

## STILL ON TRACK DESPITE THE ASH

**TUI Travel's H1 results next week should demonstrate that the company is still on track to deliver good underlying results – something that at the start of the year the market considered unlikely. Careful control of capacity and a steady improvement in customer demand should help demonstrate the resilience of the business and reinforce our view of it as one of the best quality stocks in the sector.**

- The company has recently had a couple of 'knocks' to its earnings, one of which (the volcanic ash problem of circa £70m) we would describe as exceptional and the other (the higher financing costs following the issue of its £400m convertible bond) is really just bringing forward costs that would have been incurred in about a year's time (albeit not in market estimates).
- We estimate that the 'ash' issue will affect ongoing PBT by about £3m pa through additional interest costs – which represents about 0.8% of PBT. The other way to look at this is to say that the £70m of additional cash costs will, after tax, represent about 1.5% of the company's market capitalisation.
- The company's issuance of £400m seven year 4.9% convertible bonds will impact its cash interest charge by about £10m pa (on a full year basis before the proceeds are reinvested) or about 2.3% of PBT. There is also the equity amortisation cost on these bonds of about £10m pa (2.3% of PBT) for the next seven years, which will add to the company's finance costs.
- Overall we estimate that these two items will impact TUI's ongoing EPS by about 5.4% pa in a full year. Consequently our diluted EPS for FY 2011 has reduced from 29.1p to 27.6p. For the current year the EPS adjustment slightly less and changes from 25.2p to 24.1p. We believe this has been fully reflected in the stock's 7% under-performance since 14 Apr 2010, when the 'ash' problem started.
- The majority of our revisions relate to the issue of the convertible bond and as such should be seen as a partial refinancing that is occurring a little earlier than expected, given that its £910m bank facility needs to be refinanced by June 2012.
- The underlying performance of the group is still on track – as reported in its 24 Mar 2010 pre-close update for H1 2010 – with booking trends still improving across the board. We expect this message to be reinforced when the company reports its H1 results next Tuesday (11 May).
- We still view the tour operators as one of the best quality areas within the leisure sector, offering significantly better value than some of the less defensive consumer related areas of the market such as general retailing, which are typically on P/E ratings of 12x to 13x. TUI currently trades at 10.7x for 2010E and 9.4x 2011E. We maintain our BUY rating and 359p target price.

### Research

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Rating	BUY
Target price (p)	359
Current price (p)	259
Upside/downside (%)	38.6%
Main listing index	FTSE 100
Reuters/Bloomberg	TT..L / TT/ LN
Sector	Travel & Leisure
Shares in issue (m)	1118.0
Market cap (£m)	2,895.6
Current EV (£m)	3,593.2
Last FY (debt)/cash (£m)	-337.6
Free float (%)	44.7%
52 wk range (p)	308–218
Next event: H1 2010 results	11 May 2010

Year-end Sept (£m)	2009	2010E	2011E
Revenue	13,863	13,440	14,051
EBITDA	674	703	775
EBITA	443	481	548
PBT	366	373	438
Net (debt)/cash	-338	-365	-151
Net pen. def (IAS19)	-360	-360	-360
Net assets/(def)	2,286	2,308	2,448
<b>Dil EPS (p)</b>	<b>23.5</b>	<b>24.1</b>	<b>27.6</b>
DPS (p)	10.7	11.2	12.0
FCF (p)	7.4	24.6	32.7
P/E (x)	11.0	10.7	9.4
EV/EBITDA (x)	5.5	5.2	4.4
FCF yield (%)	2.9%	9.5%	12.6%
Div yield (%)	4.1%	4.3%	4.6%
Dividend cover	2.2	2.1	2.3
Avg. debt:EBITDA (x)	1.1	1.1	0.7
Interest cover (x)	7.8	6.9	8.3
Fixed CC (x)	2.1	2.2	2.3
ROIC (%)	9.2%	10.0%	11.4%



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## H1 PREVIEW

TUI will report its H1 results (6m to Mar 2010) next Tuesday (11 May 2010). As usual these results should show a large seasonal loss in H1 and will largely be ignored by the market – of far greater importance will be the bookings outlook for its summer 2010 programme.

