Cook is at a discount as is with all parent subsidiary business. However, since the shareholders get the full price on the Quess holding of TCIL, this discount is wiped off and instead gives the shareholders the full benefit of the Quess shareholding of the parent. The benefit will get reduced if the prices of Quess fall or Thomas Cook rises. Also as the free float of the Quess Corp will suddenly increase post the spin off by percentage equivalent to the current shareholding of Thomas Cook in Quess Corp, we see an increase in the pressure on the share prices of Quess in the immediate short term stemming from the profit booking and the subsequent inevitable volatility that follows such a corporate action.

Financial Highlights

For 9M FY18, company has posted 32% revenue growth led by 29% increase in Human Resource (Quess) and 39% growth from Travels segment. EBITDA increased 35% yoy to Rs 440cr. EBITDA margin marginally increased to 5.1%. For FY17 EBITDA margin was at 3.7%. PAT surged 1.5x to Rs 216cr on the back of tax write back of Rs 32cr vs. Rs 85cr tax paid for 9M FY17. Other Income increased 25% to Rs 74cr. We estimate revenue to see 20% cagr over FY17-20E led by strong performance from HR services and robust growth momentum from Travels segment. We expect EBITDA to post 28% cagr led by turn around in Sterling Business and strong show from Travels. EBITDA margin may expand 140bps over FY17-20E. Strong revenues and robust operating performance would drive 75% PAT cagr over the same period. We believe Thomas Cook has robust growth prospects on the basis of arguments such as: 1) India's suitable Demographics, 2) Governments initiative for the sector, 3) rapid growth in Quess Corp.,4) Turn around in Sterling Holiday 5) Digitalization of business strategy. We recommend Thomas Cook as a BUY at CMP of Rs. 277 and add on declines to Rs.260 with TP of Rs 340. We have valued Thomas Cook (India) on Sum-Of-The-Parts (SOTP) basis to arrive at the target price of Rs 340.

Valuation

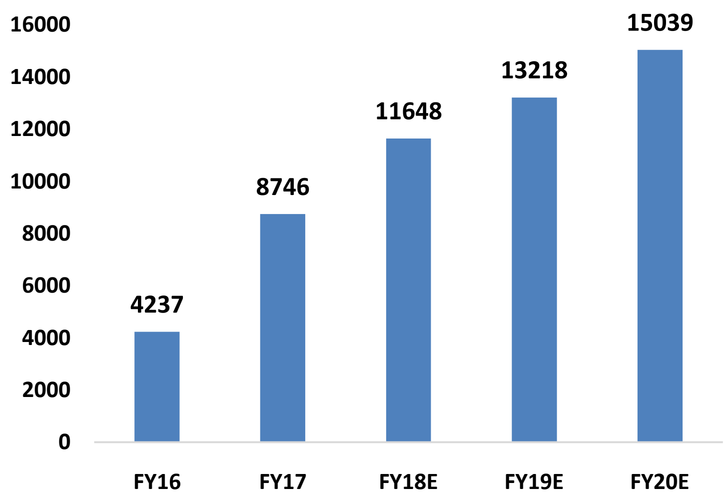
Segment	Valuation Methodology	EBITDA	Multiple (x)	FY20 Valuation (Rs cr)
Financial Services	EV/EBITDA	89	8	712
Travel and Related Services	EV/EBITDA	225	12.8	2,880
Human Resources	EV/EBITDA	462	21	6,954
Vacation Ownership (Sterling Holidays)	Invested Capital	1000	1	1,000
Enterprise Value (EV)				12,444
Target (Rs)				**340**

Source: Company, HDFC sec Research

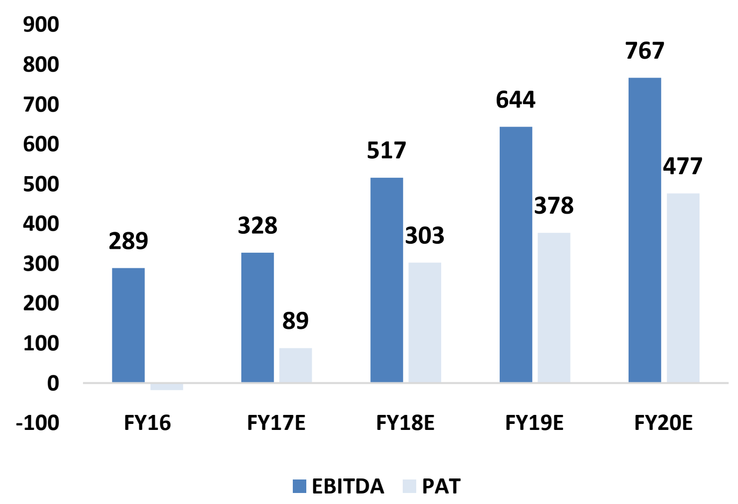
Risk & Concerns:

