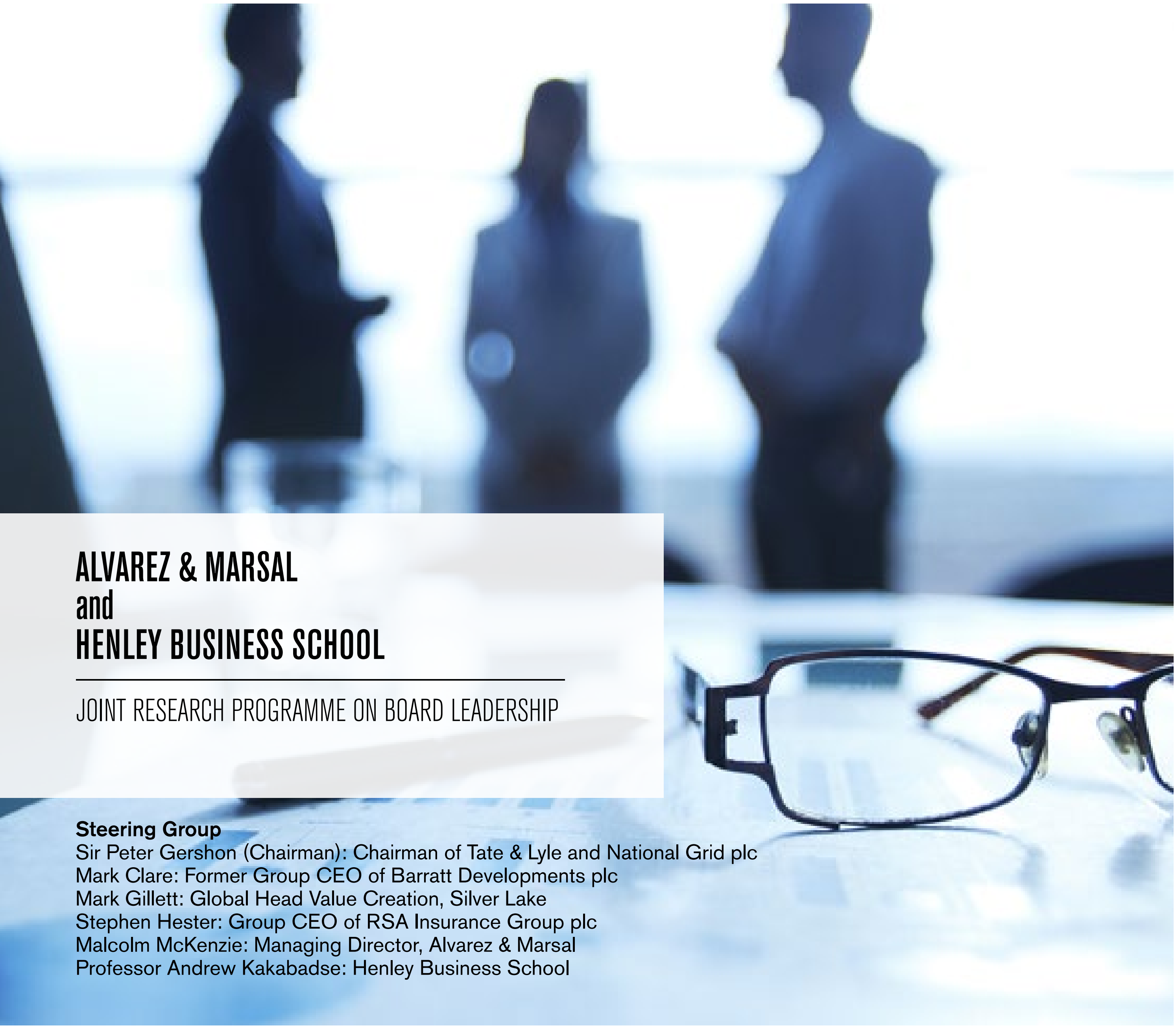
BOARDS IN CHALLENGING TIMES: EXTRAORDINARY DISRUPTIONS

Case Study: Thomas Cook's Transformation: A CEO for a Season



ALVAREZ & MARSAL
and
HENLEY BUSINESS SCHOOL

JOINT RESEARCH PROGRAMME ON BOARD LEADERSHIP

Steering Group
Sir Peter Gershon (Chairman): Chairman of Tate & Lyle and National Grid plc
Mark Clare: Former Group CEO of Barratt Developments plc
Mark Gillett: Global Head Value Creation, Silver Lake
Stephen Hester: Group CEO of RSA Insurance Group plc
Malcolm McKenzie: Managing Director, Alvarez & Marsal
Professor Andrew Kakabadse: Henley Business School