In the table below we have summarised our expectations for both TUI's 2009/10 winter programme (now finished) and its 2010 summer programme. These assumptions are very similar to the performances indicated by the company at its last update in March for the simple reason that (excluding the ash issue) we do not think they will have changed much in the intervening period. We have also included our revenue assumptions for FY 2011 and FY 2012 for each of its mainstream markets.

**Table 1: TUI Travel – Key Performance Assumptions for FY 2010–FY 2012**

	2010			2010			FY 2011	FY 2012
	Winter Demand	Winter ASP	H1 Rev	Summer Demand	Summer ASP	H2 Rev	Rev	Rev
Northern Region	-11%	8%	-3%	6%	7%	14%	2%	5%
Central Europe	-8%	-2%	-10%	-3%	1%	-3%	5%	5%
W. Europe	-1%	-5%	-6%	3%	-2%	1%	2%	2%

Source: Matrix

The above table also needs to be seen in the light of what is happening to capacity in each region; we show this below:

**Table 2: TUI Travel – Capacity Assumptions FY 2010–FY 2012**

	2010		FY 2011	FY 2012
	Winter Capacity	Summer Capacity	Capacity	Capacity
Northern Region	-13%	5%	0%	0%
Central Europe (Germany)	-9%	-5%	0%	0%
W. Europe	0%	0%	0%	0%

Source: Matrix

As can be seen, TUI significantly cut capacity for its winter 2009/10 winter programme – particularly in its Northern Region (UK -14% & Nordic -11%) which was always going to be a tougher market as winter holidays tend to be more discretionary and the company was facing tough comps from Q1 2009 (before the impact of Lehman's crash was felt).

For the summer programme TUI has actually increased capacity in the UK source market by 3% through the addition of plane capacity in Glasgow/Edinburgh and one cruise ship for the Mediterranean (the Thomson Dream). It has also increased capacity in its Nordic markets by 12% following the very strong pick-up in demand for holidays in that region (+23%) and with stable pricing (+1%). We expect its UK summer programme to now be c. 53% booked and its Nordic programme about 62% booked. Germany should be about 55% booked.

The table below shows our H1 2010 revenue and EBIT estimates. As can be seen, following the reduction in winter capacity we anticipate a c. 10% increase in its winter losses to an EBIT of -£320m.

After interest charges of about £60m we estimate an overall loss before tax for H1 of £380m. This is before exceptional items of about £70m due to the volcanic ash issue and £30m for restructuring costs (now nearly finished).

Besides the ash problem, the only 'big' specific problem area the company has at the moment is the performance of Corsair (its French scheduled airline operation with six 747 planes). This airline is over reliant on servicing French territories where TUI does not have enough critical mass. It is also very expensive to restructure the business in the French market. Nevertheless given the scale of losses – which we believe will increase from a £24m loss last year to c. £30m loss this year – it must appear very tempting to simply close the business. We doubt it would cost more than a year's current losses to do so.

