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## COVER STORY

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# THE TRINITY

How Madhavan Menon, Ajit Isaac and Ramesh Ramanathan plan to create value for Fairfax Financial Holdings



## REGULARS

 **Imagination:** Medical tourism hub Chennai gets a spanking new super-specialty hospital — this one run by the government

 **Graphically speaking:** India's energy security lies in switching to liquefied natural gas

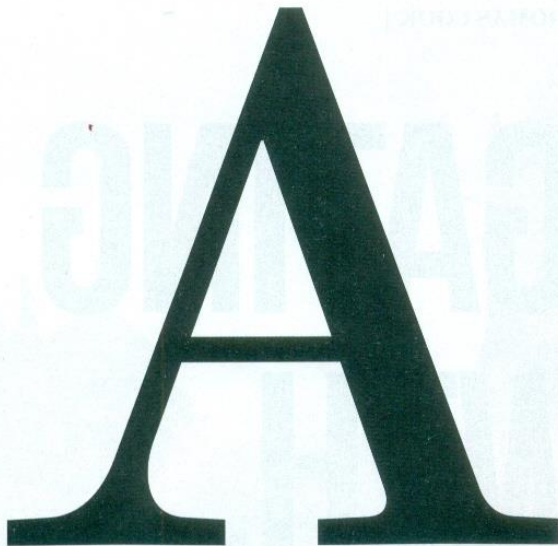


For me, it has been a long journey from being Florida-driven to being measured against the cash that we generate

— MADHAVAN MENON  
Managing Director, Thomas Cook India

10 May 2014 / [www.sterling.com](http://www.sterling.com)





₹870 crore comes with the promise of a great financial future piggybacking on an indulgent domestic audience that wants to holiday more, and offers ready-made inventory for Thomas Cook's domestic travel business.

You could call the deal a win-win but the stock market doesn't quite agree. Thomas Cook has lost 15% of its market cap after the deal was announced. What piece of the big picture envisioned by Fairbridge Capital's Harsha Raghavan and endorsed by Fairfax Financial Holdings' billionaire founder Prem Watsa is the market missing? Fairfax's Watsa has a track record against which only the deliriously high would bet, but the fact that local investing legends such as Radhakishan Damani and Rakesh Jhunjhunwala are cashing out may be the cause of investor discomfort.

After all, Damani and Jhunjhunwala are deep-pocketed investors who have never shied away from holding on to potential multi-baggers. Their exit does make the Street wonder if the gain has been front-ended for Sterling and, by corollary, has Thomas Cook overpaid? That investor doubt, however, is not the focus of this story. Rather, what is the Fairfax-controlled Thomas Cook trying to accomplish by buying not only into Sterling but also through its February, 2013 acquisition of staffing and facilities management company Ikyra Group?

#### MONEY TEMPLATE

Fairfax's ambition to replicate a Fairfax Financial Holdings in India means Thomas Cook is more than just a holding for the Canadian company, it is an investment vehicle. So, why was Thomas Cook the chosen one? Harsha Raghavan, managing director, Fairbridge Capital, explains, "Since it is a well-managed company with robust capital, long-standing history and reputation in India, we decided it was a strong platform to build on."

Thomas Cook, of course, comes with its own strengths. For many Indians, not only is the brand synonymous with foreign travel, it is also the most preferred foreign exchange vendor. None of its competitors in the travel business is a major player in foreign exchange or vice versa. Its fair play over the past six decades has

