

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.

Expedia Powers Sabre's Offer

T2R Staff

The Facts

Expedia and Travelocity have entered into an exclusive marketing agreement where Expedia will provide the technology behind the Travelocity brand in the US and Canada. The press release is clear that there is no such agreement for lastminute.com in Europe. This follows the sale of Zuji in Asia to Webjet and the disposal of Holiday Autos to Cartrawler.

The Analysis

T2RL sees this announcement as a precursor to a transaction.

Sabre's owners Texas Pacific Group (TPG) and Silver Lake Partners have held the asset since 2007 and will be seeking to exit. The timing is good as financial markets improve and Amadeus's valuation is currently around double its issue price, even with the loss of airline systems customers Virgin Australia, Etihad and the LAN part of LATAM Group to Sabre.

Sabre's purchase in 2007 by TPG and Silver Lake was based on three core business units, Travelocity, Sabre Travel Information Network (STIN, now Sabre Travel Network) and the Sabre Airline Solutions division. At the time Sabre's management believed that Travelocity would fuel a significant proportion of earnings growth and much of the enterprise value was tied to the growth of Travelocity.

T2RL believes that whilst gross bookings grew profits were more challenging. However TPG and Silver Lake together with management supported investment in the Airline Solutions (AS) division. They clearly understood that disengagement from the core airline systems could leave Sabre sitting without the technology and business process capabilities to support the primary source of revenue, airlines. Combined with industry leading sales management T2RL believes that AS has grown its revenues by about 15% per annum to more than 500 million dollars in 2012 with significant additional growth in 2013.

At the same time the Sabre Travel Network (STN) GDS business has remained resilient. Sabre Holdings has sold shares in Sabre Pacific to Abacus and in AXESS back to Japan Airlines. Sabre continues to provide booking and ticketing technology to Abacus and retains some 35% of the company.

Given Amadeus's market performance and the focus on business to business then T2RL believes Sabre wanted to sell Travelocity, so the deal with Expedia is the next best available option. It will allow Sabre to reduce its costs significantly as it becomes a huge affiliate partner and presents a better cash generating business to potential buyers of Sabre Holdings.

The online agency business is difficult. Cost of customer acquisition and marketing dominate the P&L with technology costs a critical factor. Size matters in terms of unit costs and leverage in negotiating supplier agreements. The deal with Expedia will see Sabre focus on customer acquisition and Expedia focus on supplier agreements and technology for consumer Web.

The deal makes sense for Sabre and Expedia and avoids the legal discussion on a full merger. Given the US Government's position on American and US Airways this is timely.

The Speculation

T2RL believes that Expedia remains the largest online travel agency in terms of segments booked through the GDSs. We estimate that Expedia books some 90 million flight segments through the GDSs, and another 4-5 million through direct connections including low-cost carriers that have limited GDS connectivity.

Amadeus has been successful in obtaining a slice of about 20-25 million of Expedia's bookings and this would have placed Sabre under considerable pressure coming up to any kind of transaction.

We estimate that Travelocity generates about 45 million flight segments. We believe that Travelocity would have likely received preferential GDS segment incentives from Sabre to assist the business in its growth ambitions.

Sabre would have sought to secure GDS volumes from Expedia for a number of years to avoid becoming a supplier victim of the increase in concentration of buying power. T2RL believes, given the hidden subsidy from STN at Travelocity that any Expedia deal would actually contribute positively to GDS earnings.

Sabre also owns Synxis, a successful hotel platform with considerable links to Expedia for distribution. By improving the relationship Expedia can move even closer to hotel inventories for improved pricing and market positioning. Securing inventories in the "long tail" of independent properties brings significant value in terms of consumer proposition and cost of contracting. Sabre can bring this to the party.

Finally, Expedia is one of the most efficient online players in terms of conversion, although challenged by Priceline's Booking.com in particular. Sabre has been struggling to provide an efficient and effective ecommerce platform to its airline customers that really competes with the online agents. This deal might just provide an answer. Expedia's most costly challenge is customer acquisition and a much broader affiliates program might be the only way to push earnings growth.