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TUI remained resilient while Thomas Cook tumbled amid travel sector's tough market environment

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The year 2018 was a turbulent year for the European Union's travel sector due to factors such as extreme weather conditions, Brexit uncertainties as well as the weakened consumer confidence. At the same time, the RMI-CRI Aggregate 1-year Probability of Default (PD) for EU-domiciled travel services companies increased from 16.86bps to 38.92bps, as of January 3, 2019 (See Figure 1). Travel services giants Thomas Cook Group PLC and TUI AG also reported the negative effects of the extreme weather to its earnings. However, unlike Thomas Cook, TUI managed to overcome the challenges through the diversification of its business.

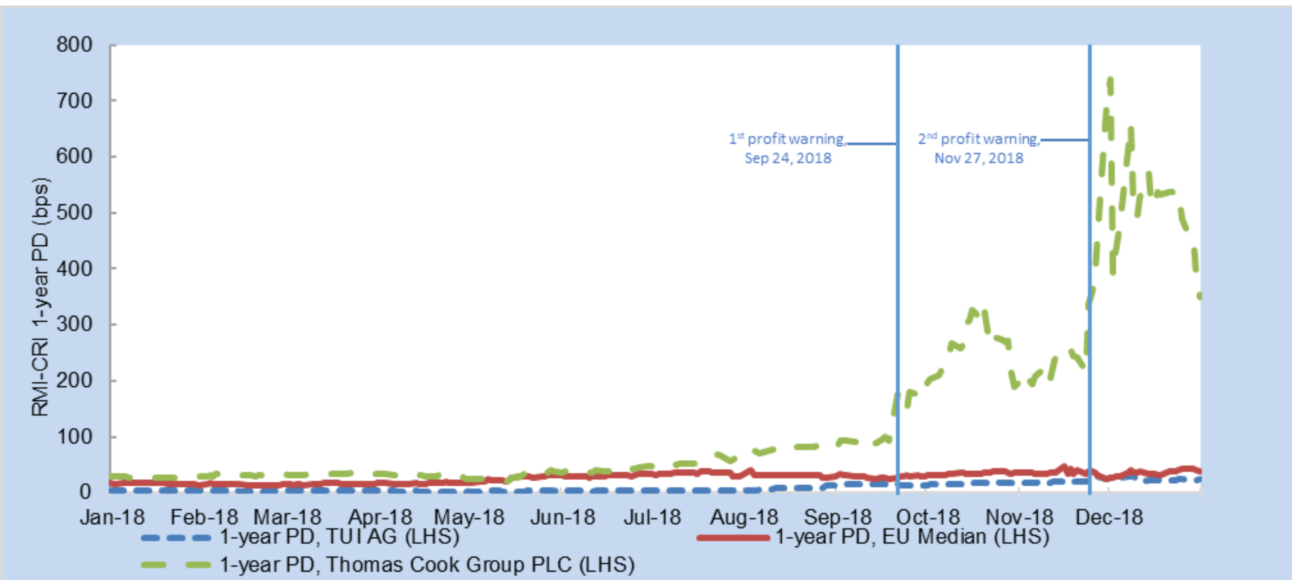

Figure 1: RMI-CRI 1-year PD for TUI AG, Thomas Cook Group PLC and RMI-CRI Aggregate 1-year-PD of 36 EU-domiciled travel services companies. *Source: RMI-CRI.*

In December 2018, TUI posted an 11% rise in earnings, although there was a decline in earnings coming from its markets and airlines division due to airline disruptions, extreme weather and the weaker British pound. However, despite the unfortunate conditions, TUI managed to outshine its competitors owing to its diversified business. For instance, TUI was able to depend on its growing hotel and cruise ship business, which are higher-margin areas with less seasonality. Owning such assets also means that TUI has a greater flexibility over pricing and less exposure to the tourism sector's woes, as compared to competitors such as Thomas Cook which buys hotel space in advance, with an uncertain business nature and higher business risk.

