

About the company

We recently worked on a company (referred to as 'CX & K' hereafter) engaged in the business of inbound & outbound travel and in foreign exchange dealings.

CX & K has English roots and is a brand that has been in existence since the 18th century, and which made its debut on the Indian bourses in 2009.

Corporate Governance and Poor Capital Allocation Issues

The key focus of our analysis here is on two significant corporate transactions done by the company.

One was a larger acquisition made in Sept 2011 – Break Holiday, while the other, a relatively smaller acquisition, was made in Oct 2015 – Trial Rooms. Details of these acquisitions are listed below:

'Break Holiday' acquisition:

Acquired in Sep 2011, Break Holiday's revenues were 4x the revenues of CX & K at the time of its acquisition. For the purpose of acquisition, CX & K formed a 100% owned SPV and financed the acquisition by debt, which resulted in the year-end D/E ratio ballooning to 3.1. Of the total purchase consideration of INR 27.7 billion, goodwill of INR 26.6 billion, (i.e. almost 96% of the price) was recorded on books.

Break Holiday operated through four business segments: Education, Adventure, Hotels and Camping.

'Trial Room' acquisition:

The Trial Room acquisition (in FY 2015), was a relatively smaller acquisition in the European online hotel booking space. CX & K's rationale for this acquisition was to attract customers to its owned and acquired hotels through the Trial Room site. It paid INR 850 million for the said

acquisition.

Subsequent sale of Businesses

FY 2012-13: Within 1 year of acquisition, 34% stake in the SPV which was formed for Break Holiday's acquisition was sold to a VC firm for INR 7650 million. This deal was termed as "value unlocking" by the management of CX & K.

FY 2013-14: Sale of the Camping segment of Break Holiday for INR 8900 million.

FY 2015-16: Sale of the adventure segment of Break Holiday for INR 2580 million; sale of Trial Room & Hotels segment of Break Holiday for INR 1885 million and INR 666 million respectively.

Lack of Clear Rationale and Strange Accounting.

We found it noteworthy/strange that in the same year of sale of Break Holiday's businesses, the company wrote off goodwill as well as recorded a profit for the same sale transaction. Its camping segment had a goodwill write-off of INR 5500 million and a gain of INR 3500 million. Adventure and Hotels segments combined, had INR 7400 million of goodwill write off and INR 4449 million of profit on sale of business.

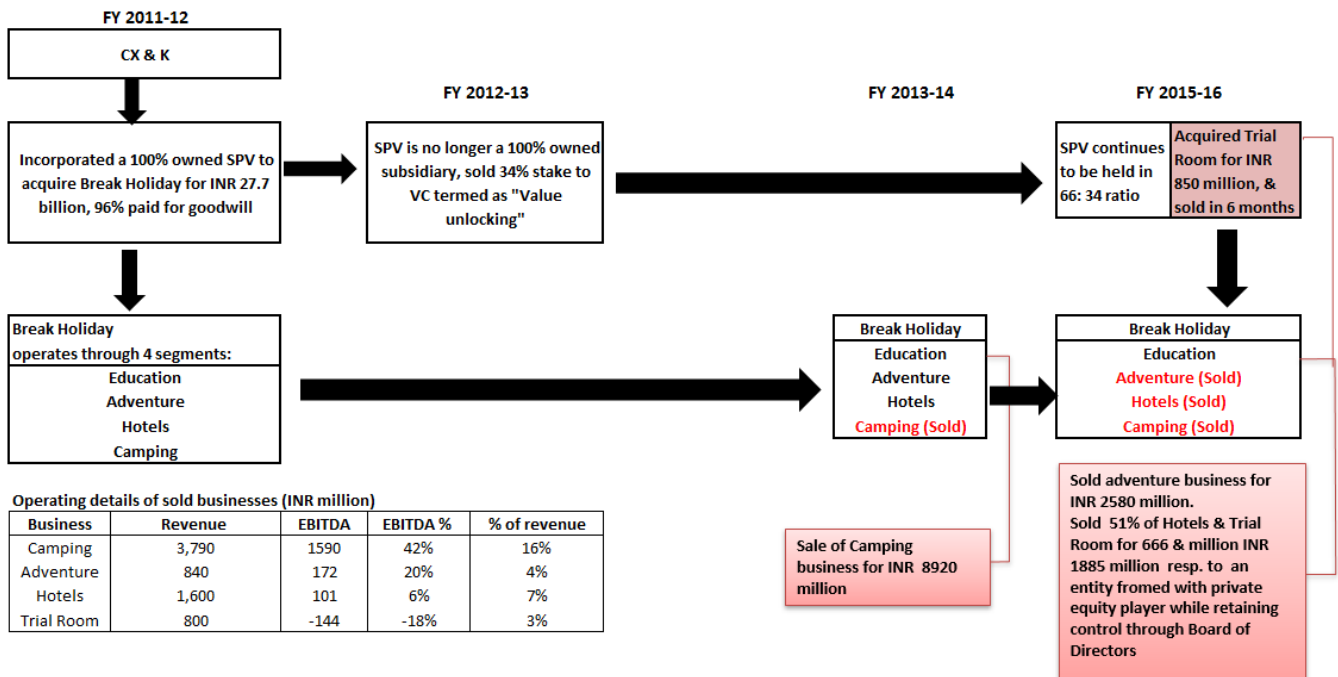
On deeper analysis we also noted that CX & K did not sell its entire stake in Hotels and Trial Rooms (acquired just 6 months ago). It sold 51% stake to an entity 'Laveran' incorporated in UK, formed by AID Funds (a private equity player) and themselves. It retained control by having the Board of Directors move to Lavern. These 2 companies henceforth are accounted for as "Investment in Associate" in the books of CX & K.