- Pressure on Thomas Cook's market share, if competition from online travel operators or unorganized low-cost travel agents increases sharply.
- Any slow-down in the economy will lead to lower consumer spending in travel & tourism.
- Safety Concerns for foreign tourists amidst local events and incidents to affect the FTA figures.
- Lack of Government support and implementation of marketing and promoting schemes of the Government in the election year, with more focus given to the latter.

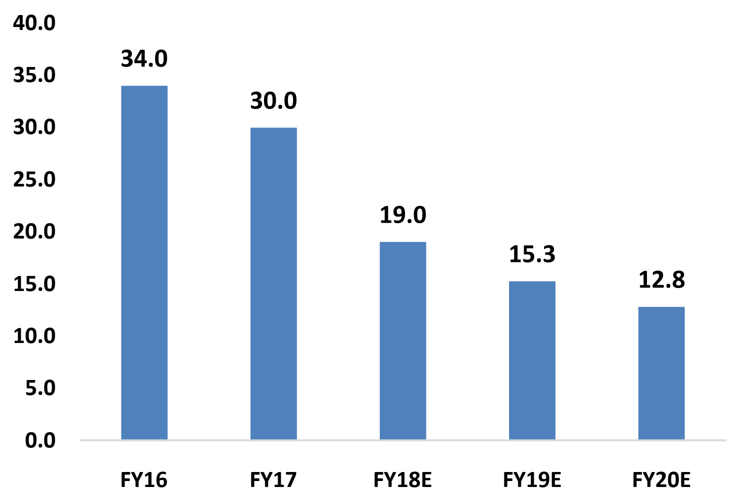
Revenue Trend over FY16-20E (Rs cr)



EBITDA & PAT to witness robust growth over FY17-20E (Rs cr)

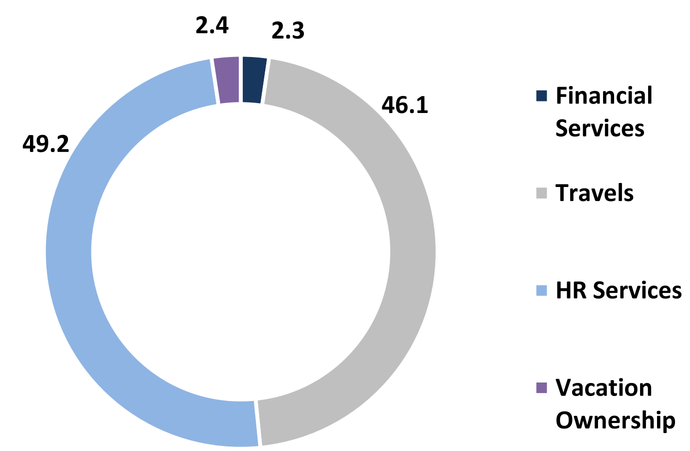


EV/EBITDA Trend



Source, Company, HDFC Sec Research

Revenue Mix (%)



Source, Company, HDFC Sec Research

Income Statement (Consolidated)

(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	**3244**	**4237**	**8746**	**11648**	**13218**	**15039**
Other Income	42	47	92	97	100	109
Total Income	**3286**	**4284**	**8838**	**11745**	**13318**	**15148**
Growth (%)	153.6	30.3	104.2	33.2	13.5	13.8
Operating Expenses	3003	3995	8418	11131	12574	14272
EBITDA	**283.6**	**289.0**	**420.3**	**613.6**	**743.9**	**875.9**
Growth (%)	**84.8**	**1.9**	**13.5**	**57.6**	**24.7**	**19.1**
EBITDA Margin (%)	**8.7**	**6.8**	**3.7**	**4.4**	**4.9**	**5.1**
Depreciation	41	64	85	119	130	148
EBIT	**242**	**225**	**335**	**495**	**614**	**728**
Interest	71	97	131	156	134	125
Exceptional Items	0	-94	0	-10	-19	-21
PBT	**171**	**34**	**204**	**329**	**461**	**582**
Tax	59	45	116	26	83	105
RPAT	**112**	**-11**	**88**	**303**	**378**	**477**
Growth (%)	63.5	-	-	241.7	24.9	26.2
EPS	3.6	-1.3	2.4	7.9	9.3	11.8

