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TUI to Buy Control of First Choice in Travel Merger

By Amy Wilson

March 19 (Bloomberg) -- TUI AG, Europe's biggest tour operator, will buy First Choice Holidays Plc to fight competition from Internet bookings and discount airlines, mirroring a combination of two rivals last month.

Hanover, Germany-based TUI will merge its tourism unit, excluding hotels, with Crawley, England-based First Choice, whose market value is about 1.6 billion pounds (\$3 billion). TUI will own 51 percent of TUI Travel Plc, which will be based in the U.K. and run by First Choice Chief Executive Officer Peter Long, the companies said.

Shares of TUI, which also owns the Hapag-Lloyd shipping line, surged the most since 2003. The company, which reported a full-year loss today, last year reduced profit forecasts and announced 3,600 job cuts. KarstadtQuelle AG agreed to combine its Thomas Cook AG division with MyTravel Group Plc last month.

The transaction "could be a very good deal for both companies," said Martina Noss, an analyst at Norddeutsche Landesbank in Hanover. "TUI has good package tours and First Choice is good in special tours." Speculation will persist that TUI will split shipping and tourism completely, Noss said, adding that she may review her "hold" rating.

TUI will transfer about 875 million euros worth of debt, including pension liabilities, to the new company. The deal "underlines our intention of pushing forward the two-pillar strategy" of shipping and tourism, Michael Frenzel, the German company's chairman, said in a statement. He said today there were no plans to the shipping division into a separate company.

Stocks Soar

First Choice shares advanced 25.75 pence, or 9.1 percent, to 309.75 pence at 3 p.m. in London, set to close at their highest since at least 1989. The company, Europe's fourth-largest vacation provider, is expanding into luxury and activity trips to avoid direct competition from low-cost airlines.

Shares of TUI rose as much as 14 percent in Frankfurt, the most since June 2003, and were recently 1.59 euros higher at 18.10 euros, valuing the company at about 4.5 billion euros (\$6 billion).

TUI Travel will sell holidays under brands including Sovereign and Sunsail to 27 million customers in 20 countries. The merged company will have "cost competitiveness" as "huge amounts of business are taking place online," Long said on a conference call.

The TUI and First Choice combination will have about 12.1 billion pounds in annual revenue, 50 percent more than the 8 billion for Thomas Cook-MyTravel. The Thomas Cook deal thwarted First Choice's own attempt at a transaction with MyTravel.

TUI vs. Thomas Cook

The merger could also be better for shareholders than the deal between Thomas Cook and MyTravel, according to Christopher Kummer, director of the Institute of Mergers, Acquisitions and Alliances at Webster University in Vienna.

“TUI and First Choice has the advantage over Thomas Cook and MyTravel because of the volume and range of holidays they can offer,” he added.

The deal will cut costs before tax by at least 100 million pounds (\$194 million) a year, First Choice said. Many of the cost reductions will take place in the U.K., TUI's Frenzel said on a separate conference call. The companies declined to give a figure for possible job cuts.

The merger could be completed as early as May, First Choice Finance Director Paul Bowtell said. He doesn't expect European competition authorities to stop the deal.

TUI, which sells holidays under the Thomson brand in the U.K., “has to improve the profitability of its tourism business,” said Christian Hamann, an analyst at Hamburger Sparkasse in Hamburg. “First Choice is much more profitable.”

TUI Loss

The German company's shares declined 2.5 percent in the year to March 16, the last day of trading before the deal was announced. First Choice stock was up 22 percent in the period.

TUI today reported a 2006 loss of 847 million euros, compared with the 733.1 million-euro estimated loss in a Bloomberg analyst survey. The German company had a 764-million-euro charge to write down goodwill linked to tourism and shipping acquisitions. TUI generates about half of its revenue from travel and the rest from shipping.

Lazard Ltd. and Deutsche Bank advised First Choice. TUI was advised by Morgan Stanley.

Credit Quality

Contracts based on 10 million euros of TUI debt fell 25,000 euros to 215,000 euros, according to Deutsche Bank AG. Credit- default swaps are based on corporate bonds and are used to speculate on a company's ability to repay debt.

The decrease indicates investors trading the swaps expect TUI's credit quality to improve. December's dividend and profit- forecast cut prompted Moody's Investors Service to cut the company's high-risk, high-yield credit rating.

The yield investors demand to hold TUI'S 5.125 percent bonds due in 2012, instead of similar maturity government debt, was little changed at 215 basis points today, according to RBC Capital.

Frenzel created TUI by whittling down the industrial conglomerate Preussag AG and acquiring Thomson Travel Group Plc. Former assets such as oil exploration flourished under their new owners, while tourism languished. Last year, TUI shares dropped 12 percent, their worst annual return since 2002 and the worst performance on Germany's DAX Index.

To offset demand swings in travel, Frenzel sought to bolster Hapag-Lloyd, whose roots date back to 1847, and bought CP Ships Ltd. for \$2 billion. Shareholders may pressure Frenzel to abandon his vow to keep shipping and tourism united, Webster's Kummer said.

“It's very difficult to justify having the two different businesses,” Kummer said. “It would be the logical step to split them up.”

Revenue at TUI's shipping unit rose 63 percent to 6.3 billion euros in 2006, compared with unchanged revenue from tourism, which was 14.1 billion euros.

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