**Table 3: TUI Travel – Revenue & EBIT Analysis for 2009 and 2010 by half year**

Year-end Sept	H1 2009	H2 2009	FY 2009	+/- %	H1 2010E	+/- %	H2 2010E	+/- %	FY 2010E	+/- %
<b>Revenue</b>										
Northern Region	1,655	2,567	4,222	-3.6%	1,391	-16.0%	2684	4.6%	4,075	-3.5%
Central Europe	1,776	3,020	4,796	2.0%	1,631	-8.2%	2958	-2.0%	4,589	-4.3%
Western Europe	953	1,699	2,652	-3.7%	896	-6.0%	1639	-3.5%	2,535	-4.4%
<b>Total mainstream sectors</b>	<b>4,384</b>	<b>7,286</b>	<b>11,670</b>	<b>-1.4%</b>	<b>3,917</b>	<b>-10.7%</b>	<b>7,482</b>	<b>-0.1%</b>	<b>11,599</b>	<b>-4.0%</b>
Spec. & Emerging mkts	404	421	825	0.7%	308	-23.7%	338	-19.5%	647	-21.6%
Activity Sector	404	412	816	4.7%	440	9.0%	491	19.3%	932	14.2%
OD Services	187	365	552	0.0%	224	20.0%	438	20.0%	662	20.0%
<b>Total specialist sectors</b>	<b>995</b>	<b>1,198</b>	<b>2,193</b>	<b>0.0%</b>	<b>973</b>	<b>-2.2%</b>	<b>1,268</b>	<b>5.9%</b>	<b>2,391</b>	<b>9.0%</b>
<b>Total revenue</b>	<b>5,379</b>	<b>8,484</b>	<b>13,863</b>	<b>-0.5%</b>	<b>4,890</b>	<b>-9.1%</b>	<b>8,550</b>	<b>0.8%</b>	<b>13,990</b>	<b>0.9%</b>
<b>EBIT margins</b>										
Northern Region	-6.8%	12.4%	4.9%		-10.4%		12.9%		5.1%	
Central Europe	-6.8%	6.2%	1.4%		-6.3%		6.1%		1.6%	
Western Europe	-6.7%	5.7%	1.2%		-8.1%		6.1%		1.1%	
<b>Mainstream sectors</b>	<b>-6.8%</b>	<b>8.3%</b>	<b>2.6%</b>		<b>-8.1%</b>		<b>8.8%</b>		<b>2.8%</b>	
Specialist & emerging mkts	2.9%	4.6%	3.8%		1.0%		5.0%		3.8%	
Activity sector	1.6%	12.8%	7.2%		1.3%		12.9%		7.4%	
OD Services	-1.6%	17.3%	10.9%		-1.3%		17.3%		11.0%	
<b>Group avg.</b>	<b>-5.4%</b>	<b>8.6%</b>	<b>3.2%</b>		<b>-6.5%</b>		<b>9.2%</b>		<b>3.5%</b>	
<b>EBIT</b>										
Northern Region	-113	319	206	15.9%	-145	-28.1%	373	17.0%	228	10.6%
Central Europe	-120	186	66	6.1%	-102	15.0%	176	-5.5%	74	11.7%
Western Europe	-64	97	33	-11.5%	-72	-12.5%	100	2.7%	28	-16.3%
<b>Mainstream sectors</b>	<b>-297</b>	<b>602</b>	<b>305</b>	<b>10.0%</b>	<b>-319</b>	<b>9.4%</b>	<b>648</b>	<b>7.6%</b>	<b>329</b>	<b>7.9%</b>
Specialist & emerging mkts	12	19	31	18.3%	3	-74.6%	21	11.0%	24	-21.6%
Activity Sector	6	53	59	19.2%	6	-10.0%	63	20.7%	69	17.4%
ODestination Services/ A&D	-3	63	60	4.5%	-3	0.0%	76	20.4%	73	21.4%
<b>Total specialist sectors</b>	<b>15</b>	<b>135</b>	<b>150</b>	<b>12.7%</b>	<b>6</b>	<b>-19.7%</b>	<b>161</b>	<b>18.6%</b>	<b>172</b>	<b>14.7%</b>
Share of profits from assoc & JVs	5	10	15	1.4%	5	0.0%	7	-32.5%	12	-21.7%
Corporate	-12	-15	-27	-0.7%	-12	0.0%	-14	-6.1%	-26	-3.4%
<b>Total clean EBIT</b>	<b>-289</b>	<b>732</b>	<b>443</b>	<b>11.3%</b>	<b>-320</b>	<b>-10.8%</b>	<b>801</b>	<b>9.5%</b>	<b>481</b>	<b>8.6%</b>

Source: Company data; Matrix estimates

The table below gives our full year revenue and EBIT estimates for TUI Travel until FY 2012.

