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.

Lufthansa To Sell Systems but not to the Obvious Buyer

T2R Staff

The Facts

Manager Magazin in Germany has reported that Lufthansa is separately negotiating with IBM and India's Tata Group to sell a 51% stake in Lufthansa Systems, the Frankfurt-based company that supplies IT services to the Lufthansa Group as well as a wide range of other airlines and some customers from other industries. The magazine claims that a deal will soon be finalised.

The Analysis

Lufthansa Systems is one of several IT companies that have been spun out of the business of a passenger airline. The best known of all such companies is Sabre, which was floated away from American Airlines in 1996 and is now one of the dominant providers of technology and distribution services to the airline industry. Other examples include Mercator, the IT arm of the Emirates Group which is constituted as a separate company although it is still wholly owned by the Group, and Covia which was spun off by United Airlines in the 1990s and now forms part of the Travelport GDS company.

Lufthansa Systems has had an eventful history. At its inception in 1995 a the company was set up as a joint venture between Lufthansa and EDS, the IT services company now owned by Hewlett-Packard. This arrangement did not stand the test of time and Lufthansa Group soon moved to buy out the 25% EDS stake.

In the supply of information technology to the airline industry the largest value item is invariably the Passenger Services System (PSS), which is worth about the same as all other application services combined according to research by T2RL in 2010/11. From its inception LH Systems had an important PSS business, supplying services to the parent carrier as well as a range of other airlines. This business was undermined when Lufthansa became one of the first airlines to sign up for the Star Alliance Common IT Platform (CITP) from Amadeus in 2006. Without the critical mass provided by Lufthansa Group's 70 million annual passengers it was uneconomic for LH Systems to continue offering its mainframe-based PSS services. The Group authorised investment in a new generation PSS, to be based on the AirCore product set from Unisys but after spending three years in development this project was abandoned in 2008.

Despite its travails in the PSS space Lufthansa Systems remains one of the most important suppliers of operational IT systems to the airline industry. It has market-leading products in flight planning, flight operations, crew management, revenue management, frequent flyer and many other applications with wide applicability to the airline industry. In fact T2RL research shows that only Sabre and SITA offer a wider range of technology products to the industry. In 2010 Lufthansa Systems generated revenues of €595 million.

Both of the potential buyers identified by Manager Magazin are very large IT services companies but neither currently has an extensive business in airline applications products.

IBM was an early leader in airline PSS development but left the market for applications to its own airline customers in the 1970s. Tata is India's largest conglomerate and Tata Consulting Services is a $6.5Bn corporation with interests across the range of IT services, but it also lacks a range of airline application products. Both companies have the resources available to finance a purchase of Lufthansa Systems but it is not completely clear what strategic interest would be served by doing so.

On the other hand there is a potential buyer for whom Lufthansa Systems would be an excellent strategic fit. Amadeus started life as a specialised distribution services company, with a reservations system used by more travel agents than any other as well as by the sales offices of 155 airlines. During the last decade it has built its PSS product range to the point where it is about to become the market leader, but so far it has a very limited range of operational IT systems for the airline industry. An acquisition of Lufthansa Systems would immediately provide Amadeus with a very comprehensive range of airline IT products. It could then present itself to the market as a true "one stop shop", able to provide all the IT needs of its customer airlines.

Amadeus and Lufthansa Systems have not always managed to work together as effectively as they should given their common heritage. Lufthansa was one of the founders of Amadeus and key staff seconded from the airline were instrumental in getting the fledgling company off the ground. There has been discussion of a merger between the two businesses several times over the years but so far no more than discussion. However the strategic benefits of bringing the capabilities of the two companies together should be clear enough for the management at Amadeus to run the numbers once again.

The Speculation

While Amadeus could derive great strategic advantage from acquiring the intellectual property assets of Lufthansa Systems there may be others in the market with an interest in preventing such a union taking place. Currently Sabre and SITA are the only companies with both a substantial PSS and a range of operational systems. Neither of these companies would be likely to find raising the purchase price as easy as Amadeus or indeed IBM or TCS. Nevertheless they might have a very strong interest in preventing Amadeus making an instant transition from distribution specialist to full-service IT supplier.

If a majority stake in Lufthansa System is indeed in play the manoeuvring in the market place before its future is determined could be quite complex and lead to a result that is by no means obvious.

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Travel Technology Research Ltd (T2R) is an independent research and consulting company that specialises in the market place for airline IT systems. Based on data gathered and analysed since the year 2000 it has defined and tracked classifications of airlines and their IT providers. Its research is used by airlines to enable them to make informed choices of systems and vendors and by the vendors to help them develop products that best meet the current and future needs of the airline industry.