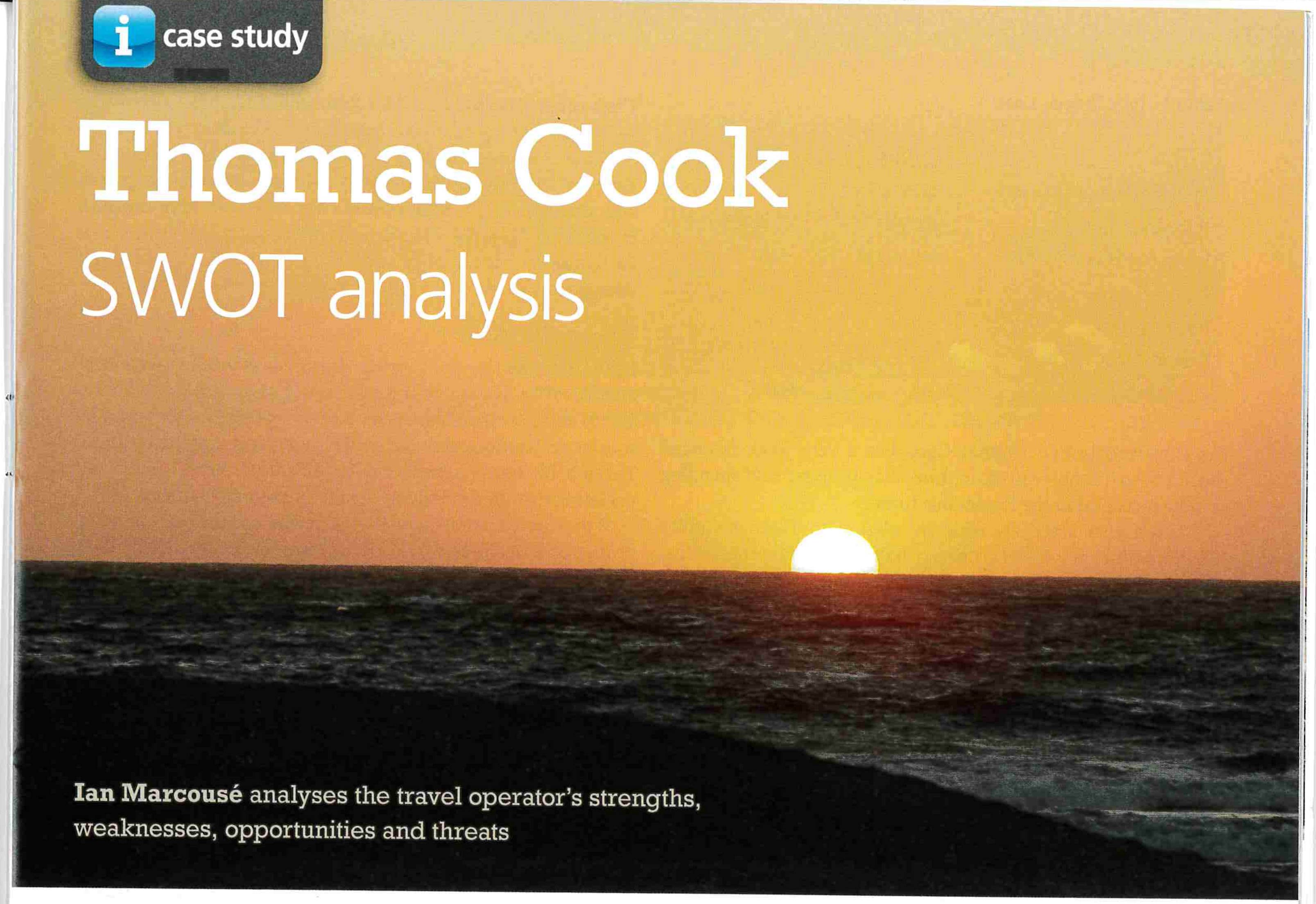
Thomas Cook

SWOT analysis



Ian Marcousé analyses the travel operator's strengths, weaknesses, opportunities and threats

Although it invented the package holiday more than 170 years ago, the modern version of Thomas Cook can be traced back to 2007. Since then it has absorbed 460 high street Cooperative Travel stores — just as the travel market went increasingly digital.

In late November 2018 Thomas Cook announced its second profit warning in as many months, blaming the hot summer weather. In mid-December, arch rival Tui Group said there were no problems with the UK's hot summer, leaving Thomas Cook isolated.

