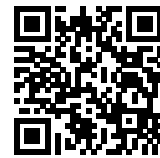


Thomas Cook - Popular Questions...& Our Answers

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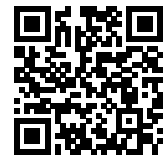
Rupesh Tailor, Everest Research, 19 June 2019

- Following on from our [note](#) on Thomas Cook published on 4/6/19, we take the opportunity to address in this blog post some of the **common questions we have received from investors**. Following our buy recommendation at a price of 37.12 on Thomas Cook's 6.25% 2022 senior unsecured bonds, soon followed by the announcement that Thomas Cook was in discussions with Fosun regarding a potential bid from the latter for Thomas Cook's tour operations, the bonds rallied to a price of c. 50 but have since fallen back to c. 38.93 (yield c. 51%). The fallback in bond prices was in part driven by last Friday's new story that one of Thomas Cook's bank lenders was marketing for sale £30m of the new 1st lien facility at par, £50m of the RCF at c. 50% and £25m of an LC at c. 50%
- **We believe this represents another good entry point in Thomas Cook's 6.25% 2022 senior unsecured bonds and add to our model portfolio long with a further 2% of model portfolio AUM at 38.93, taking our long position to c. 5% at an average price of 37.84**
- **Question #1 – Is the risk-reward better in the RCF than in the senior unsecured bonds?** We recognise that the RCF would move from a currently pari passu position vs the senior unsecured bonds to a 2nd lien secured position should the new £300m 1st lien secured facility come into force and that therefore the RCF potentially may become senior to the senior unsecured bonds so that if both are purchasable at similar prices why not buy the former?
- Notwithstanding that not all investors can buy RCFs, **we see limited benefit in being 2nd lien in a security package capped at £300m (see our previous [blog post](#)) where the 1st lien facility entirely spans that £300m security cap and we would expect the £300m 1st lien facility to be substantially, if not fully, drawn in any scenario resulting in enforcement on the collateral**
- This then raises the question as to whether the degree of priming senior unsecured bondholders face could be increased. Whilst there are some differences in Permitted Liens language across the 2022 and 2023 bonds, we think the **general carve-out (£650m currently given the % of Total Assets alternative currently yields a smaller lien basket across both bonds) is the most binding currently suggesting priming of the senior unsecured bonds could be increased from the planned £300m (note that this priming has not yet occurred as per our previous [blog post](#)) to**



£650m

- **However, we are not convinced that lenders would increase the size of any 1st lien facility to span a wider security package than the envisaged £300m** – the circumstances in which a larger facility would be needed would be those in which the ultimate liquidity squeeze materialises (customers stop booking en masse; advance payments from those that do book get withheld by credit card companies; hotel suppliers want payment upfront etc) and in this scenario we doubt that lenders would have the risk appetite to extend further funds against what could be a diminishing business value at that point. **Indeed the very possibility that a lender might already be trying to sell the new 1st lien facility, only weeks having agreed to enter this, suggests appetite to increase the security cap and size of 1st lien facility would be limited.** (It also potentially says something about at least that particular bank lender's view of Thomas Cook's prospects to implement some form of break-up / turnaround)
- Whilst UK insolvency law does have a type of “voidable preferences” remedy, empirically our understanding is that this is difficult to prove and so is unlikely to be a significant deterrent to increasing the security cap
- **Overall, we feel the RCF should perhaps trade modestly higher than Thomas Cook's senior unsecured bonds but we would not pay more than 5 percentage points for this optionality in the RCF.** Whilst we can envisage the RCF being fully paid down come FY 2019 (September 30th) given the usual seasonal working capital movement, we would view this as temporary ahead of the Q1 2020 working capital reversal and therefore we would not expect RCF holders to get a significantly better exit point than the senior unsecured bonds just on the back of the seasonal movement
- **Question #2 – Why wouldn't a buyer of any part of Thomas Cook not just wait to acquire parts out of administration more cheaply?** As for parts of the Group Airline we would note the following: (1) **slots in Germany cannot, by law, be traded** – so any acquirer would need to buy the business and not just the slots; whilst this could occur post administration, it becomes harder for any acquirer to ensure they will be the highest bidder at this point; (2) **Europe's short haul airline market needs consolidation over the next 5 years to gain better control of capacity and we believe the larger players at each airport will be keen to ensure that they are the best bid for any airlines that come up for sale at their airports** – here we view an acquisition of Thomas Cook's Condor business as a defensive move for Lufthansa and its Eurowings low cost carrier where it dominates across Condor's Frankfurt, Dusseldorf and Munich airports of operation



- As for the Group Tour Operator, the longer Thomas Cook remains with adverse media coverage the greater (and potentially more permanent) the damage to its customer franchise becomes. **Any serious bidder (and we outline the strong financial and strategic logic for Fosun to combine Thomas Cook's Group Tour Operator with its Club Med business in our [note](#)) we believe would see more merit in acquiring (at a still low price) the Group Tour Operator (or parts thereof) pre administration and before permanent damage is done to its franchise rather than at a lower price in administration with the franchise permanently damaged**
- **Question #3 – Can the group really be separated, particularly in terms of the Group Tour Operator vs Group Airline?** We do not doubt that there are implications (both negative and positive) for acquirers of all or part of Thomas Cook's Group Airline of being tied in to the Group Tour Operator's network requirements (but also benefitting from early season visibility on seat capacity sales) under long term commercial services agreements as per the premium/discount valuation analysis in our [note](#). We also recognise that having a weak Group Tour Operator post any sale is a potential deterrent to Group Airline buyers but note that **the bids Thomas Cook has received for all or parts of the Group Airline are already on the basis of the long term commercial services agreements – of course, this would likely be reflected in the price but we don't see this as insurmountable currently. Key of course is the plan for any continuing business post airline sales which we assess in our [note](#)**
- **Question #4 – What damage is there to Thomas Cook's Summer 2019 bookings from adverse media coverage over recent months?** We are currently updating our proprietary bookings and pricing tracker for Summer Season 2019 and expect to publish on this in due course
- **Question #5 – Regarding sale valuations of different parts of the business, which quarter's net debt figure is the correct one to use to deduct from enterprise value given the strong seasonality in net debt driven by working capital movement?** As per our [note](#), we view Q1 as being the truest measure of net debt in Thomas Cook's business, this being the point at which substantially all peak summer season customers have paid (for holidays and flights) *and* hotel suppliers have been paid. **Whilst in our [note](#) we model break-up valuations based on this highest level of net debt, we view this as conservative and that many acquirers would likely deduct not the seasonally highest level of net debt but more of an average over the year given that, for a going-concern, working capital funding at points in the year is a reality of Thomas Cook's business**

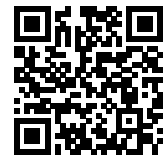
Contact Rupesh Tailor at Everest Research to discuss: rupesh.tailor@everestresearch.co.uk



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