Table 4: TUI Travel – Revenue &amp; EBIT Analysis (FY 2007 to FY 2012)

Year-end Sept	2007	2008	+/- %	2009	+/- %	2010E	+/- %	2011E	+/- %	2012E	+/- %
<b>Revenue</b>											
Northern Region	4,317	4,378	1.4%	4,222	-3.6%	4,075	-3.5%	4,016	-1.4%	4,217	5.0%
Central Europe	4,254	4,702	10.5%	4,796	2.0%	4,589	-4.3%	4,829	5.2%	5,083	5.2%
Western Europe	2,440	2,753	12.8%	2,652	-3.7%	2,535	-4.4%	2,591	2.2%	2,649	2.3%
<b>Total mainstream sectors</b>	<b>11,010</b>	<b>11,832</b>		<b>11,670</b>	<b>-1.4%</b>	<b>11,199</b>	<b>-4.0%</b>	<b>11,437</b>	<b>2.1%</b>	<b>11,949</b>	<b>4.5%</b>
Spec. & Emerging mkts	730	819	12.3%	825	0.7%	647	-21.6%	820	26.8%	861	5.0%
Activity Sector	658	780	18.4%	816	4.7%	932	14.2%	1,066	14.4%	1,098	3.0%
OD Services	441	502		552	0.0%	662	20.0%	729	10.0%	787	8.0%
<b>Total specialist sectors</b>	<b>1,829</b>	<b>2,100</b>		<b>2,193</b>	<b>0.0%</b>	<b>2,241</b>	<b>2.2%</b>	<b>2,614</b>	<b>16.7%</b>	<b>2,746</b>	<b>5.0%</b>
<b>Total revenue</b>	<b>12,839</b>	<b>13,933</b>	<b>8.5%</b>	<b>13,863</b>	<b>-0.5%</b>	<b>13,440</b>	<b>-3.1%</b>	<b>14,051</b>	<b>4.5%</b>	<b>14,695</b>	<b>4.6%</b>
<b>EBIT margins</b>											
Northern Region	2.2%	4.1%		4.9%		5.6%		6.1%		6.1%	
Central Europe	1.0%	1.3%		1.4%		1.6%		1.6%		1.7%	
Western Europe	0.3%	1.4%		1.2%		1.1%		1.8%		2.0%	
<b>Mainstream sectors</b>	<b>1.3%</b>	<b>2.3%</b>		<b>2.6%</b>		<b>2.9%</b>		<b>3.2%</b>		<b>3.3%</b>	
Specialist & emerging mkts	4.1%	3.2%		3.8%		3.8%		3.8%		3.8%	
Activity sector	6.0%	6.4%		7.2%		7.4%		7.5%		7.6%	
OD Services	11.1%	11.4%		10.9%		11.0%		11.0%		11.0%	
<b>Group avg.</b>	<b>2.0%</b>	<b>2.9%</b>		<b>3.2%</b>		<b>3.6%</b>		<b>3.9%</b>		<b>4.0%</b>	
<b>EBIT</b>											
Northern Region	96	178	84.9%	206	15.9%	228	10.6%	245	7.3%	257	5.0%
Central Europe	42	62	50.1%	66	6.1%	74	11.7%	78	5.7%	85	9.5%
Western Europe	7	37	404.1%	33	-11.5%	28	-16.3%	46	68.0%	53	14.4%
<b>Mainstream sectors</b>	<b>145</b>	<b>277</b>	<b>91.2%</b>	<b>305</b>	<b>10.0%</b>	<b>329</b>	<b>7.9%</b>	<b>369</b>	<b>12.1%</b>	<b>395</b>	<b>7.1%</b>
Specialist & emerging mkts	30	26	-12.4%	31	18.3%	24	-21.6%	31	26.8%	32	5.0%
Activity Sector	40	50	25.0%	59	19.2%	69	17.4%	80	15.4%	83	3.8%
ODestination Services/ A&D	49	57	16.7%	60	4.5%	73	21.4%	80	10.0%	87	8.0%
<b>Total specialist sectors</b>	<b>119</b>	<b>133</b>	<b>12.1%</b>	<b>150</b>	<b>12.7%</b>	<b>166</b>	<b>10.9%</b>	<b>191</b>	<b>14.7%</b>	<b>202</b>	<b>5.8%</b>
Share of profits from assoc & JVs	13	15	15.6%	15	1.4%	12	-21.7%	14	22.0%	15	5.0%
Corporate	-16	-27	70.0%	-27	-0.7%	-26	-3.4%	-26	0.2%	-27	4.0%
<b>Total clean EBIT</b>	<b>261</b>	<b>398</b>	<b>52.8%</b>	<b>443</b>	<b>11.3%</b>	<b>481</b>	<b>8.6%</b>	<b>548</b>	<b>13.9%</b>	<b>585</b>	<b>6.8%</b>