Strengths

Thomas Cook is the oldest name in the holiday market, potentially gaining credibility from its experience worldwide. It is a name that holidaymakers should be able to trust. The business has 600 UK stores (down from 1,200) and its Swiss chief executive says that 600 'is a reasonable number for now'. It also has an effective e-commerce website, obtaining 48% of its bookings from online sales. UK online bookings rose 30% in 2017/18, and in Germany by 25%.

Clear strategy

The business has a clear strategy: to switch from being a travel agent selling other people's holidays to channelling customers towards its own-brand hotels and flying them there in its own planes. This would create a vertically integrated business that can absorb every part of the value chain, from customer orders through to customer spending at hotel bars.

In 2017/18 sales of holidays to own-brand hotels rose 15% compared with the company's 5% revenue growth overall. The annual report suggests that the own-brand hotels provide higher profit margins per holiday. Understandably, Thomas Cook plans to open 20 more hotels in 2019.

Market segmentation is also part of the Thomas Cook strategy, as shown by its Cook's Club concept. These are dedicated new, own-brand hotels targeted at young adults rather than families. Online reviews to date are mixed (they always are), but the average customer ratings look impressive.

Thomas Cook also deserves credit for developing a joint venture in China. In 2017/18 its Chinese customer numbers grew eight-fold. There is a clear objective of building the Chinese business up to a meaningful size 'to diversify away from our dependence on north and western European markets' (2018 annual report). In China it uses the huge Alibaba online platform and is working on its first own-brand, 200-room hotel in the country.

Weaknesses

Although its current strategy has strengths, it may be too little, too late. Own-brand hotels make sense, but big rival Tui got there first (Table 1). It has spent hugely on hotels and also on cruise ships (Thomas Cook has none). In 2017 Tui invested three times more than Thomas Cook on new assets such as hotels.

Table 1 Tui v Thomas Cook

	Tui (UK and Germany)	Thomas Cook (UK)
Annual revenue 2017/18	£17.1 billion	£9.6 billion
UK market share	20.6%	16.8%
Pre-tax profits 2017/18	£845 million	–£50 million
Aircraft owned	150	93
Hotels owned	380	200
Cruise ships owned	15	0
Employees	70,000	22,000

As explained below, Thomas Cook has a very weak financial position, so it is not realistic to think that its investment spending can be increased in the foreseeable future.

There's also a serious issue in relation to Thomas Cook's distribution channels. With nearly half of sales coming online, and annual growth of 25–30% in e-commerce sales, having 600 physical travel agencies seems like a recipe for loss-making.

The business needs to be bolder about adjusting to the new reality — though that would mean closures and redundancies.

Table 2 shows the dire state of Thomas Cook's finances. Between 2011 and 2018 the company had zero revenue growth and although its liquidity position has improved from dreadful to awful, its gearing should be a major source of concern. If Tui chose to start a price war in 2019, Thomas Cook would struggle to survive.