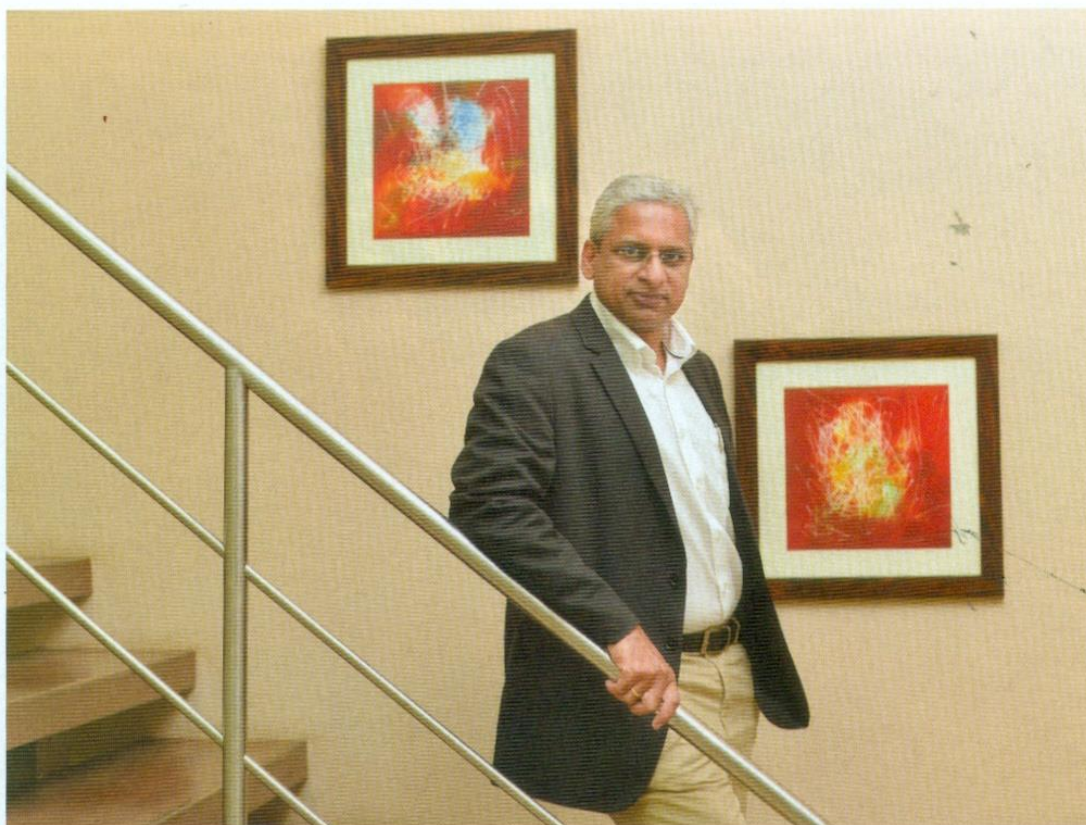
as he approached his 59<sup>th</sup> birthday, Madhavan Menon was living life out of a trolley bag. His work-related trips also included frequent sorties to Chennai, the reason for which would become clear a little before February 12, the day he would turn a year older. Left to himself, Menon would like to keep a low profile. But the acquisition of Sterling Holiday Resorts by Thomas Cook India, the company that he heads, has cast him into the spotlight.

When we meet him at the Thomas Cook head office in downtown Mumbai, he sounds a little perturbed about the feedback reaching his ears. "My peers in the travel industry feel Thomas Cook is diluting its brand. We are not, because we will continue to be focused on travel and foreign exchange. The transaction has not been properly understood," he complains. From his point of view, Thomas Cook couldn't have got a better gift on the eve of his 59<sup>th</sup> birthday: a company that will not only bring in more cash as it emerges out of the woods, but also give Menon's company a competitive advantage in its business. The acquisition of Sterling for an estimated

even rubbed off on the regulator and Thomas Cook's licence has features that nobody else has. Mahesh Iyer, chief operating officer, foreign exchange, explains, "We are allowed foreign exchange accounts and can remit money out of the country but other authorised dealers have to use banks as a conduit. We are also the only non-bank issuer of a pre-paid forex card — nobody else has been given that permission in the country." In terms of volume, the forex arm churns about \$4.5 billion each year and the difference between it and the next biggest player is probably a hundred times. Undoubtedly, Iyer's unit is a powerhouse that contributes about 60-65% of standalone revenue (CY13 — ₹378 crore) and an equivalent number to net profit. "I buy and sell foreign currency. The faster the turnaround, the better is the return on capital. To harness that efficiency across 150-plus shops in about 90-odd cities is the most difficult and the most lucrative part of the business," he reminds.

Thomas Cook's towering presence in the foreign exchange business has a solid regulatory moat and Fairfax surely must have done its homework. Until the Indian arm of Thomas Cook, it had never bought a travel business anywhere in the world before. What is most sublime, however, is the change of heart that Menon underwent. Until February, 2012, Menon had nev-





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“ Sometimes, not all the synergies are laid out on the table. Of our workforce of 70,000 people, almost 15,000 to 20,000 are possible customers for Sterling

—AJIT ISAAC, Chairman, Ikya Group

While this robust business model may have appealed to Fairfax, the attendant benefits for its first acquisition Thomas Cook may have certainly tipped its hand when it paid ₹256 crore for a 74% stake in February, 2013. It is not only Thomas Cook that is benefiting from Fairfax; there is a rub-off at Ikya, too. Isaac recalls a conversation with a client – a component supplier to Blackberry – who would endlessly keep negotiating for a lower rate; when he got to know that Fairfax was the new owner of not only Ikya but also Blackberry, “He just stood up and said, ‘It is fine, we will not negotiate rates anymore, we want to be associated with you,’” laughs Isaac.