Henley Business School
UNIVERSITY OF READING

A & M

RESEARCH CASE STUDY

THOMAS COOK'S TRANSFORMATION: A CEO FOR A SEASON

This case study is based on an analysis of interviews conducted by the research team during the first and second quarters of 2015 with the following participants:

- **Frank Meysman** | Chairman of the Board | Thomas Cook plc
- **Harriet Green** | Former Chief Executive Officer | Thomas Cook plc
- **James Sandford** | Group Head of Investor Relations | Thomas Cook plc
- **Michael Healy** | Chief Financial Officer | Thomas Cook plc
- **Paul Callaghan** | Head of Transformation | Thomas Cook plc
- **Peter Fankhauser** | Chief Executive Officer | Thomas Cook plc
- **Simon Taurins** | Managing Director | Credit Suisse Investment Banking Division

INTRODUCTION

In 2012, Thomas Cook was facing an extraordinary disruption. Investors had lost confidence in the business and the share price had fallen from a high of 335p in mid-2007 to around 14p in July 2012.

The business was carrying significant debt (£1.2 billion of bank debt, £630 million of bonds and over £1.5 billion of "uncommitted" facilities) and producing poor profits (no EBIT post exceptional since 2010 and three profit warnings in 2011 as well as delayed results).

The root causes of these issues were both external and internal. By 2008, traditional tour operators were facing increasing competition and losing market share from online businesses in the digital space and from low-cost airline carriers. Then, in the late 2000s, the entire travel industry hit a downturn as a result of the global financial crisis.

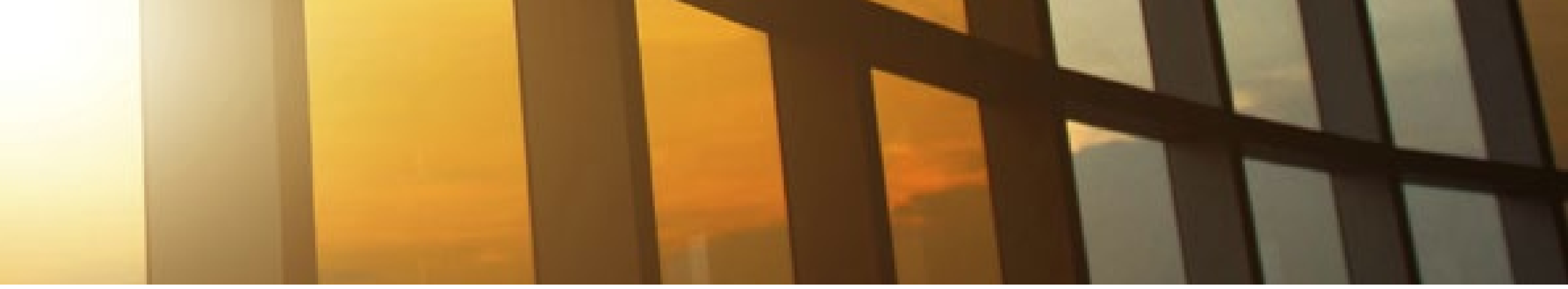
Thomas Cook had become siloed and fragmented due to the fact that it had grown through a series of acquisitions without ample realisation of synergies. There was weak governance and little focus on cost control. This all contributed to low morale and shattered confidence. However, the business still had a sound, fundamental core with a strong, iconic brand, a loyal customer base of over 23 million customers per year and revenues approaching £10 billion. In October 2011, a new Chairman, Frank Meysman, was appointed.

The new Chairman immediately oversaw the creation of an emergency working capital facility in November 2011. He then implemented a stabilisation plan, orchestrated a change of leadership and initiated a 'Transformational Disruption' of the business.

CALLING OUT THE ISSUE AT THOMAS COOK

When Chairman Frank Meysman joined Thomas Cook in October 2011, the company was already in crisis. On the 22nd October 2011, The Guardian reports "Thomas Cook: from net cash to debt crisis in four years" and in November 2011, the Telegraph states "Doubts surfaced over future of Thomas Cook…tour operator's share price nosedived by three-quarters."