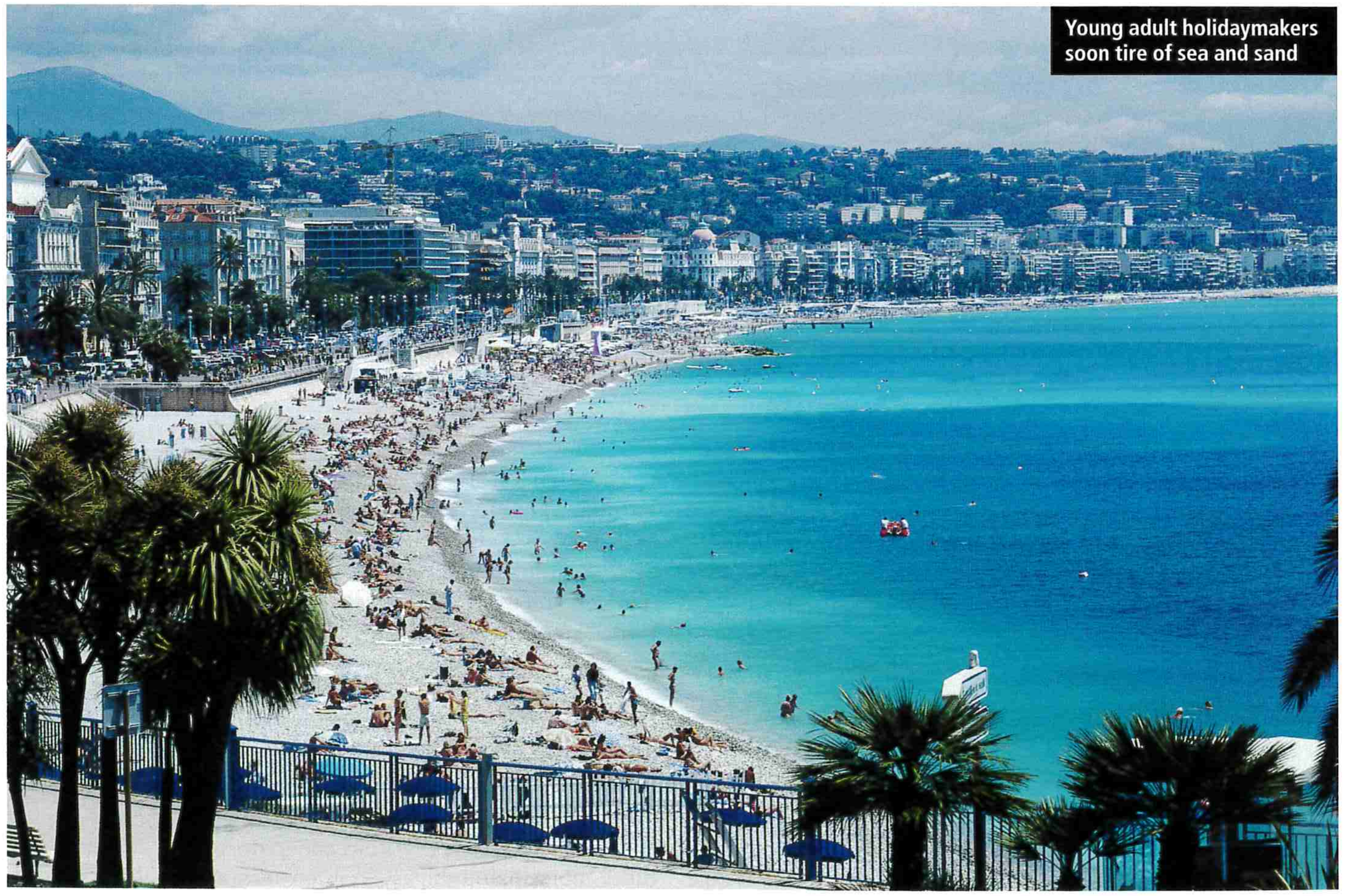
Any profits at all?

Figure 1 shows the company's awful performance between 2011 and 2018. Its pre-tax profit total for 2011 to 2018 was minus £1,091 million. Shareholders have been kept reasonably happy by regular declarations about the 'underlying profit' of the business. That's a bit like a school having dreadful A-level results but declaring that the 'underlying results' are actually rather good.

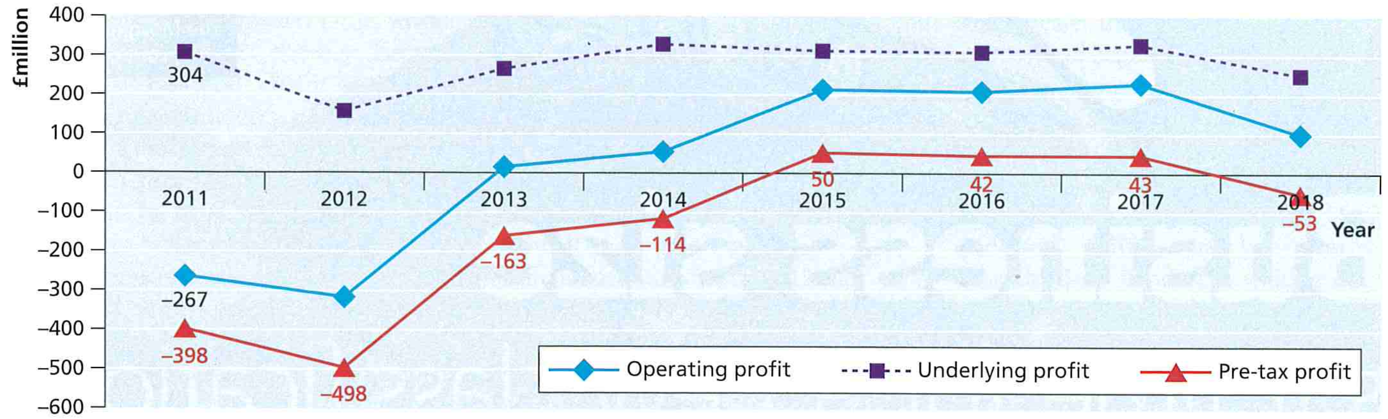
If they were accurate, underlying profits and the real operating profits of a business would tie together over time. Each year's operating profit might jump up and down depending on erratic factors such as the pound's exchange rate. The underlying profit would smooth the figures out, helping to show the long-term position. When the underlying figures are a consistent exaggeration (as in Figure 1), any shareholder should smell a rat. Over the period 2011–18, underlying profits at Thomas Cook were £2 billion more than operating profit

