MOODY'S
INVESTORS SERVICE

CREDIT FOCUS

Rate this Research

Amadeus' IT Solutions will continue to deliver strong revenue growth and high profitability

RATINGS

Issuer Rating	Baa2
Outlook	Stable

KEY INDICATORS

	6/30/13(L)	12/31/12	12/31/11
Pretax Income (USD Million)	$1,008.8	$944.8	$937.0
Revenue (USD Million)	$3,875.9	$3,741.9	$3,840.9
RCF / Net Debt	48.1%	41.8%	35.7%
FCF / Debt	18.8%	19.4%	18.7%

Source: Moody's Financial Metrics

Analyst Contacts:

PARIS +33.1.7070.2229

Knut Slatten +33.1.5330.1077
Assistant Vice President - Analyst
knut.slatten@moodys.com

Marie Fischer-Sabatié +33.1.5330.1056
Vice President - Senior Credit Officer
marie.fischer-sabatie@moodys.com

Eric de Bodard +33.1.5330.1040
Managing Director - Corporate Finance
eric.debodard@moodys.com

» **IT Solutions is becoming increasingly important in Amadeus' (Baa2 stable) business mix.** The division has been outgrowing the distribution franchise for a number of years and we expect that the IT division will continue increasing its overall share of revenues in the business mix.

» **Strong market fundamentals provide a high degree of revenue visibility.** The business-model is largely transaction-driven depending upon the total number of passengers travelled. As the business model is supported by very favourable growth prospects for air traffic and a solid backlog of contracted airlines, we expect that IT Solutions will benefit from a high degree of revenue visibility over the next 3-5 years.

» **With contribution margins above 70%, IT Solutions displays profit-margins that are above the group average.** The division benefits from positive operating leverage and profitability grows as the number of passengers boarded increases. The development of new services to airports and hotels will lead to higher R&D expenses over the next 2-3 years and may negatively affect profitability.

» **IT Solutions benefits from high barriers to entry.** Contracts are of a long duration, typically lasting 10-15 years. Barriers to entry are further enhanced by high capex requirements and Amadeus' leading position within the segment.

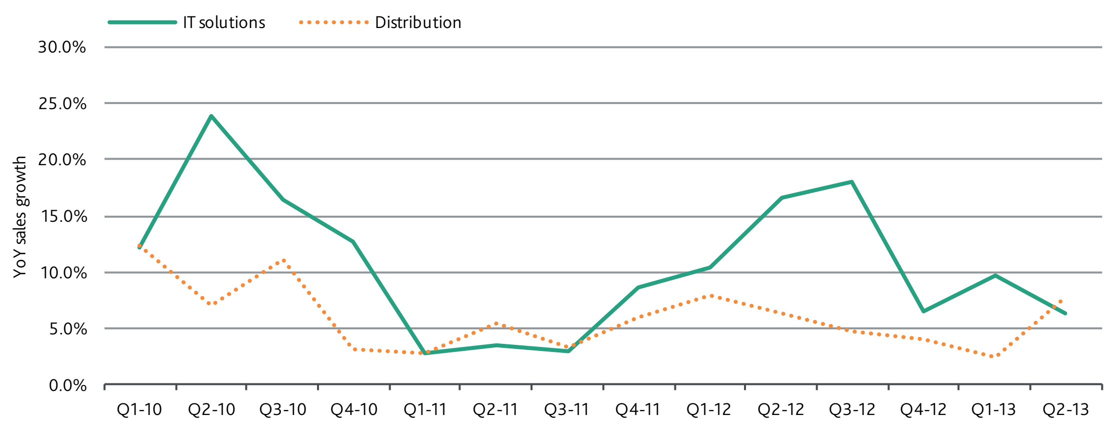
» **A strong presence in IT solutions reduces the overall level of business risk deemed to be high in the universe of travel distribution**. Travel distribution is subject to a number of risks, including the ongoing disintermediation bypassing the Global Distribution Systems (GDS). Whereas customer concentration remains high in IT Solutions, Amadeus' revenue diversification reduces exposure to pure-play travel distribution, which we consider as carrying a higher level of business risk.

» **Bolt-on acquisitions may take place to strengthen existing profile.** Because of the highly consolidated nature of the GDS industry, acquisitions in distribution are highly unlikely. Acquisitions, if any, are therefore more likely to materialise in IT Solutions. We would expect such acquisitions to be bolt-on, financed by the company's free cash flow.

IT Solutions is becoming increasingly important in Amadeus' business mix

In the late 1990s, Amadeus started targeting airlines with various IT solutions. These typically include reservations, inventory management, and other operational processes at airports and often replaced the airlines internally developed legacy systems. Over the past few years, IT Solutions – currently representing 24% of group revenues – has recorded very strong growth and is currently growing faster than the company's distribution business, which has historically been the main revenue driver. Supported by very favourable market fundamentals, we believe IT Solutions' share of total revenues will continue to increase. Amadeus claims it is the leading player in IT Solutions, with a market share of around 25%.