Ikya has been growing at a CAGR of 65% over the past three years and will close FY14 with a turnover of ₹1,500 crore and an estimated net profit of ₹45 crore. This daz-

zling pace has hardly whetted Isaac’s appetite as he chases a new growth target that sounds like a company hotline: 1-800-5000. Simplified, Ikya Group wants to be a ₹5,000 crore company by 2017, its first decade of existence and have an Ebitda of 800 basis points. In order to get there, Isaac will not only increase revenue from his annuity businesses, he is also open to acquisition of security firms and software technology services.

#### WHOLE NEW WORLD

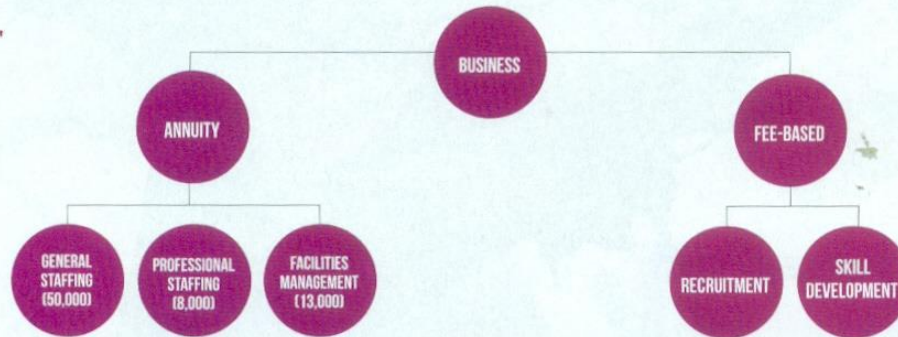
While Isaac is preoccupied chasing his audacious goal and working on getting a foothold in the American market to benefit from Fairfax’s network, Thomas Cook is not letting up on its growth plan either. In 2000, when Menon joined the company, popular opinion was, “In

**IKYA’S COMPETITIVE ADVANTAGE IS THAT IT’S THE ONLY BUSINESS SERVICES AGGREGATOR IN INDIA WITH DEEP DELIVERY EXPERTISE**



### Fixed income

By increasing annuity revenue, Ikya wants to make its cash flow more predictable



Note: employee count for quarter ended December, 2013

10 years Thomas Cook will be dead because everything will be online.” Cut to 2014, that prediction has come only half true. Online travel agents (OTAs) dominate the market they created but are now moving into Thomas Cook’s space – packaged holidays. In an effort to hold on to its perch, the company is chasing growth on multiple fronts, be it outbound, inbound, domestic or online.

Menon rules out an acquisition in the online space as he has the product knowledge, domain knowledge and distribution and “OTAs don’t generate cash or are finding it difficult to generate cash.” Still, he is using the online platform to reach out to as many potential customers as possible. Iyer says one online initiative that has been a success is online sales of forex. “We started selling forex online about nine months ago. We do about 500 transactions a month and expect to reach 1,500 transactions a month by the end of this year. We also sold 60,000 prepaid forex cards with a loaded value of \$205 million in CY13. From nothing in forex prepaid cards, dominated by Visa, our card network partner MasterCard now has a double digit market share.”

### Hot favourite

For most Indian tourists, visiting Europe is a must

in %



\*includes Australia, South Africa, New Zealand etc

Even as the forex unit chugs along, morphing into a payments solutions provider, the outbound (about 40% repeat clientele) and domestic businesses are expected to grow more rapidly. Jatinder Paul Singh, head, leisure travel (outbound), says reach is Thomas Cook’s biggest strength. “We operate through 140 franchisees, 160 preferred sales agents and close to 60 owned outlets. Holidays are no longer a once a year activity and that is why we need to be easily accessible.”

The nature and preferences of Indians vacationing overseas has also undergone a visible change. Earlier, travellers took what was on offer, but now with rising disposable income and increased internet usage there is more awareness. People are taking two domestic holidays and an international vacation as and when they get the opportunity. So, when a long weekend arrives, traffic to Goa, Kerala or visa on arrival destinations such as Thailand, Hong Kong and Maldives sees a surge. Peter Kerkar, director, Cox & Kings, says there is an increasing demand for community-specific holidays. “The market is going regional and people prefer travelling with their own community. There are pure vegetarian tours for the Gujarati and Jain communities and customised group tours for the Maharashtrian community,” he adds. This trend is being cashed on by Thomas Cook, too, through its regional tours that now also encompass Tamil Nadu, Karnataka, the Hindi belt of Lucknow, Kanpur, Jaipur, and parts of Punjab.