Between 2008 and 2011, when consumer spending was severely affected by the financial crisis and economic recession that followed, Thomas Cook embarked on major acquisitions and realised a share buyback of about £290 million whilst still paying dividends. The Guardian stated that Thomas Cook had "shot itself in the foot via an appallingly timed share buy-back and an acquisition spree." This combined with the



continuous rise of budget airlines and the growth of online tour operators and travel agencies left the company in a very difficult cash situation.

Some voices were advocating a debt-equity swap which would have dramatically destroyed value for shareholders. Yet the new Chairman believed that if appropriate changes were made in leadership and on the Board, the company could be turned around and set on a foundation for future profitable growth. He then went on to change four Non-Executive Directors, re-build the Board and hire a new Management team. This gave a clear signal inside the business and to the outside world that changes were starting from the top.

> “...I WAS LUCKY THAT MICHAEL HEALY JOINED FIRST. I DON’T THINK THAT HARRIET WOULD HAVE PICKED MICHAEL HEALY BUT THEY WORKED PERFECTLY TOGETHER.”

ESTABLISHING THE CORRECT SCORE AND STYLE OF LEADERSHIP

Frank’s first action was to make changes to the Board. His first appointment was CFO Michael Healy, who joined the company in May 2012 and was appointed CFO in July 2012. With substantial experience and a track record in consumer businesses and financial markets, the new CFO was initially charged with putting in place and delivering a ‘hunker down’ strategy to secure the financial lifelines of the business and obtain the support of bankers, creditors and suppliers.

Against conventional wisdom, the CFO was appointed before the CEO, preventing the CEO from selecting the CFO. This helped to ensure constructive challenge between the CFO and the CEO, with appropriate priority given to the immediate financial challenges.

“...I was lucky that Michael Healy joined first. I don’t think that Harriet would have picked Michael Healy but they worked perfectly together.”

Harriet Green was announced as CEO on July 2012, having been credited with the successful transformation of FTSE 250 consumer electronics company Premier Farnell. Harriet took over from Sam Weihagen who had been interim Chief Executive following the resignation of the former Chief Executive Manny Fontenla-Novoa in August 2011.

Harriet’s remit was to develop and implement the long-term strategy for future growth, and to lead the business transformation and the engagement with the key internal and external stakeholders.

“[The CEO] was clearly owning the strategy. So their ownership [Group CEO, CFO and U.K. CEO] was very clear and well defined and they chose to work very closely as a team without politics with a very common mission.”

Harriet brought the drive, dynamism and charisma required to transform the business, to achieve a psychological change in staff and to instil trust from external stakeholders. Her understanding of technology, British nationality and established links within London also contributed to her successful appointment.

Whilst working closely as a team, the CEO and CFO split their responsibilities – the CFO dealt with the immediate financial ‘firefighting,’ allowing the CEO to focus on the medium to long-term aspects of the business, the strategy and transformation. The CFO explained:

“...your head goes...you start thinking that the bank nearly pulled me today or whatever and you’re not thinking about the long-term, you can´t see it, how can you maintain a view and a vision when you’ve just been rolling in the muck with some unsecure creditor or supplier, it’s not easy.”

This implied a lot of communication between these key roles to ensure the necessary alignment between short-term actions and long-term vision and strategy.

Also critical to the transformation was Peter Fankhauser who was then CEO for the U.K. segment before being appointed Group COO in November 2013 and ultimately Group CEO in November 2014.

In November last year, the market was caught by surprise by the unexpected announcement of the departure of Harriet as the Group's CEO and her replacement by Peter Fankhauser. Whilst unexpected, the transition from Harriet to Peter was carefully planned and followed a robust governance process. Harriet appointed Peter to Group COO in November 2013 to help break down the silos across the business and signal plans for her succession. The timing of the transition was triggered by the need for a shift in emphasis from strategic thinking to execution.

"You need somebody that has the drive to change and spin the wheels, but then you have to make sure that the car also moves forward."

There was also a desire to avoid a transition mid-way through a financial year and any ambiguity about who was running the company as a result of an extended transition period. Peter brought a deep operational knowledge of the business and understanding of the travel industry. He could now focus on execution whilst incrementally improving and refining the transformation strategy put in place by the previous CEO.

The Chairman's official press release to the London Stock Exchange stated:

"Harriet has had a highly positive impact on this company. We emerge from her transformation stronger, with a clear strategy, world-class leadership team, updated brand, and a renewed focus on the customer. The succession plan she devised will now take effect and the new chief Executive , Peter, will drive the company forward as we focus on winning the commercial battle against other operators."