In contrast, Thomas Cook issued two profit warnings within a span of two months in 2018 and suspended its dividend, before releasing its full year results at the end of 2018. At the same time, The RMI-CRI 1-year PD for Thomas Cook soared to 739.43bps, before decreasing to 350.17bps as of January 3, 2019 (see Figure 1).

Companies	Revenue (GBP mn)		Net Income (GBP mn)		Total Debt/T12M EBIT (X)	
	Y2017	Y2018	Y2017	Y2018	Y2017	Y2018
TUI AG	18,535.0	19,523.9	644.8	732.5	2.56	3.23
Thomas Cook Group PLC	9,007.0	9,584.0	13.0	-163.0	6.26	14.72

Table 1: Financial figures for TUI AG and Thomas Cook Group PLC. *Source: Bloomberg*

As seen in Table 1, while Thomas Cook's revenue increased by 6% YoY, it suffered a net income loss of GBP 163mn. Multiple reasons may have accounted for its financial woes. Firstly, consumers delayed booking their holidays last year due to the prolonged period of heatwave, which led to a high discounting. As a result, its UK market share suffered from promotional activity in the sector, on top of an already competitive market for holidays to Spain. Secondly, circumstantial factors such as the collapse of AirBerlin and NIKI in 2017 also led to a higher operating cost for Thomas Cook, as it had to find replacement flights for its customers. Analysts also believe that greater proportion of holidaymakers are putting together their own holidays using online platforms such as AirBnB combined with budget flights (e.g. RyanAir), instead of the traditional holiday packages offered by companies such as Thomas Cook.

As a result of its poor financial performance, its bonds have dropped in value and the cost of insuring its debt against defaulting on payment hit a record high. Given the worsening credit profile, as also shown by the Total Debt/EBIT of 14.72X in Table 1, credit rating agency Moody's downgraded its rating on the company to B2 from B1, with a negative outlook.

Thomas Cook's ongoing improvement strategies include accelerating its own-brand hotel growth to pursue higher margin. However, certain analysts such as the investor director at AJ Bell, Russ Mould, remain skeptical of this strategy as it would not be an easy sell due to the general public's association of Thomas Cook with cheap holidays. Thomas Cook is also increasing its online presence through integration with Expedia technology to level the playing field with other operators and online travel agents. This transition has proved to be a good strategy as currently online sales already account for 48% of its total bookings and the number is expected to go higher.

It should be noted that travel services companies like Thomas Cook should still expect challenges associated with the uncertainty of Brexit which is likely to remain at least until March 29, 2019, when the UK is due to leave the EU. Such challenges would be characterized by late bookings which may put more pressure on the profit margin, as consumers are unsure of the probable impact that Brexit may impose on travel for UK citizens.

Credit News

PG&E to consider a bankruptcy filing within weeks

Jan 7. The largest utility company in California state, PG&E Corp is considering whether to file for bankruptcy protection in as soon as weeks to organise the billions of dollars in potential liabilities from wildfires its equipment may have ignited. The potential of the bankruptcy filing may force state legislators to come up with a rescue package. Since the deadliest wildfire in California history broke out in early Nov 2018, the San Francisco-based company has lost more than half its market value. Aside from the bankruptcy option, PG&E is currently exploring changes to its board and restructuring its business by selling its natural gas business. (The Business Times)

Saudi banks set for 4-year high growth as rates offset oil

Jan 6. Saudi Arabian banks is expected to reach its highest growth in four years with rising interest rates and increase government spending to offset the risk of higher bad-debt charges. The pre-tax earnings of the country's 12 listed banks will probably climb 12.4% in 2019. The stock prices of the banks represented by the Tadawul Banks Index climbed 31% in 2018 despite a 38% drop in oil prices in the fourth quarter and a contraction in the economy in 2017. Strong mortgage lending may continue in 2019 and compensate for slower growth in personal loans and car leases. Future challenges include growing loan books outside of retail mortgages, weak oil prices and competition from digital-payment platforms. (Bloomberg)