AID funds is based in Cayman Islands. The name of AID funds was found linked to certain disclosures made through the 'Paradise Papers' leaks concerning unaccounted money in off-shore tax havens. On examining the filings of Laveran with the regulatory authority in UK, we discovered that both AID funds and CX & K had (in 2016) ceased to be "Persons having significant control" over Lavern and 5 out of the 9 directors who had moved from Hotels and Trail Room to Lavern had resigned. This could mean that either AID funds or CX & K sold their stake or Lavern issued new shares. No further details were available on further course of transactions that took place.

Prima facie this helped CX & K keep all the losses/profits and debts of Trial Room and Hotels off its books, in reality however, CX & K did exercise control over Trial Room and Hotels and

ideally should have consolidated the same.

The following chart shows the flow of transactions at a glance-



Disposals of 3 subsidiaries of Break Holiday	INR million
Price paid for Acquisition of the Break Holiday	27,707
Sale price of all business sold	12,140
Write off of goodwill over 2015 & 2016 on disposals	(12,995)
% of goodwill written off to total cost of Acq.	47%
% of goodwill written off to total goodwill on acq.	52%
Profit on sale of business (as reported by company)	7,948
Loss on the transaction (as calculated by us)	(5,048)

Our Understanding of the Transaction:

The company sold off 3 businesses from Break Holiday and wrote off 50% of the goodwill. Net loss in the transaction to the company was (INR 12,900 million - INR 7,900 million) = INR 5000 million and the holding period has been very short, which reflects the poor capital allocation made by the company. The rationale/accounting logic of writing off the goodwill

and booking gain on sale of business in the same year is also not clearly understood.

Again, in Nov 2017, the 34% stake of SPV originally sold in 2013 to the VC was sold to GHJ Capital. GHJ Capital holds 2.72% stake in CX & K. In March 2018, further 11% of the said SPV was sold for INR 4500 million, again termed as “continuous efforts for value unlocking”.

Other observations:

1/3rd of the profits wiped out due to non-recurring /extraordinary items:

In the last 5 years, the frequency of X/O items has increased due to write off of goodwill and profits on sale of the above-mentioned transactions. X/O items have wiped off 35% of the CX & K’s total profits.

(INR mln)

FY year ended March (INR millions)	2012	2013	2014	2015	2016	2017
Extra-ordinaries	(203)	(342)	(456)	(3,087)	(3,406)	(109)
Reported PAT	416	2,484	3,832	918	539	1,470

Poor Interest coverage ratio and impact on operating cash flow:

Debt assumed by the company for acquisitions has an impact on the company’s interest coverage ratio which, although improving, is still well below the industry accepted level of 5. Huge interest expenses have also impacted the operating cash flow (OCF) as most of it has been consumed by interest payments. It is reflected in the poor (OCF + Interest)/Interest ratio of the CX & K.

Particulars (INR millions)	2012	2013	2014	2015	2016	2017
OCF	(2,612)	(1,478)	5,004	2,180	5,144	836
EBIT	1,182	5,751	7,190	8,125	7,674	7,525
Interest expense	1,843	3,705	3,236	3,244	2,537	2,255
OCF+Interest	(769)	2,227	8,240	5,424	7,680	3,091
(OCF+Interest)/Interest	(0.4)	0.6	2.5	1.7	3.0	1.4
EBIT/Interest	0.6	1.6	2.2	2.5	3.0	3.3

High % of shareholdings pledged by the Promoters and dilution by QIP:

Particulars	# shares	Issue Price	Avg share price	Premium/disc	Recipients
# shares o/s 31/03/2013	136.52	-	-	-	-
Issue in Nov 2014	32.79	305	282	8.2%	QIP
Issue in Jan 2015	7.25	310	310	-0.1%	Issue of share warrants
Current S/O	176.56	-	-	-	-

(Note: Issue price and avg. share price relate to price per share)

As per the available data, since Q2 FY-14, on an average, CX & K’ promoters have pledged

66% of their shareholdings, the trend following an upward movement in recent years. Shares have been pledged against the loans taken from financial institutions. In addition to pledging shares at an all time high level, the company had placed a QIP issue and issued warrants to promoters. QIP diluted the promoter holdings from 39% to 32%.