The Chairman commented on the important dynamic between Peter, Harriet and Michael and how this, in his view, was the secret to the successful turnaround and transformation of the business.

"If I look back as to what's the success of the transformation I think it's the fact that you have three people that have unique strengths that work together. None of those three could have done it individually and none of those three should claim that they have done it. But each of them really worked together. That's the essence of the transformation."

Frank, the Chairman, provided important leadership throughout the transition. He had replaced Michael Beckett in October 2011 following a search process that started in the U.K. and was then extended internationally.

The new Chairman needed significant emotional resilience and as well as energy to rapidly progress multiple actions. Within a month of joining Thomas Cook, the business had come close to bankruptcy and within six months, he had overseen the change of three Non-Executive directors, reduced Thomas Cook's debt by £400 million, achieved a refinancing deal with the banks and appointed a new CFO and CEO.

"Having cycled across America in his younger years, Meysman is one for a challenge, but this was going some." (The Telegraph, May 2012)

Frank had a vision for the business and skillfully built and maintained a Board with a mix of skills and styles to secure Thomas Cook's survival and long-term success. In recruiting Harriet, he and the Board recognised the need for an individual with the required style to shake up and mobilise the business, prioritising a passion for ecommerce and technology over travel industry knowledge. He relied on Roger Burnell, the Senior Independent Director, for a deep understanding of the business. The Board appointed Dawn Airy and Emre Berkin as Independent Non-Executive Directors to provide the required international and technology sector experience.

"I had somebody onboard with Roger Burnell who really understood the business."

As a turnaround CEO, Harriet recognised the need to put in place a succession plan at an early stage, and plans were developed to prepare Peter for the CEO role. However, the timing and execution of the plan was ultimately determined by the Board, under the leadership of the Chairman.

DETERMINING DIRECTIONAL RESPONSE AND ALIGNMENT

Thomas Cook's transformation story can be discussed in three steps. The first involved the initial stabilisation of the business, putting in place the financial restructuring and cost-out activities to ensure survival of the business. The second step involved development of a coherent strategy for growth and a transformation programme, putting in place the right people and structures and transforming the capabilities and culture of the business. The third step is still underway and focuses on delivery of the 'high tech, high touch' digital strategy.

1. STABILISE THE BUSINESS; "SAVE THE SHIP"

In October 2011, the new Chairman arrived, secured a new banking facility and initiated changes to the Board, bringing time and stability to the group. A 'hunker down strategy' was put in place by the CFO to enhance the group's cash position and restore trust from bankers, creditors and suppliers. A cost-out program composed of two 'waves' was launched, with an objective of £450 million or 5 percent of the entire cost base. This included dramatic reductions in the number of high street stores from 1,122 to 850, and 3,500 employees put under consultation. To realise cash, a plan of divestures worth £150 million was pursued to dispose of non-performing assets or poorly integrated acquisitions, especially in the U.K. segment.

Peter was appointed U.K. Chief Executive Officer in charge of turning around the U.K. segment which had excessive cost and complexity and represented over a third of Thomas Cook's revenues, whilst generating no profit. The numerous previous acquisitions meant that the U.K. was a loose federation of businesses. The disposal of these businesses helped to realise the necessary cash to self finance the U.K. turnaround.

"I said as well that we have to finance the turnaround principally on our own."

> YOU NEED SOMEBODY THAT HAS THE DRIVE TO CHANGE AND SPIN THE WHEELS, BUT THEN YOU HAVE TO MAKE SURE THAT THE CAR ALSO MOVES FORWARD.

Within the first six months, the three existing U.K. Boards, with 22 Executive members, were reduced to one Board with only nine Executives.

Another key efficiency initiative was the integration of the airline group, from four distinct airlines into one. This was successfully led by Christoph Debus, a newly hired Executive with a strong track record in airlines.

By reducing the dependency on the tour operator to fill airline seats, the U.K. business was able to take out some unprofitable capacity. The consolidated airline was kept separate from the tour operator business, whilst maintaining some coordination at the top.

"…we decoupled two units (airline and tour operator) and said there has to be strong links, we managed that really from the top…we educated people that they have to respect each other but you have tension…but it's better to have tension than everybody falls asleep."