Table 2 Thomas Cook plc: key financial ratios

	2011	2012	2013	2014	2015	2016	2017	2018
Revenue (£m)	9,809	9,491	9,315	8,588	7,834	7,812	9,006	9,584
Current ratio	0.45	0.43	0.54	0.47	0.55	0.57	0.54	0.51
Gearing ratio	59.30%	80.70%	78.80%	85%	83.70%	83.20%	88.70%	87.60%



Young adult holidaymakers soon tire of sea and sand



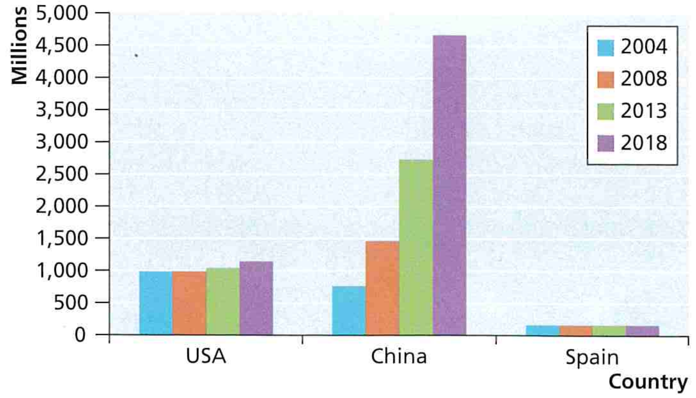
Source: Thomas Cook annual reports and accounts

Figure 1 Thomas Cook profits

As well as the financial issues, a long-running scandal may have dented the company's image. In 2006 two young children were poisoned by a carbon monoxide leak on their Thomas Cook holiday in Corfu. Their tragic death was made worse by crass handling by the tour operator. As late as 2013 the *Daily Mail* was still running articles updating readers on Thomas Cook's insensitivity to the parents' distress. This episode would have hurt the company's reputation, though whether the damage has lasted is unclear.

Opportunities

China is the world's fastest-growing market for tourism. It is now the number one in international travel (though Thomas Cook is not yet targeting that) and also the number one in domestic travel, i.e. Chinese families holidaying in China. Figure 2 shows the dramatic growth that led to China overtaking the USA by 2008, with a growth rate of over 500% between 2004 and 2018. For Thomas Cook to be positioning itself in that market is clever and brave. Brave because attacking such a huge, fast-growing market usually requires a lot of cash — and that's something the company lacks.



Source: Euromonitor

Figure 2 Domestic travel: number of holidays at home

Another opportunity may lie in market segments such as the one targeted by Cook's Club. Young adults tend to quickly tire of sea and sand, and want something more exciting. Adventure experiences may be the next step, perhaps growing out of Cook's Club.

Threats

The biggest threat to Thomas Cook is financial. Viewed rationally, this business should no longer exist. It only keeps going by regularly persuading shareholders to put more cash into its balance sheet. In theory, the flow of cash should be in the other direction, with the company paying dividends into shareholders' pockets. If 2019 proves to be a tough year for the UK economy and the UK financial system, Thomas Cook may struggle to keep going.

Then there's Brexit. If it goes badly, most economists believe that an already-weak pound will weaken further. If the pound hits parity with the euro, UK families will holiday at home rather than in the euro area. City-break holidays might be hit hardest, as the prices of city-centre European hotels and restaurants become unaffordable to those using pounds.

For Thomas Cook, a difficult Brexit is an existential threat. Fortunately for the business, it has already developed non-euro, weak-currency destinations such as Turkey. It will have to pivot to a huge increase in hotel capacity in Turkey, and a big cut in Spain and Italy. Ironically, having its own-brand hotels means less flexibility, and Brexit may upset this strategy.

Conclusion

Thomas Cook's shares were once 280p and are now 30p. Despite that collapse, it's still hard to say that 30p represents value for money. Even though tourism is a global growth market, Thomas Cook is struggling to stay relevant in a world that no longer needs old-style travel agents. Customers can research desired destinations online, and do all the bookings themselves. If Thomas Cook plc still exists in 10 years' time, it will probably be because it made the right strategic decisions in China and somehow managed to overcome its financial weaknesses.

Ian Marcousé teaches business and economics at Claremont School in Surrey and at the Institute of Education, London.