

T2RL'S First View is our rapid analysis of breaking news. It helps provide perspective, putting the facts in the context of our wider and deeper knowledge of the market.

HP takes the PSS game to a whole new level

T2R Staff

The Facts

Hewlett-Packard has announced its marketing name for the new generation of passenger systems destined to deliver the American Airlines Jetstream project. The name chosen is Agilaire. HP also announced a licence agreement with Pegasus for technology services.

No formal announcement has yet been made about United Airlines moving to HP-SHARES from Travelport following its merger with Continental.

The Analysis

HP has a contract with American Airlines to deliver its new generation passenger management system. American took about 6 years to reach this decision. Competitors including Unisys's AirCore, Sabre and Amadeus were considered before American invited EDS to participate in the Request For Proposals in late 2004. EDS was bought by HP in May 2008 and the Jetstream deal was announced a year later.

Ultimately American is in a great place. It is understood that the contract carries significant penalties for non-performance and HP certainly has a balance sheet to underwrite these guarantees. Until such time as its competitors can do things that American cannot do, then AA is sitting pretty. Monte Ford, the CIO and Gerard Arpey, the CEO are probably not worried at all. Should HP not be able to deliver, American can easily return to the market to buy what it needs. The other vendors would be happy to have another opportunity, none more so than Amadeus which still badly needs a customer in North America.

HP is however carrying significant contract risk. The American delivery dates have never been made public, but the deal was struck over a year ago and HP needs to get on with the job. The announcement of the arrangement with Pegasus indicates that it is looking to build a new-generation, global, inventory distribution system - an NGC-GDS (New Generation Cloudbase GDS).

This does make some sense.

The GDSs are still very profitable. Amadeus's IPO was a massive success and the Private Equity shareholders have so far made back more than 7.5 times their initial investment. Amadeus has about a hundred millionaires on its staff too. This is despite the widespread opinion of industry pundits in 2001 that the GDS business was on its last legs.

HP can see these numbers and must find them very attractive compared to EDS's outsourcing business.

To build a GDS you need volume of inventory and volume of distribution - both sides of the network. You need to be friendly with the airlines that own the inventory and willing to provide reasonable terms to the airlines that wish to distribute their inventory.

The Speculation

Agilaire is an interesting choice for a name but it's probably better than Shares A, B and Axs-Res.

If the current rumours of HP winning the business of United Airlines prove to be correct it will have three of the top five airlines in the USA, which together boarded 325 million passengers in 2009. This represents a 46% market share in the US and a clear leadership position. With the addition of a small number of international customers HP will have 14% of the world market, putting it into a strong second place behind Amadeus in serving network airlines.

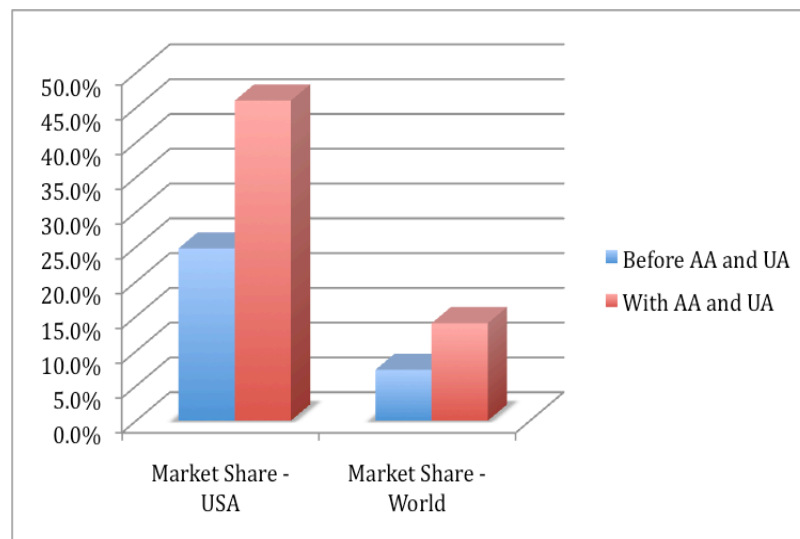


Figure 1. HP Market Shares before and after AA and UA

Delta Air Lines must also be considering its future with respect to Travelport following the aborted IPO and the possible loss of United. Delta's relationship with Air France/ KLM is getting closer and closer. These business partners will be very keen for Delta to understand the benefits of Amadeus as Air France / KLM transitions to the new generation Altea DCS over the next couple of years. There is no doubt that Delta will be deeply involved as Air France / KLM handle Delta passengers and vice-versa. Air France's new generation revenue management will probably only work with Amadeus's inventory - a further incentive for Delta to favour Amadeus.

Delta's challenge will be to negotiate a fair contract with Amadeus, although if it did this now, while Amadeus is highly motivated to find its first North American PSS customer, it would have a very willing supplier.

Delta could however still elect to join its compatriots in a US based NGC-GDS, served by HP, although the implications of such an arrangement would be considerable.

Travelport will be in difficulties if either possibility transpires. Its recent agreement with Navitaire is very well timed, but possibly not enough to give it a real place on the PSS stage.

However the pieces fall into place Continental, United and American will eventually need advanced functionality. They need to compete and they will want to process their passengers more proactively with focussed availability and advanced customer journey processing. Ultimately HP needs to make some moves to mitigate its contract risk at American and to deliver a sustainable and attractive roadmap to its existing customers.

In the search for that capability HP has enough money to buy just about anybody that's for sale. That could of course include Sabre, but it could even be Amadeus. Amadeus's shareholders (with the likely exception of Air France) are probably ready to sell now and it's clear they will make even more money on the sale of Opodo.

Sabre's price is likely to be significantly less than Amadeus's. Its Travelocity business is operating in a very tough market sector – just ask Orbitz about its current problems with American.

This still leaves several other potential targets. Some private equity firms are rumoured to have been chasing SITA, but buying SITA would require the agreement of a large number of airlines and this would take considerable time. SITA is also very difficult to value as a cooperative and its relationship with Orange as a reseller of network services is complicated by the issue of telecoms licences in unusual geographic locations.

Navitaire is another option, but it would require an unfeasible amount of work for its Newskies product to take on and support the business models of American and United. It is unlikely that Accenture would sell the business cheaply enough to justify the necessary post-purchase investment.

Of course ITA also has some interesting technology developed for the failed Air Canada project. Should Google's acquisition go ahead HP might have access to some interesting components there too.

It could make some smaller moves. It could buy Datalex for example. This would probably help United, an existing Datalex customer, and even possibly deliver e-commerce for American alongside the HP fares and shopping capability. However this doesn't solve the bigger problem of delivering a new-generation reservation system of the scale necessary to support American and United.

This is why the Pegasus deal is interesting. HP has bought a licence. It did not buy the business. It agreed a price for technology now and probably an economic rent for the future. This is a very interesting model. It's built on Oracle and HP has plenty of buying power there too.

Airlines will like this. They don't have the skill and scale to write code any more and they don't have the buying power. HP has both of these things in spades.

Whatever happens HP is changing the game. The PSS is at the heart of distribution. It always has been and it always will be. Amadeus invested in PSS to protect and grow its overall business and it has been very successful. Sabre has also invested and has been successful in winning new customers in the lucrative hybrid market.

The thought of these US majors collaborating through HP on an NGC-GDS is an interesting one. It might drive Southwest into the arms of Sabre or Amadeus even faster.

In any case HP is back on the global stage and its next steps require attention and understanding for its competitors, potential partners and airlines considering their options in the next few years.