At the end of this step, Thomas Cook was able to refinance £1.6 billion of debt, saw its maturities extended and raised £425 million of new equity with a rights issue 97 percent subscribed by existing shareholders. This provided operational flexibility and facilitated the execution of the ongoing business transformation. Furthermore, the U.K. segment was quickly turning around and by the third quarter of 2013 had already taken out £105 million of cost.

2. STRATEGY & TRANSFORMATION; "DECIDE WHERE YOU WANT TO BE"

The second step focused on developing a coherent strategy for growth and galvanizing the business to drive the company's transformation into the digital world. Running in parallel with Step one, it was driven essentially by the CEO with external advisory support.

Having conducted the largest customer survey in the travel industry with 18,000 respondents, the strategy was defined as "High Tech, High Touch, Personal and Trusted." It was announced at the Capital Markets Morning in March 2013.

This step also involved building key capabilities into the business leadership at all levels, identifying talent required for digital and renewing the corporate culture by implementing a number of initiatives to help leaders to understand digital (via iClinics), to focus on customer experience (top 200 leaders experiencing a TC holiday in FY14) and drive innovation and continuous improvement (online lean awareness training).

In changing culture, small acts mattered, such as setting a rigorous structure of regular meetings, issuing pre-reads in advance and ensuring attendees arrived on time.

The transformation strategy was deeply embedded into the performance management system with relentless communication across the business from the CEO to ensure the necessary alignment and engagement. An online tool was launched to allow instant peer to peer recognition and a new CEO Award was introduced to recognise and drive best practice in customer service.

This phase also included a change of corporate image and brand with the launch of the Sunny Heart Brand, representing for customers, personalised and trusted holidays and high tech delivery. The former Head of Transformation and current Head of Investor Relations commented on Harriet's style:

"…energising and galvanising the business and shaking the business up… she then made it very clear it was a burning platform and had clear strategies in place to try and fix it. It meant disruption but it went down extremely well."

3. OPERATIONALISE; "MAKE SURE THE SHIP MOVES"

The appointment of Peter as Group CEO marked the start of this third step in Thomas Cook's transformation. This step is still underway, focusing on delivery of the digital transformation which sits at the heart of the strategy. This will include development of a single group-wide online environment and "dynamic" packaging tool as well as an accurate database of all customer interactions, creation of an omni-channel world with automatic 'recognition' of returning customers and tailored offerings, and effective engagement with customers outside holidays.

APPLYING THE RIGHT DISCIPLINES

GET THE RIGHT PEOPLE IN PLACE

At Board level, Thomas Cook needed a team who understood the business, the consumer, the financial aspects and the long-term vision. The Chairman recruited new Board Members, each time asking the Executive search companies for the best male and best female candidates. Today the Board is over a third female, with nationalities from Turkey, Belgium, Netherlands, the U.S. and U.K., signaling that it is not a U.K. company, but a truly international company.

Establishing the required leadership across the business, with the right mindset and skills, was extremely important. The CEO formed a top team composed of one third from the existing team, one third promoted from within and a further third from outside the company. This ensured the right blend of skills and experience, and balance of knowledge of the business with fresh external perspectives.

The company has established a new central Ecommerce Centre of Excellence and Digital Advisory Board led by the CEO and staffed with external experts, including John Straw, an experienced digital entrepreneur.

More widely, a pioneering Executive development program for 50 of the top 150 business leaders was put in place to further ensure leadership was informed and aligned with the requirements of the 'new digital era.' Thomas Cook has trained more than 400 senior employees and is developing and implementing a digital training programme, all of which is helping to drive the business towards a more digital future.

ENSURE EFFECTIVE STAKEHOLDER MANAGEMENT

As a 'Transformational Disruption', effective management of both internal and external stakeholders was critical to the survival and future success of the business. Harriet recognised the importance of instilling belief and initiating engagement from the start.

"We had to convince employees, customers, and investors that we were going to succeed – we needed to create a psychology of turnaround and pace."

Prior to joining Thomas Cook as the new CEO, Harriet focused on gaining an external perspective by talking to investors, analysts and the media. Once appointed she then took the same approach internally, talking to as many people as possible within the business. In her first month she launched a survey that received 8,000 detailed responses, to which she responded within 24 hours. This gave the message that quick action was required to get the business back on track.

Using this information, Harriet, with support from senior leadership, identified '15 big decisions' which were considered vital to the recovery of Thomas Cook. She took these with her everywhere as handwritten notes in order to engage the various parts of the business.