Source: Company data; Matrix

Table 5: TUI Travel - Summary P&amp;L

Year-end Sept	2007	2008	+/- %	2009	+/- %	2010E	+/- %	2011E	+/- %	2012E	+/- %
Total revenue	12,839	13,933	8.5%	13,863	-0.5%	13,440	-3.1%	14,051	4.5%	14,695	4.6%
Group avg.margin	2.0%	2.9%		3.2%		3.6%		3.9%		4.0%	
<b>Total clean EBIT</b>	<b>261</b>	<b>398</b>		<b>443</b>	<b>11.3%</b>	<b>481</b>	<b>8.6%</b>	<b>548</b>	<b>13.9%</b>	<b>585</b>	<b>6.8%</b>
Excep & g/will amort	-204	-582		-406		-170		-50		-50	
<b>Reported EBIT</b>	<b>56</b>	<b>-184</b>		<b>37</b>		<b>311</b>		<b>498</b>		<b>535</b>	
Net int on net debt & fin leases		-78		-57		-70		-66		-52	
Amort of convertible equity		N/A		N/A		-16		-22		-22	
Net interest on pensions		-4		-17		-17		-17		-17	
Other net fin (exp)/inc		3		-3		-5		-5		-5	
Total other interest		-1		-20		-22		-22		-22	
<b>Total net interest</b>	<b>-38</b>	<b>-78</b>		<b>-77</b>		<b>-108</b>		<b>-110</b>		<b>-96</b>	
<i>Int. cover (exc pen. &amp; equity amort)</i>	6.9	5.1		7.8		6.9		8.3		11.2	
Reported PBT	18	-262		-52		203		388		439	
<b>Clean PBT</b>	<b>223</b>	<b>320</b>	<b>43.5%</b>	<b>366</b>	<b>13.8%</b>	<b>373</b>	<b>0.5%</b>	<b>438</b>	<b>11.6%</b>	<b>489</b>	<b>9.3%</b>
Clean tax rate	28%	28%		28%		27%		27%		27%	
Clean tax charge	-62	-90		-102		-101		-118		-132	
Exceptional tax	51	90		144		0		0		0	
Total tax	-12	0		42		0		0		0	
Clean net profit	160	230		264		272		320		357	
Disc items	0	0		-14		0		0		0	
Reported net profit	7	-262		-24		102		270		307	
MI's share of (profit)/loss	0	-4		-1		-1		-1		-1	
Clean attrib profit	160	226		263		271		319		356	
Reported attrib profit	7	-267		-25		101		269		306	
Y/E no. of shares in issue (m)		1118		1118		1118.0		1118.0		1118.0	
Avg. shares in issue (m)	681.1	1108.7		1107		1107.0		1107.0		1107.0	
Avg. diluted No. shares (m)	681.9	1118		1118		1261.8		1322.8		1322.8	
Clean basic EPS (p)	14.4	20.4	41.7%	23.8	14.0%	24.6	3.4%	28.9	17.4%	32.2	11.6%
<b>Clean dil EPS (p)</b>	<b>14.3</b>	<b>20.2</b>	<b>41.3%</b>	<b>23.5</b>	<b>15.1%</b>	<b>24.1</b>	<b>2.8%</b>	<b>27.6</b>	<b>14.5%</b>	<b>30.5</b>	<b>10.2%</b>
<b>Dividend (p)</b>	<b>8.4</b>	<b>9.7</b>		<b>10.7</b>	<b>10.3%</b>	<b>11.2</b>	<b>5.0%</b>	<b>12.0</b>	<b>7.0%</b>	<b>12.6</b>	<b>5.0%</b>
Dividend cover	1.7	2.1		2.2		2.2		2.4		2.6	