The other notable change seems to be the price indifference on part of frequent vacationers. Kerkar says, “We have observed that experienced travellers (those who have travelled maybe two or three times), opt for customised holidays wherein they choose a destination and tour the place extensively. It may be Switzerland, Australia, France etc. Many also opt for gourmet vacations. For such customers price is not an issue, the experience is.”





“ We can remit money out of the country but other authorised dealers have to use banks as a conduit

—MAHESH IYER  
Chief operating officer, foreign exchange



“ At parties, people talk about their vacations. They do not want to give up their bragging rights

—JATINDER PAUL SINGH  
Head, leisure travel (outbound)

Unlike Thomas Cook, which is increasing its domestic focus, competitor Cox & King’s growth strategy is resting on leisure and education travel. In Europe, its offerings such as PGL and Meininger are benefiting from a resilient student travel market, a segment that Thomas Cook, too, has started targeting. For inbound leader, Le Passage to India, however, managing director, Arjun Sharma says while the fall in the rupee did help, overall the current fiscal has been a bit of a challenge owing to the global slowdown and the adverse publicity about crimes against women in India. “It also does not help that competitors such as Sri Lanka, Malaysia, and Thailand are offering user-friendly visa services at globally acceptable prices. India is outpricing itself on account of high aviation taxes as well as prohibitively high visa costs,” laments Sharma.

Compared with overseas visitors, there is a clear divergence as Indians are not forgoing their holidays, the

depreciating currency or a less-than-expected increment be damned. They are either opting to change the destination or shortening their stay. Singh says, “Customers plan well in advance and don’t change their big holiday; at most they will tweak their weekend holidays. School kids talk about where they went to vacation, at family get-togethers or parties, people talk about their vacations. They do not want to give up their bragging rights.” Singh is also aggressively targeting the free individual traveller (FIT) not only from a margin perspective but also to reach out to a new set of customers. Right now, FIT is about 35-40% of total outbound traffic while group tours comprise about 60%.

While service quality matters across all the companies invested in by Fairfax, at Thomas Cook, it is gospel. The memorable experience provided by its tour managers generates a positive word of mouth and results in new and repeat business. Naturally, the Thomas Cook

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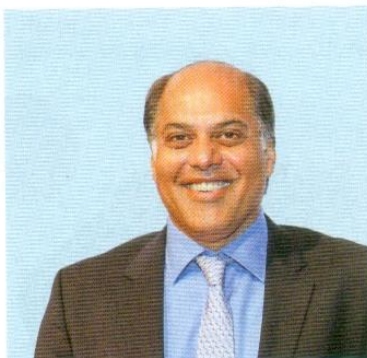


VISHAL KOUL



“India is out pricing itself on account of high aviation taxes as well as prohibitively high visa costs

—ARJUN SHARMA  
Managing director, Le Passage to India



“Experienced travelers opt for customised holidays. For such customers price is not an issue, the experience is

—PETER KERKAR  
Director, Cox & Kings

brand plays a major role in drawing in customers and there is a likelihood of that brand name being taken away. Thomas Cook India currently pays a royalty of \$350,000 a year to Thomas Cook Group, UK, and the current agreement prohibits it from integrating any non-travel business into Thomas Cook.

When Fairfax acquired Thomas Cook India, it retained the right to use the brand name till 2025. Even if the brand name reverts to the erstwhile parent, Menon believes it is going to be business as usual. “We don’t know whether this brand name would be available to us after the end of the agreed time period but we have enough time to figure it out. We are not taking it for granted but at the same time, a brand change is not a life changer.”

#### ALL FOR ONE

The fast growing domestic segment is not only fragmented but also price sensitive. This is where the Thomas Cook brand, probably, is the weakest. So, does the acquisition of Sterling (9MFY14 revenue — ₹95 crore) then, tilt the domestic and inbound stake in favour of Thomas Cook at least compared with other national players such as Cox & Kings, Kuoni and Le Passage to India? While Kerkar says that

Cox & Kings does not do much business with Sterling, Sharma feels that as time-share holidays are a fast growing segment, Thomas Cook will benefit from the synergies it derives in its domestic business than the inbound market.