Mr. Healy also played a crucial role handling relations with the creditors, banks and suppliers and building the necessary trust to implement the transformation plan. The CFO's existing relationships and credibility with the banks and hedge funds was critical to effectively manage these stakeholders in the early stages of the transformation.

WE HAD TO CONVINCE EMPLOYEES, CUSTOMERS, AND INVESTORS THAT WE WERE GOING TO SUCCEED – WE NEEDED TO CREATE A PSYCHOLOGY OF TURNAROUND AND PACE.

ARTICULATE THE PURPOSE, TAKE CALCULATED RISKS AND GET PACE

Reacting with pace to the disruption was essential, particularly in the initial stages of the response, when there needed to be the right balance between action and discussion.

"…when you come into a company in such a mess, then there's no real place for consensus, discussion with…you need the authority and autonomy to get on with it, because you don't really have time…"

The Chairman explained the changing nature of interactions with the Board as the disruption evolved. In the initial 12 months when pace is the priority, the Group CEO, CFO and U.K. CEO were given the trust and autonomy to address the immediate priorities.

"When you are in a crisis you don't as a Board challenge the execution of how your ship is rescued. You ask the captain, please rescue the ship. Over time when you are in more normal waters you will then challenge the captain and say, are you sure you're going towards the right direction, what are the alternative routes? And you have much more of a challenging environment."

BE EVIDENCE LED

The transformation of Thomas Cook was data led. It effectively pulled data from the periphery to inform the development of the strategy and support decision-making on restructuring.

The leadership team initially employed an employee survey which returned 8,000 responses, talked extensively with other senior leaders throughout the company, and gathered external views on strategy and market views from banks, brokers and industry analysts.

Thomas Cook also conducted the largest ever customer survey in the travel industry (18,000 respondents) and used this information and support from external advisors to design a long-term strategy with the customer quite literally at its heart.

However, Thomas Cook Executives were unanimous that speed is everything and sometimes takes priority, even when data is lacking. Some mistakes and losses in the process are inevitable and need to be accepted.

"It's not business as usual, it's quite a frenetic environment where you need to be able to make decisions and be confident at making decisions… if it's not right I'll change it later. But at the time it's the right decision based on the information I have at the time."

REALISE STRATEGIC ALIGNMENT AND ENGAGEMENT

Realising continuous strategic alignment and engagement is a critical discipline upon which successful transformations are built. At Thomas Cook this was achieved by establishing a Leadership Council which was attended by the top 150 managers. The 15 big decisions were announced and discussed at the first Leadership Council in September 2012 to ensure that there was one clear vision and consistent action at all levels of leadership.

Other initiatives included the formation of a new Executive committee aligned with strategy, with a mandate to coordinate its implementation with the trust and support from the Board of Directors. Getting the Board of Directors behind the strategy was critical.

"We had a two day strategy session with the Board, not part of the board meetings but just with the Board going through all of it, so if you like there is a reaffirmation of strategy not just from me and the CEO but from the entire Board, the entire board really were where the strategy is, so they've been very much involved in that."

USE TRUSTED, INDEPENDENT ADVISORS

Independent advisors were used to help develop the strategy and set up the transformation programme. They became a trusted partner for Harriet in particular, providing industry knowledge and support throughout the first two years of the transformation. External support was also obtained by the CFO to put in place a 26 week cash forecasting process.

As the focus moved from strategy development to execution, and with the appointment of Peter Fankhauser as Group CEO, it was important to scale back the dependency on external consultants and allow the business to drive forward the change as 'business as usual.'

THOMAS COOK: SUCCESS AND THE FUTURE

Thomas Cook has recovered from one of the most difficult chapters in its history, and is today a renewed, stronger company. The confidence in the company has been significantly restored, as demonstrated by the €400 million bond issue in January 2015 which was two times oversubscribed. However, both the industry, through the recent terrorist attacks in Tunisia, and Thomas Cook specifically, through a poor initial handling of a tragic fatal incident with holiday makers, have faced some significant PR challenges. The strength of Thomas Cook's brand and loyalty of its customer base have again contributed to its survival.