Source: Company, HDFC sec Research

Balance Sheet (Consolidated)

As at March	FY15	FY16	FY17	FY18E	FY19E	FY20E
SOURCE OF FUNDS						
Share Capital	**31.7**	**36.6**	**36.7**	**36.7**	**36.7**	**36.7**
Reserves & Surplus	1302	1210	1484	1749	2072	2490
Shareholders' Funds	**1334**	**1247**	**1521**	**1785**	**2109**	**2527**
Long Term Debt	102	448	738	649	617	568
Net Deferred Taxes	5	1	141	163	171	153
Long Term Provisions & Others	355	406	494	483	501	529
Minority Interest	**210**	**120**	**281**	**768**	**768**	**768**
Total Source of Funds	**2004**	**2221**	**3175**	**3849**	**4165**	**4544**
APPLICATION OF FUNDS						
Net Block	554	832	867	866	906	907
Deferred Tax Assets (net)	3	40	40	40	40	40
Long Term Loans & Advances	218	324	665	743	825	912
Goodwill	743	811	1255	1334	1334	1334
Total Non Current Assets	**1518**	**2006**	**2827**	**2983**	**3105**	**3193**
Current Investments	339	130	141	670	772	882
Trade Receivables	645	884	1011	1532	1702	1945
Short term Loans & Advances	161	361	519	571	588	541
Cash & Equivalents	278	985	1376	1495	1534	1677
Other Current Assets	185	341	580	690	787	881
Total Current Assets	**1611**	**2704**	**3635**	**4971**	**5394**	**5946**
Short-Term Borrowings	270	370	556	528	486	447
Trade Payables	307	1050	1216	1799	1998	2248
Other Current Liab & Provisions	505	1023	1277	1545	1622	1704
Short-Term Provisions	43	103	180	186	180	164
Total Current Liabilities	**1125**	**2546**	**3347**	**4165**	**4394**	**4670**
Net Current Assets	486	158	347	866	1060	1337
Total Application of Funds	**2004**	**2221**	**3175**	**3849**	**4165**	**4544**

Source: Company, HDFC sec Research

Cash Flow (Consolidated)

(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	171	34	204	329	461	582
Non-operating & EO items	596	-118	-92	-97	-100	-109
Interest Expenses	71	97	131	156	134	125
Depreciation	41	64	85	119	130	148
Working Capital Change	-107	1,036	155	-399	-156	-134
Tax Paid	-59	-45	-116	-26	-83	-105
OPERATING CASH FLOW (a)	**715**	**1,068**	**366**	**81**	**386**	**508**
Capex	-582	-473	-120	-118	-170	-150
Free Cash Flow	133	594	246	-37	216	358
Investments	-472	-210	-786	-157	-82	-86
Non-operating income	42	47	92	97	100	109
INVESTING CASH FLOW (b)	**-1,012**	**-637**	**-814**	**-178**	**-152**	**-128**
Debt Issuance / (Repaid)	332	394	519	-78	-6	-39
Interest Expenses	-71	-97	-131	-156	-134	-125
FCFE	393	891	634	-270	76	193
Share Capital Issuance Incl MI	171	-85	161	487	0	0
Dividend	-16	-16	-21	-38	-55	-73
FINANCING CASH FLOW (c)	**415**	**196**	**527**	**216**	**-195**	**-238**
NET CASH FLOW (a+b+c)	**118**	**627**	**79**	**119**	**39**	**143**

Source: Company, HDFC sec Research

Key Ratios

(Rs Cr)	FY15	FY16	FY17	FY18E	FY19E	FY20E
EBITDA Margin	8.7	6.8	3.7	4.4	4.9	5.1
EBIT Margin	7.5	5.3	3.8	4.2	4.6	4.8
APAT Margin	3.5	-0.4	1.0	2.6	2.9	3.2
RoE	8.9	-3.0	6.3	17.5	17.5	18.6
RoCE	12.1	10.1	10.6	12.9	14.7	16.0
Solvency Ratio						
Net Debt/EBITDA (x)	-0.9	-1.0	-0.7	-1.9	-1.9	-2.0
D/E	0.3	0.7	0.9	0.7	0.5	0.4
Net D/E	-0.2	-0.2	-0.1	-0.6	-0.6	-0.6
Interest Coverage	3.4	2.3	2.6	3.2	4.6	5.8
PER SHARE DATA						
EPS	3.6	-1.3	2.4	7.9	9.3	11.8
CEPS	4.2	0.7	4.7	11.1	12.8	15.8
BV	48.7	29.1	41.5	48.8	57.6	69.1
Dividend	0.5	0.4	0.5	0.9	1.3	1.7
Turnover Ratios (days)						
Debtor days	73	76	42	48	47	47
Inventory days	0	0	0	0	0	1
Creditors days	37	96	53	59	58	58
VALUATION						
P/E	76.7	-210.0	115.4	34.6	29.4	23.2
P/BV	5.6	9.4	6.6	5.6	4.7	4.0
EV/EBITDA	34.6	34.0	30.0	19.0	15.3	12.8
EV / Revenues	3.0	2.3	1.1	0.8	0.7	0.7
Dividend Yield (%)	0.2	0.1	0.2	0.3	0.5	0.6