Other indicators:

Company has an average F score, poor M score for 10 out of 13 years and a AZS score which shows that it lies in the distressed zone (less than 1.1) most of the time, as can be seen from the table below –

Particulars	Average	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
F Score	4.9	4	6	4	4	6	3	1	7	7	7	4	6
M Score	(1.52)	(1.79)	(0.02)	(0.45)	0.17	(1.81)	(2.17)	0.07	(1.65)	(2.25)	(2.53)	(2.60)	(2.16)
AZS Score		0.95	1.20	1.36	1.42	3.53	2.93	0.39	0.77	0.80	1.43	1.10	1.30

High level of unearned revenues in comparison to peers:

CX & K reports unearned revenue in the range of 30-40% of total revenues. This % is much higher than the unearned revenues of its competitors which range in 15-20% and thus raises some questions on the revenue recognition policies.

(INR millions)	2012	2013	2014	2015	2016	2017
Unearned revenue	6,999	7,067	10,327	7,607	5,929	9,406
as % of sales	83.5%	39.1%	44.8%	29.6%	25.2%	43.2%

CONCLUSION:

With rising living standards and the increasing propensity of Indians for discretionary consumption, even if the domestic travel and leisure sector offers significant tailwind, a sidecar investment journey to prosperity with a shaky management might eventually lead to an untoward accident.

Glossary

M-Score: M-score is a model used as tool for identifying the probability of earnings manipulations in financial analysis. In his out of sample tests, Prof. M. Beneish found that he could correctly identify 76% of manipulators, whilst only incorrectly



Lost and Found: The Many Acquisitions of a Travel Company

identifying 17.5% of non-manipulators.

AZ Score:

Altman Z score is the output of a credit strength test that measures a company's likelihood of bankruptcy.

Greater than 2.6	Safe zone
1.1 - 2.6	Grey zone
Below 1.1	Distress zone

F-Score:

Also known as Pitrosky score, F score tries to capture the strength of the fundamentals of the company by measuring the change in nine financial ratios on YoY basis. A high F-score on a scale of 0-9 is better for the company.

Statutory Details:- Multi-Act Equity Consultancy Private Limited
(SEBI Registered Portfolio Manager – Registration No. INP000002965)

Disclaimer

The views expressed in this article are for educational and reading purpose only. Multi-Act Equity Consultancy Private Limited (MAECL) does not solicit any course of action based on these views and the reader is advised to exercise independent judgment and act upon the same based on its/his/her sole discretion, their own investigations and risk-reward preferences.

The article is prepared on the basis of publicly available information, internally developed data and from sources believed to be reliable. Due care has been taken to ensure that the facts are accurate and the views are fair.

MAECL, its associates or any of their respective directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such views and consequently are not liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way for decisions taken based on the said article.

It is stated that, as permitted by SEBI Regulations and the Company's Employee Dealing Policy, the associates, employees, affiliates of MAECL may have interests in securities referred to in the information.

The contents herein – information or views – do not amount to distribution, guidelines, an offer or solicitation of any offer to buy or sell any securities or financial instruments, directly or indirectly, in the United States of America (US), in Canada, in jurisdictions where such distribution or offer is not authorized and in FATF non-compliant jurisdiction and are particularly not for US persons (being persons resident in the US, corporations, partnerships or other entities created or organized in or under the laws of the US or any person falling within the definition of the term "US person" under Regulation S promulgated



Lost and Found: The Many Acquisitions of a Travel Company

under the US Securities Act of 1933, as amended) and persons of Canada.

Risk factors

General risk factors

- a. Securities investments are subject to market risks and there is no assurance or guarantee that the objective of the investments will be achieved.
- b. Past performance of MAECL does not indicate its future performance.
- b. As with any investment in securities, the value of investments can go up or down depending on the factors and forces affecting the capital market. MAECL is not responsible / liable for any losses resulting from such factors.
- c. Securities investments are subject to external risks such as war, natural calamities, and policy changes of local / international markets which affect stock markets.
- d. MAECL has renewed its SEBI PMS registration effective October 14, 2011 and has commenced its portfolio management activities with effect from January 2011. However MAECL has more than 10 years of experience in managing its own funds invested in the domestic market.