The group is now looking to access long-term banking financing and is debating strategic projects related to geographical expansion in China as well as the group's position in the context of an evolving airline industry. The business is defining a new operating model, which will have customer centricity and the group's digital journey at its core. Thomas Cook's CEO explained:

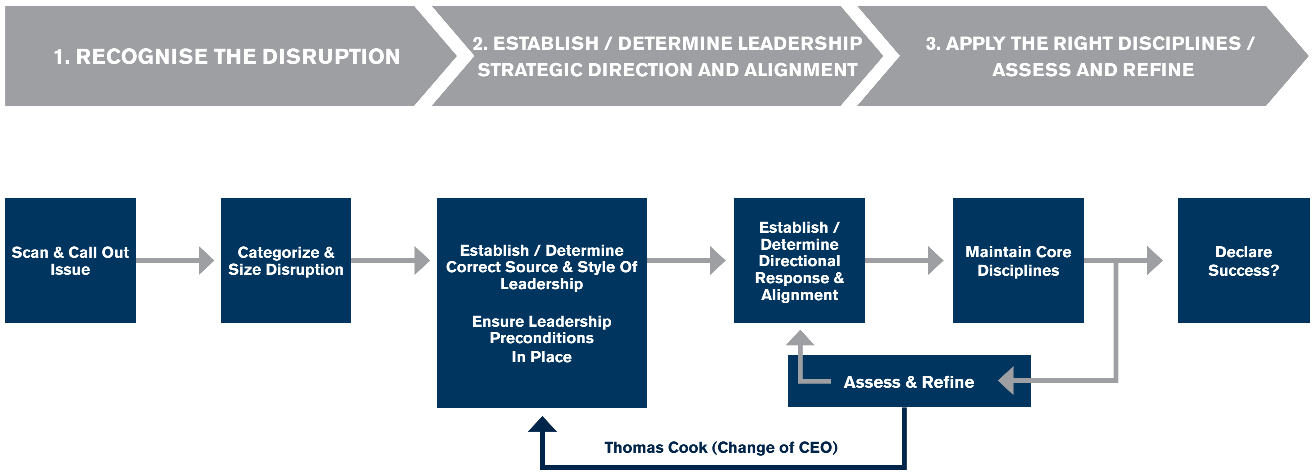
"Digital is going to help us to get to the transformation and this is an important cornerstone…the other thing is we get the customer centricity right…this is now really about changing the business model and really getting the efficiencies much better."

Today Thomas Cook is a much more resilient company from a financial and product point of view, but the Chairman remains focused on ensuring that the drive and momentum from the transformation continues, that the business retains both an internal and external perspective and strikes the right balance between change and stability.

"It's a continuous element. The car in which we are driving looks kind of the way we like it to look like, but if you don't move forward somebody else is going to overtake you."

APPENDIX A: THOMAS COOK'S JOURNEY - ALIGNMENT WITH THE FRAMEWORK

Based on our research framework, outlined below, Thomas Cook broadly followed this process but changed the source and style of leadership three times with the change of CEO from Sam Weihagen to Harriet Green and ultimately Peter Fankhauser. In effect Thomas Cook returned from 'Assess and Refine' to 'Establish Correct Source and Style of Leadership' as shown below.