Source: Company data, Matrix

Table 6: TUI Travel - Cash Flow

Year-end Sept (£m)	2007	2008	2009	2010E	2011E	2012E
Operating profit	261	398	443	481	548	585
Deprec. & amort. of software	259	230	216	221	227	233
Other non-cash items	0	14	0	0	0	0
<b>Clean EBITDA</b>	<b>520</b>	<b>642</b>	<b>659</b>	<b>703</b>	<b>775</b>	<b>818</b>
Total working capital	246	25	-167	-90	-50	-52
Other/provisions	27	2	0	0	0	0
FRS20/employee benefits	-24	-44	-66	-70	-70	-70
<b>Clean op cash flow</b>	<b>768</b>	<b>625</b>	<b>426</b>	<b>543</b>	<b>655</b>	<b>696</b>
Exceptional items	-231	-165	-189	-170	-20	0
<b>Reported free cash flow</b>	<b>537</b>	<b>460</b>	<b>237</b>	<b>373</b>	<b>635</b>	<b>696</b>
Interest	-4	-56	-62	-63	-49	-35
Tax	-36	-34	-43	-52	-89	-99
Dividends paid to MI	-2	-5	-5	-5	-5	-5
Maintenance capex	-80	-204	-234	-150	-150	-150
<b>Clean free cash flow</b>	<b>634</b>	<b>327</b>	<b>82</b>	<b>272</b>	<b>362</b>	<b>406</b>
Total free cash flow	415	162	-107	102	342	406
Dividends	-13	-65	-105	-121	-129	-135
	402	97	-79	64	144	163
Asset sales	18	83	71	50	0	0
Sale & leasebacks	0	264	90	0	0	0
Business disposals	0	3	0	0	0	0
Capex on aircraft for S&LB	0	-73	0	0	0	0
Purchase of minorities	-16	-20	0	0	0	0
Investment in JVs	0	-10	-51	0	0	0
Acquisitions	-114	-84	-53	-100	0	0
New equity	-23	0	0	42	0	0
Share buy-back	0	0	0	0	0	0
Change in value of hedges	0	0	86	0	0	0
FX	35	-120	-144	0	0	0
Other	-698	-39	11	0	0	0
<b>(Inc)/dec. in net debt</b>	<b>-396</b>	<b>101</b>	<b>-202</b>	<b>-27</b>	<b>213</b>	<b>271</b>
Opening net (debt)/cash	159	-237	-136	-338	-365	-151
<b>Closing net (debt)/cash</b>	<b>-237</b>	<b>-137</b>	<b>-338</b>	<b>-365</b>	<b>-151</b>	<b>120</b>
<b>Avg. net (debt)/cash (e)</b>			-738	-765	-551	-280
<b>Avg. net debt: EBITDA</b>			<b>1.12</b>	<b>1.09</b>	<b>0.71</b>	<b>0.34</b>

Source: Company data; Matrix

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