The afternoon we meet Isaac, he has just returned from Chennai after meeting Sterling managing director Ramesh Ramanathan to discuss, he says, ‘the renewal of my elapsed Sterling membership, number 1916.’ An impish grin later, he lets away that he and Ramanathan discussed the possibility of working out a special Sterling holiday scheme for Ikya’s employees. “Sometimes, not all the synergies are laid out on the table. We have to manufacture some of them. Of our workforce of 70,000, almost 15,000 to 20,000 are possible customers for Sterling.”

There is another low-hanging fruit: managing the properties of Sterling, which is over a million sq ft. Adding that to the 110 million sq ft it already manages could add a couple of crore in revenue. After coming into the Fairfax fold, it took less than two quarters for Ikya to start managing Thomas Cook’s head office. Now, Ikya manages Thomas Cook’s properties throughout the country and all ticketing for Ikya is done by the travel company.

Between Sterling and Thomas Cook, there are even greater synergies and they will have to be exploited

### A REJUVENATED DEBT-FREE STERLING WOULD ONLY MEAN ENHANCED CASH FLOW FOR THOMAS COOK AND THAT WOULD EVENTUALLY JUSTIFY THE FAIRFAX INVESTMENT



to the full to make the merger a financial success. To begin with, the time-share business itself is fairly lucrative compared with a hotel business, for the simple reason that the accommodation is pre-sold to customers. This de-risks some of the non-occupancy that hotels normally face. Then, there is the advantage of multiple streams of revenue. Not only does additional revenue come in from new members, annual subscription fees and money spent on food and beverages by members during their stay keeps the cash counter ticking. Of Sterling's average room rental of ₹3,000, about 50% comes from food and beverages. The proverbial icing on the cake is that the advance money paid by members is available for the company to utilise either for resort expansion or to earn an interest on it. Almost 80% of its new members opt for funding through EMIs, on which the company earns an average interest of 16%.

#### PRESENT VALUE

While Fairfax's capital infusion brings in much-needed manna, the biggest asset – and something that is not reflected in Sterling's books – is its managing director. Unlike other marquee investors who are cashing out, time-share pioneer Ramanathan (Set up and grew Sterling as well as Mahindra Holidays) – will continue to stay invested even after Sterling is merged into Thomas Cook. His presence was certainly a prime factor for Fairfax. "Sterling is a very well-managed company under Ramesh Ramanathan. Of course, they have had some ups and downs, but they have a long track record and, therefore, we considered it a good investment," says Raghavan.

The over-reliance on Ramanathan's expertise may seem like a risk but over the past three years he has led a visible turnaround. "While it is the hardest that I have worked my entire career, it has also been the most satisfying," states Ramanathan. "When I rejoined in 2011 from Mahindra Holidays, the price of a new membership was less than ₹1 lakh. Since then, we have moved the price up to ₹2.25 lakh. We have climbed from 20% occupancy to 52% and are aiming for 60-65% next year."

#### Sizing it right

*Future expansion at Sterling could be more through leased properties than outright buys*

RESORTS	11 <sup>*</sup> / 8 <sup>**</sup>
TOTAL ROOMS	1107 <sup>*</sup> / 416 <sup>**</sup>
ACTIVE MEMBERS	70,000
NEW MEMBER ADDITIONS	450 per month
LAND BANK(ACRES)	150
AVERAGE REALISATION***	₹225,000
UPCOMING RESORTS	GOA, COORG

\*\*\* this is per room

\*owned \*\*leased

Sterling is consciously targeting tier 2 and tier 3 towns to keep up the sales momentum and opening up more destinations in the North and West. As Indians are now on the move all-season, there is a high probability of a domestic traveller buying a time-share membership or using Sterling's resorts for a short holiday.

Pushing them in that direction will be the combined feet on street of both Thomas Cook and Sterling. "Half our capacity is used for time-share and the other half is used for non-member activity. While we run the risk of non-member non-occupancy, Thomas Cook will drive in more non-members as they step up their domestic push," says Ramanathan. The current occupancy of 52% is split 60:40 between members and non-members.