APPENDIX B: THOMAS COOK TRANSFORMATION JOURNEY

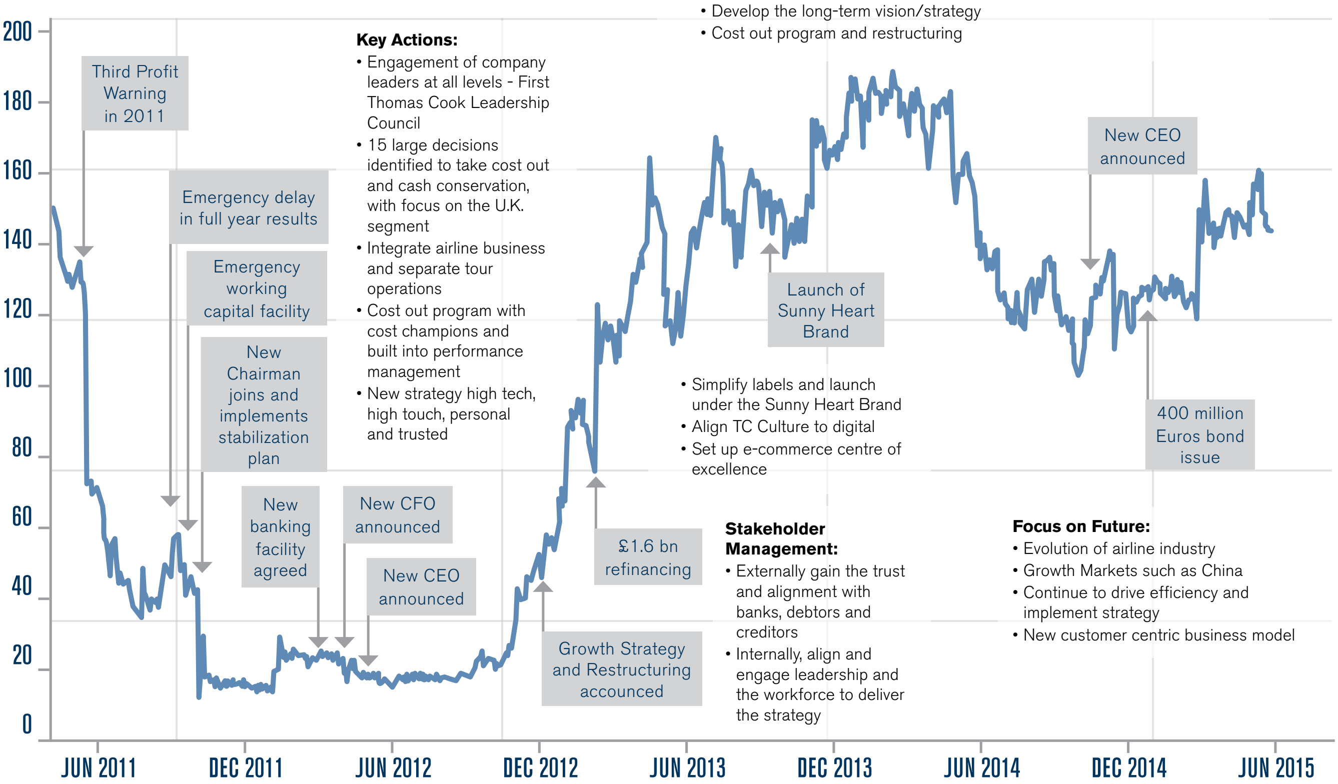
1. RECOGNISE THE DISRUPTION	2. DETERMINE LEADERSHIP, STRATEGIC DIRECTION & ALIGNMENT	3. APPLY THE RIGHT DISCIPLINES / ASSESS & REFINE

- Disruption had been recognized but perhaps not sized adequately
- Consequently, action was "too little too late"
- Ultimately, there was the recognition that a much more fundamental change was required

Right Source of Leadership:
- Chairman identifies CEO & CFO with transformation credentials
- Right Preconditions in place: high resilience, communication, integrity and high levels of IQ, EQ and XQ

Strategic Direction & Alignment:
- New Chairman changes board - CEO and CFO appointed
- "Hunker Down" strategy and long-term transformation

Apply the Right Disciplines:
- Realize Strategic Alignment and Engagement:
  - TC leaderhip council implemented
  - New Executive committee aligned with strategy
  - Board supportive of management and strategy
- Get The Right Prople In Place:
  - New top management team
  - Executive development program for 50 of Top 150
- Be Data Led:
  - Pulled data from the periphery to support informed restructuring
  - Largest customer survey in travel industry (18,000 respondents)
- Articulate The Purpose, Take Calculated Risks And Get Pace:
  - Develop the long-term vision/strategy
  - Cost out program and restructuring



Key Actions:
- Engagement of company leaders at all levels - First Thomas Cook Leadership Council
- 15 large decisions identified to take cost out and cash conservation, with focus on the U.K. segment
- Integrate airline business and separate tour operations
- Cost out program with cost champions and built into performance management
- New strategy high tech, high touch, personal and trusted

- Simplify labels and launch under the Sunny Heart Brand
- Align TC Culture to digital
- Set up e-commerce centre of excellence

Stakeholder Management:
- Externally gain the trust and alignment with banks, debtors and creditors
- Internally, align and engage leadership and the workforce to deliver the strategy

Focus on Future:
- Evolution of airline industry
- Growth Markets such as China
- Continue to drive efficiency and implement strategy
- New customer centric business model

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to activate change and achieve results.

Privately-held since 1983, A&M is a leading global professional services firm that delivers performance improvement, turnaround management and business advisory services to organizations seeking to transform operations, catapult growth and accelerate results through decisive action. Our senior professionals are experienced operators, world-class consultants and industry veterans who draw upon the firm's restructuring heritage to help leaders turn change into a strategic business asset, manage risk and unlock value at every stage.

When action matters, find us at: www.alvarezandmarsal.com

Follow us on: