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Travelport Loan Restructuring Reflects Deeper Problems

T2R Staff

The Facts

On September 30th Travelport announced that it has successfully restructured a \$715M unsecured PIK (Payment in Kind) debt and deferred payment until 1 December 2016.

The Analysis

The press release from Travelport portrays this as a reasonably routine piece of financial engineering common to many large companies operating in the modern financial markets. However there are aspects to the transaction not mentioned in the company's statement that suggest there is much more to it than meets the eye.

- A group representing 25% of Travelport's bond holders attempted to block the deal, claiming that the company was engaged in a fraudulent transfer of assets
- Both Moody's and Standard and Poor's downgraded their ratings of Travelport bonds during August and September
- The new facility carries an interest rate of approximately 13%, which under the terms of a PIK loan may be met by issuing new debt
- Owners Blackstone Group had been preparing to put Travelport Holdings into Chapter 11 bankruptcy if necessary to force through the restructuring
- The need to restructure debts is driven by the need to avoid falling out of compliance with a debt-to-earnings ratio requirement in its loan agreement.

T2RL is not a financial analyst and we will leave commentary on the financial manoeuvrings to those more expert than we are. It is the last point that is of most interest to an observer of the travel technology market. The reason that Travelport is having issues with its debt to earnings ratio is simple enough. It does not have enough earnings. Travelport CFO Philip Emery said in a conference call on 4 August that EBITDA has been reduced in both the last two years and that further earnings reduction of \$60 million is expected as a result of United Airlines' decision to migrate its internal reservations functions to the SHARES system supplied by Hewlett-Packard.

Although the loss of United Airlines is a substantial problem for Travelport it is far from the only reason that the business has been in decline in recent years. Expedia, the world's biggest online travel agent, transferred all of its GDS business away from Travelport's Worldspan system, Amadeus has made major inroads into the Middle Eastern markets that had previously been very profitable for Galileo and Travelport is highly exposed to the United States market that has seen the biggest drop in travel agency bookings as airlines rushed to embrace online sales. In addition to these revenue challenges Travelport is unique amongst the major GDS companies in continuing to operate three separate and highly expensive mainframe back-end systems – Apollo, Galileo and Worldspan.

Travelport is also unique in this group of three in having no substantial business outside of airline distribution. Amadeus has a very successful airline IT division that has achieved a dominant position in the market for Passenger Services Systems in top-tier airlines. Sabre has an even more broadly based business supplying software services to meet both the commercial and operational needs of airline customers. These businesses have not materialised out of thin air. Even under private equity ownership both Amadeus and Sabre have continued to invest substantially in product development, something that Travelport has conspicuously failed to do.

These factors along with general turmoil in world financial markets meant that an attempted IPO of Travelport in 2010 had to be withdrawn and there is no early prospect of a new offering. The case due to be heard by a Texas court in June 2012¹ could lead to major changes in the structure of the GDS business, at least in the United States. This will generate further uncertainty about the prospects for the GDS companies and make it highly unlikely that a Travelport IPO could be contemplated before the end of 2012.

The Speculation

Various commentators have forecast the end of the GDS business since at least the turn of the century. For the last decade they have been proved dead wrong but there is no doubt that the pressures on the companies are still increasing. Sabre and Amadeus have both responded positively to the challenges and their business appears secure in the medium term at least. Travelport has not been anything like so forward-looking and is now facing serious issues. Its business is in a downward spiral and the loss of the United hosting contract is just one blow amongst many.

If Travelport is to break out of the spiral it will need inspired leadership, investment in new product lines and the savings that it can make from the consolidation of its three core systems. The loan refinancing it has just announced will buy it some breathing space but it is far from clear whether it will be able to use that space to address the fundamental problems.

Despite the debt burden and the shrinking EBITDA, Travelport is still valuable. Amadeus or Sabre could absorb its subscribers and bookings relatively easily. This would increase volume and drive additional profits. Maybe Amadeus takes North America and Sabre the rest of the World. Travelsky might also see Travelport as an opportunity to make its mark on the global stage.

¹ See "Department of Justice Investigation of Alleged Anti Trust Behaviour in the GDS Industry" a T2RL report dated 18July 2011 and subsequent T2RL news digest reports.