Thomson Reuters: Is the Giant Awakening?

Description

Thomson Reuters (TSX:TRI) was formed in 2008 through the merger of Canada-based Thomson Corporation and U.K.-based Reuters Group and is today a leader in the global information-services industry. The company operates in 100 countries, services 40,000 clients and 400,000 end users, and employs 60,000 people.

Since the 2008 merger, the revenues, profits and free cash flow of the company stagnated. The difficult global economic environment during 2008-10 certainly did not help, and the relatively poor performance of the largest division, Financial and Risk, hurt the overall business.

The Financial and Risk division contributed 55% of revenues and 51% of the operating profit in 2012. Profit before interest, tax and depreciation ("EBITDA") declined from $1.83 billion in 2009 to $1.69 billion in 2012 while the EBITDA margins also dropped substantially. By comparison, the other three divisions fared relatively well, lifting their combined EBITDA by 12.2%, and also managed to protect their profit margins.

Over the past few years, company management has taken a number of actions to improve revenue growth and profit margins and reduce costs. These included a rationalisation of the operating infrastructure and a drastic reduction in the number of products. As part of this process the number of global data centres have been reduced from 27 to 15 with an eventual target of 9 by 2016, and a multitude of products have been combined into the single platforms of Elektron and Eikon.

Will the giant awaken?

The company expects that these corrective measures will lead to an improvement in the EBITDA margin of the Financial and Risk division to around 30% by 2015. Based on our estimates, achieving this target could have a substantial positive impact on the overall company profits. The early signs are promising — in the third quarter of 2013, this division reported positive net sales for the first time in over two years and EBITDA margins improved to 26.4% from the 24.4% level of 2012.

The turnaround of the Financial and Risk division is a work in progress. However, the company has the benefit of a prominent global franchise, a strong balance sheet and prolific cash generation capabilities, providing the breathing space for the turnaround.

The financial success of the Financial and Risk division are dependent on the performance of the financial markets, including equities, fixed income, forex, derivatives and commodities. The much improved market conditions will further support the recovery of this division.

Is it time to buy?

The stock trades on a 2013 forward price/earnings ratio of 18 times, an enterprise value/EBITA of 10.5 times and a dividend yield of 3.4%. This is not cheap, but is in line with listed peers and does not appear to take into account the upside potential should the performance of the Financial and Risk division improve and the profit margins recover.

The company has a magnificent track record of uninterrupted and increasing dividend payments, regularly buys back shares and intends to spend another $1 billion on share buybacks by the end of 2014.

The company announced at the time of the third quarter results that it would lay off 3000 employees, take a $350 million charge for “simplification costs” (which would result in an annual cost saving of $300 million) and contribute $500 million to pre-fund pension plan obligations. Although this is now public knowledge, the 2013 results announcement expected on 12 February may create some market volatility and possibly a very good buying opportunity.

Foolish bottom line

The stock is not a bargain at the moment but offers an exposure to a high quality global footprint, significant financial strength, an attractive dividend yield and the possibility of a strong improvement in the profitability of its largest division over the next few years. Look for entry points, ideally below $40.

CATEGORY

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