China's second peer-to-peer lending lapse in a week costs investors USD 330mn

Jan 4. Hangzhou-based Xinhehui, a Chinese peer-to-peer lender, told investors the repayments on a total of CNY 2.26bn of products issued would not be made, highlighting risks to the nation's broader financial system as rising defaults and tougher regulations hit the USD 176bn industry. Another P2P lender, Shanghai based Yidai, also faced financial losses and issued a plan to refund its lenders in three to five years with an outstanding principal balance of CNY 4bn. Tougher regulations and rising bankruptcies have worried P2P investors and lending on these online platforms has dropped. According to estimates, as few as 300 P2P firms will remain by the end of 2019 from 1000 in 2018. (The Business Times)

Brexit threat to European sovereign bond sales

Jan 4. European governments risked losing their access to London-based banks that help sell their bonds if the UK crashes out of the EU without a deal. This is due to the regulation in place in most EU countries which prohibit bankers based outside the trading bloc from helping to sell bonds. Losing access to London-based banks could increase the cost of raising funds for some countries, especially since London is still the centre of liquidity for the trading euro debt and particularly periphery debt. Given the uncertainty whether UK can get a deal before exiting the EU, countries are pushing investment banks to move their operations to the EU by early this year. (FT)

China slashes banks' reserve requirements again as growth slows

Jan 4. Amid increasing worries about the health of the world's second-largest economy arising from both slowing domestic demand and US tariffs on its export, China is cutting its reserve requirements banks have to hold for the 5th time in a year. This will free up CNY 800bn for banks to lend. The size of the cut is at the higher end of market's expectations and the funds released is the largest amount among the cuts since Jan 2018. Futher actions may include more cuts in the reserve requirement ratios and more cuts in taxes and fees as indicated by Premier Li Keqiang. Economic growth is expected to cool to around 6.5% in 2018, the weakest since 1990 and further deceleration may come in 2019 with growth forecasted to be just over 6%. (Reuters)

Leveraged loans suffered biggest monthly decline in seven years (Bloomberg)

Global investors sidestep Indian bankruptcy with rescue finance (FT)

Cost to insure Bristol-Myers debt jumps as leverage balloons (Reuters)

Regulatory Updates

Sri Lanka to halve maximum foreign holding limit in government securities

Jan 2. Sri Lanka plans to lower the maximum limit for foreign holdings of government securities from the current 10% to 5% after suffering about USD 1bn in foreign outflows from rupee-denominated government securities in 2018. Almost 42% of the outflows happened in the months following the recent political crisis triggered by the sacking of Prime Minister Ranil Wickremesinghe. Policy inconsistencies and political instability also discouraged long-term foreign investment and led to rating downgrades by credit agencies. Foreigners held 3.1% of the total outstanding government securities of LKR 5.29tn as of 26 December 2018 and this new regulation is expected to prevent possible hot money flows and improve the quality of reserves. (The Business Times)

Ringfencing rules could leave British banks at a disadvantage

Jan 1. Ringfencing rules came into force on 1 Jan 2019, aiming to prevent taxpayer bailouts of "too big to fail" banks that risk customer deposits when bets by their investment-banking units go wrong. A ringfenced bank must be a separate legal entity with its own board, and there will be limits on how much capital retail and investment banking entities can share. The BoE's Prudential Regulation Authority is overseeing the changes, which directly affect Barclays, HSBC, Royal Bank of Scotland, Lloyds Banking Group and Santander as these UK banks hold more than GBP 25bn in deposits. Since European and US banks are not subject to the rules, the landmark changes led to concerns that foreign banks could have an advantage on their British rivals, which are already facing issues from Brexit. (FT)

Western insurers rush to seize on China market opening (FT)

India parliamentary panel asks central bank to ease bank capital requirements (Reuters)

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