Source: Company, HDFC sec Research

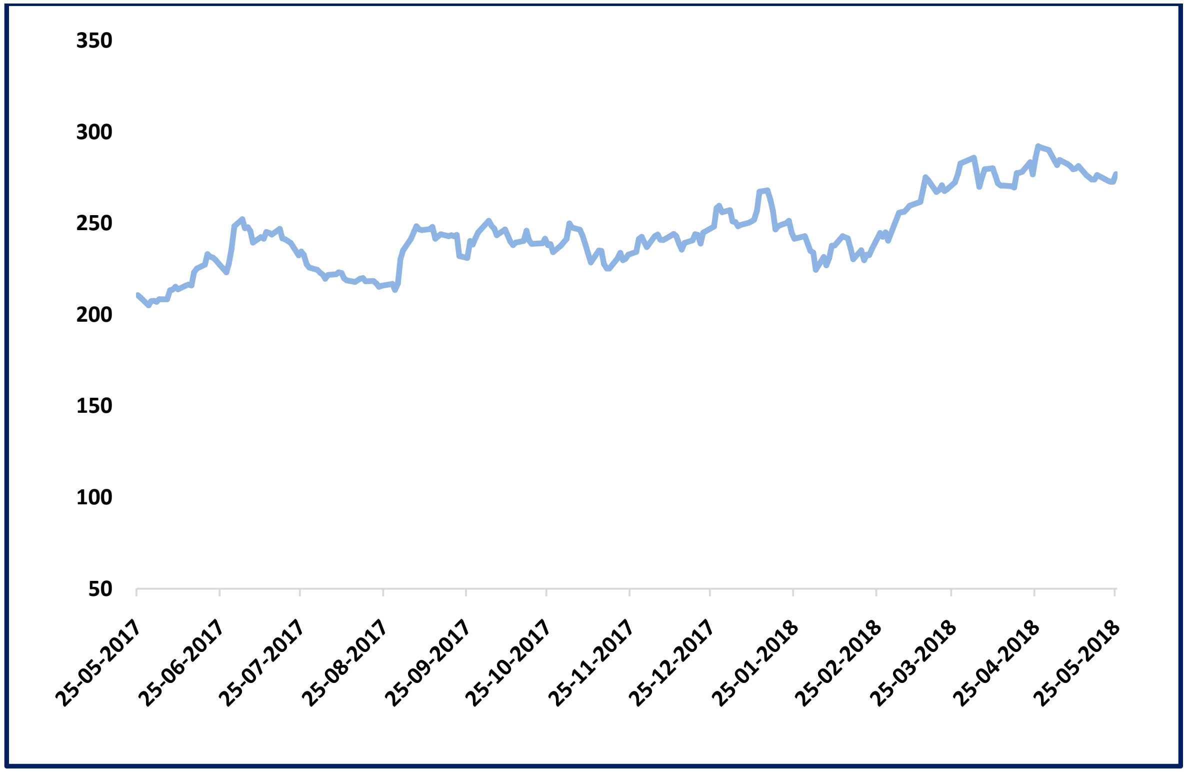
Rating Chart

R E T U R N	HIGH			
	MEDIUM			
	LOW			
		LOW	MEDIUM	HIGH
		RISK		

Ratings Explanation:

RATING	Risk - Return	BEAR CASE	BASE CASE	BULL CASE
BLUE	LOW RISK - LOW RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 20% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 15% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 15%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 20% OR MORE
YELLOW	MEDIUM RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 35% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 20% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 35% OR MORE
RED	HIGH RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 50% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 30% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 50% OR MORE

Price Chart



Rating Definition:

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

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