Sterling's competition may be limited but is formidable. Prime among them is Mahindra Holidays, a com-

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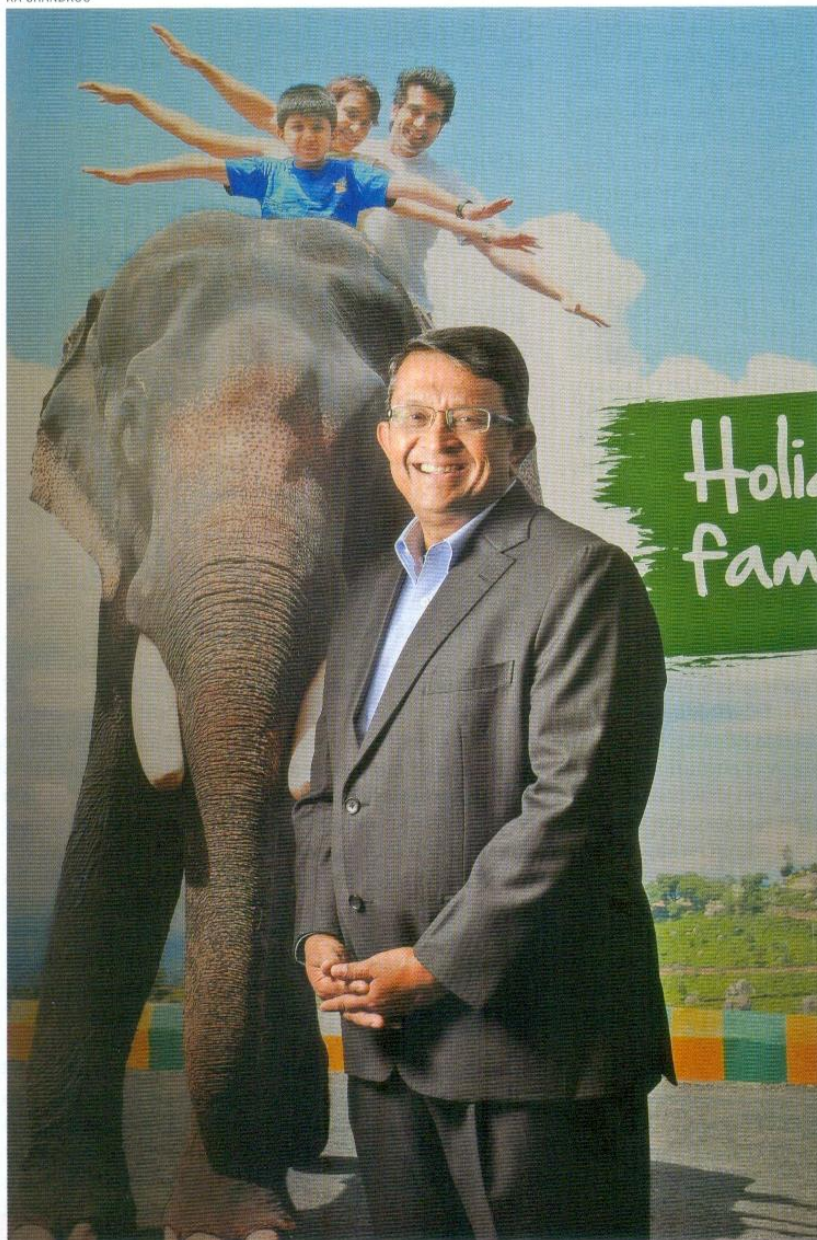


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“We operate in the mid-market and that gives us scope to expand. I feel there is scope to take our price to ₹2.75 lakh over the next two and a half years

—RAMESH RAMANATHAN  
Managing director, Sterling Holiday Resorts

pany that Ramanathan himself built over the 12 years that he was there. In his second innings at Sterling, Ramanathan not only knows the pitfalls, but also has a clear idea of the opportunities ahead. “We operate in the mid-market and that gives us scope to expand. Compared with ₹2.25 lakh for Sterling, a new membership at Mahindra Holidays will cost ₹3.7 lakh. I feel there is scope to take our price to ₹2.75 lakh over the next two and a half years.”

The average room realisation across Sterling is also expected to go up once all its rooms have been refurbished. The average room realisation at its Munnar and Ooty resorts used to be less than ₹2,000 and post refurbishment has moved to ₹3,900 and ₹3,500, respectively. A rejuvenated debt-free Sterling would only mean enhanced cash flow for Thomas Cook and that would eventually justify the monies being invested by Fairfax in Sterling.

Like its present holdings, Fairfax will continue to look for companies with the same set of ingredients – a growth franchise run by a good management. Fairbridge Capital’s

website does mention that probable investments will be between \$20 million and \$200 million but the real juice is in identifying companies that complement the existing Fairfax India portfolio. But make no mistake; it also has to be a great standalone business. For those looking for tell-tale signs that Fairbridge is on the prowl again: either Prem Watsa is planning an India visit or it is February. ☺