TRAVEL TECHNOLOGY RESEARCH
FIRST VIEW

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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.

American Airlines Beats Orbitz and Travelport, Amadeus Wins

T2R Staff

The Facts

American Airlines (AA) has succeeded in removing its flights, availability and pricing from Orbitz as of 21st December 2010. Circuit court Judge Martin Agran in Cook County, Illinois overturned an injunction granted on 1st December preventing American from pulling inventory.

AA has told Orbitz customers that they must make changes through the American call centre.

In a show of solidarity Expedia has removed American Airlines from its priced availability displays.

The Analysis

American Airlines is on a mission to transform distribution in the United States. Led by the head of merchandising at AA, Cory Garner, but clearly with the solid support of senior management, AA wants to change the way airline inventory is marketed and sold. Its requirements are remarkably simply stated: to distribute inventory through the most cost efficient channel for any given customer or customer segment. AA understands that distribution channels are about efficiency.

American wants to work with Orbitz using a Direct Connection, ie to connect its passenger services systems (PSS) supplied by HP and Sabre directly with the travel agents own systems. This was one of the drivers for AA when it helped found Orbitz in the first place, the opportunity to use Supplier Link. AA likely divested its share of Orbitz in 2005 because of the threat of regulatory interference, increasing costs associated with technology and customer acquisition and competition and duplication of investment with AA.com.

This is taken from the Orbitz website from 2002:

CHICAGO (August 19, 2002) - - Orbitz, the travel website with the most low fares, today announced implementation of its breakthrough Supplier Link technology with American Airlines, making Orbitz the first Internet company to replace all intermediary functionality in order to book tickets directly with airline reservation systems. Three more U.S. carriers, including US Airways and two others to be announced later this year, are expected to have Supplier Links complete by year-end, which will result in significant cost savings by enabling them to avoid Global Distribution System (GDS) fees. Orbitz has also signed agreements for Supplier Links with seven other carriers.

"Orbitz was founded to be a low cost distribution channel for travel purchasing, and as a result, has been able to offer consumers access to lower-priced fares," said Jeff Katz, President and Chief Executive Officer of Orbitz. "The move to a Supplier Link with American and other airlines is another step toward reducing supplier costs in travel distribution and decreasing, ultimately, the fares that consumers pay for their tickets."

By launching a Supplier Link with Orbitz, American Airlines is expected to save up to 77% on every ticket booked through Orbitz.com. Industry experts have estimated potential industry savings of $1 billion and up on distribution costs through more streamlined and efficient airline ticketing systems like Orbitz' Supplier Link.

Despite the fact that Orbitz allegedly generates some $800M of annual revenue for American, AA must believe these customers will move to AA.com or other distributors such as Priceline and Travelocity and it will retain most of this revenue. It is not yet clear whether American anticipated Expedia's rapid retaliatory action and whether Priceline and Travelocity will take similar action.

T2RL believes American has picked on Orbitz because it is powered by Travelport's GDSs, Worldspan and Galileo as ultimately the AA - Orbitz dispute centres around American's attempts to get Orbitz to work through its Direct Connection for inventory. Orbitz does have a Direct Connection in place with American but Travelport has been making it difficult to increase AA bookings with this technology. Travelport has two key points of leverage; ownership (48% and board seats) and, probably more importantly in this case, a distribution contract with volumes and thresholds.

Orbitz receives lucrative incentives from Travelport for bookings made in its GDS systems. Whilst no information is available in the public domain, T2RL estimates that in 2009 Orbitz represented about a third of the total bookings made by American Airlines through online agents using GDSs - some 20-25 million bookings. Let's assume that Galileo and Worldspan represented 7 million bookings and the AA direct connect bookings were about 3 million. This gives 10 million bookings for $800M in revenues, about $80 per booked segment or $200 per ticket at 2.5 segments per ticket.

AA will make a net saving of about $4-5 on its GDS costs for each of these bookings, assuming they continue to be made in AA.com. There will be minor savings if they move to other distributors also powered by the GDSs. This is not about these savings, it's about the ability to negotiate access to inventory on AA's terms. This explains Expedia's move to push AA flights to a second set of screens and not sell from the primary search. Expedia knows only too well what the effect of the change in presentation will have.

The risk of American losing business overall is small. Experience shows that travel buyers are smart enough to move from one site to another and they will usually check the airline's own site to make sure they really have the lowest fare.

The Speculation

AA is threatening the GDS model successfully, but only in North America. There will be little or no short-term impact outside the USA.

Fragmentation of content reduces the GDS value proposition to travel agents, both online and traditional. Agents in the United States in particular will have to consider implementing technology that allows shopping against both GDS and Direct Connections. Farelogix and ITA Software are two vendors with products that have this capability.

The argument that the consumer will lose out is nonsense and unsustainable. The AA-Orbitz ruling demonstrates that Judge Agran agrees that consumers will not suffer and that they have ample opportunity to buy the best fares from American through other channels.

Travel agents can buy or build technology that combines aggregated and fragmented content. Those that use this capability will be forced to give up GDS rebates for bookings from airlines with substantial volume but smaller carriers will be unable to shift agency behaviour. They will continue to pay booking fees to fund agency incentives for the largest distributors of airline inventory such as Expedia, Travelocity and Priceline. Suppliers like Datalex, Farelogix and ITA will also benefit. Developments like Expedia's in-house aggregation of priced availability will pay dividends assuming they work efficiently. Smaller fare specialists like Everbread will also be more in demand as agents will need multi-source pricing engines that are easy to integrate.

Ultimately Travelport and its owners Blackstone and One Equity Partners are likely to suffer the most. Seven million bookings is a significant volume to lose when you are trying to sell yourself and you have already failed once to come to the market.

American Airlines will have thought through the failed Travelport IPO carefully and will be using this to exert additional commercial pressure. AA is very much aware that it accounts for more than 10% of the total online agency bookings generated by Travelport's collective GDS brands.

Expedia has already responded by pushing AA's listings out of the prime locations on its displays. Expedia is protecting its GDS segment revenues, which we estimate to be 70-80 million segments over 12 months at around $2-3 incentive per segment. This accounts for a significant proportion of Expedia's current profits. Its reported net income for the nine months to 30 September 2010 was $350M. Assuming 9/12 of 70 million x $2.5 then GDS segment rebates accounted for 37% of net income for the period. It is no wonder it has responded to American's push to make Direct Connect the way to obtain its inventory.

American's customers will weather the storm and find their way to AA's inventory. Price sensitive customers will continue to shop for the cheapest deal and use multiple sites to get their bargains. Where AA has the lowest fares for any given route and schedule it will continue to attract customers with or without Orbitz and possibly Expedia. Consumers know how to find the best deals. Indeed Expedia may just be undermining its own perception in the market place and deepening AA's relationship further with Sabre and Travelocity.

In our view American will eventually agree terms with Orbitz. Anything else would be madness. Travelport will lose GDS revenues and more bookings will flow through the Direct Connections.

The GDS world will have received a jolt, but other airlines will not follow as quickly in withdrawing content from distributors due to the specific market structures in their respective points of sale. Expedia, Priceline and Travelocity will fight hard to keep their GDS rebates including multi-GDS connection and will develop business logic to get the best combination of inventory and GDS rebates, but in the end their dependence on the US market will see a reduction in their profits.

Amadeus is the winner. Its lower volume exposure to the US market combined with a more fragmented customer base will mean its rivals have even less ability to compete in respect of financial incentives and product development resources. As long as Amadeus spends its advantage wisely it will strengthen its position further in terms of cash generation and market domination.