EXHIBIT 1
IT Solutions is growing faster than the distribution-segment



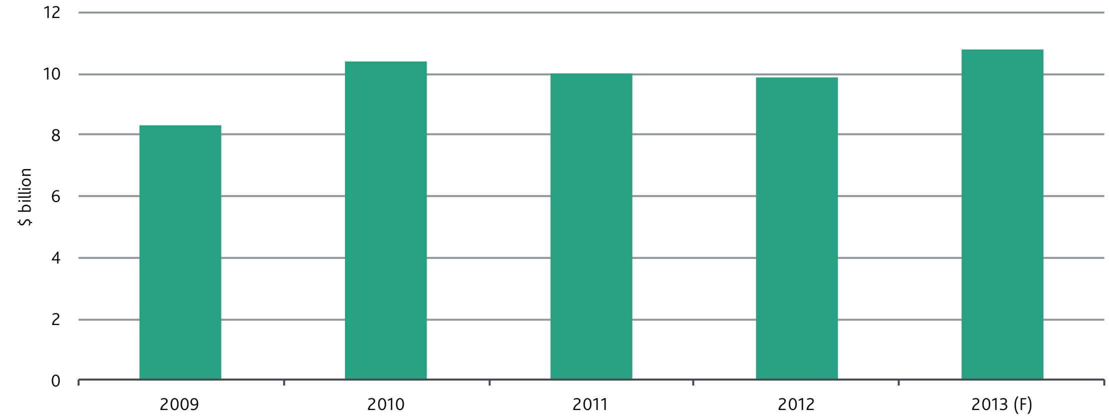
Source: Amadeus

Strong market fundamentals provide a high degree of revenue visibility

The business model underpinning IT Solutions is mainly transaction driven, meaning that the customers (airlines) pay a fixed amount for each passenger boarded when making use of Amadeus' services. Further growth of the airline segment will therefore be driven by an increase in the total number of passengers and/or capturing new airlines as customers. Sita – an airline IT-provider – estimates the market for airline IT operational spend to be around $10 billion in 2013.

EXHIBIT 2

We expect that the market for airline IT spend will continue growing

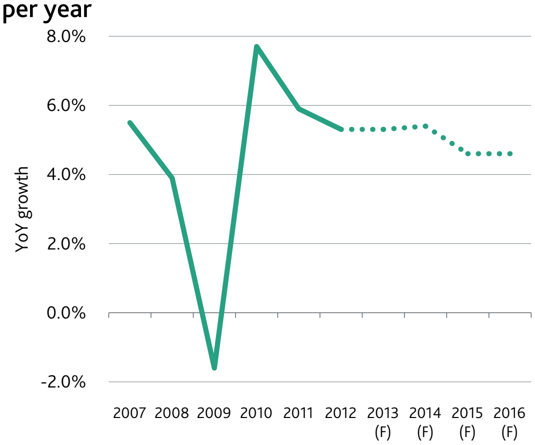


Source: SITA

We expect that Amadeus will benefit from three broader trends, which should boost revenues from airlines IT Solutions. Firstly, air travel has historically tended to grow with a multiplier to GDP-growth and we expect this to continue. IATA expects RPK-growth to be around 5% per year until 2016. However, because of Amadeus' large exposure to Europe, where GDP-growth on balance is anticipated to be lower than global GDP growth, we expect Amadeus' like-for-like growth will be somewhat lower.

EXHIBIT 3

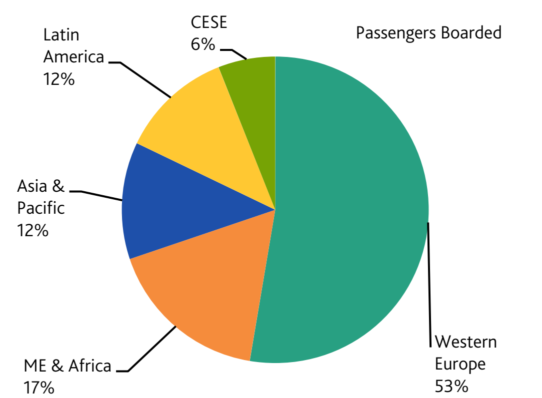
Global RPK-growth expected to be around 5% per year



Source: IATA & Moody's research

EXHIBIT 4

IT Solutions is skewed towards Western Europe



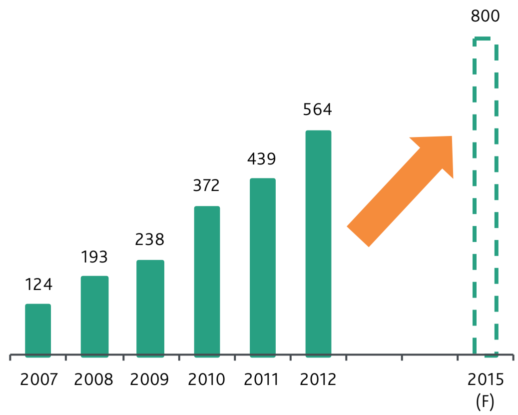
Source: Amadeus annual report

Secondly, we believe that airlines will continue the ongoing trend towards externalising IT-systems as it offers them the possibility of replacing fixed costs with a variable cost. For the next three years, the company's Altea-platform offers a high degree of visibility to future revenues as a number of airlines are expected to migrate onto the platform. This will naturally contribute to an increase in the total number of passengers and Amadeus has communicated that it expects to reach out to more than 800 million passengers by 2015. Amadeus has a very strong position in the European market, but is currently not running any of the passenger service systems (PSS) for the large American airlines. We note this over time may constitute a substantial opportunity.

EXHIBIT 5

Passengers Boarded projected to reach 800 million by 2015

Passengers Boarded (PB)



Source: Amadeus and Moody's Research

EXHIBIT 6

Pipeline of contracted airlines remains healthy

SAS, Cathay, Singapore Airlines	2012
Czech Airlines	January 2012
EVA Airways	H1 2013
Thai Airlines	H2 2013
Asiana	H2 2013
Garuda Indonesia	H1 2014
Southwest (Intl)	H1 2014
Other undisclosed	H1 2014
Korean Air	H2 2014
All Nippon Airways (Intl)	H1 2015

Source: Amadeus

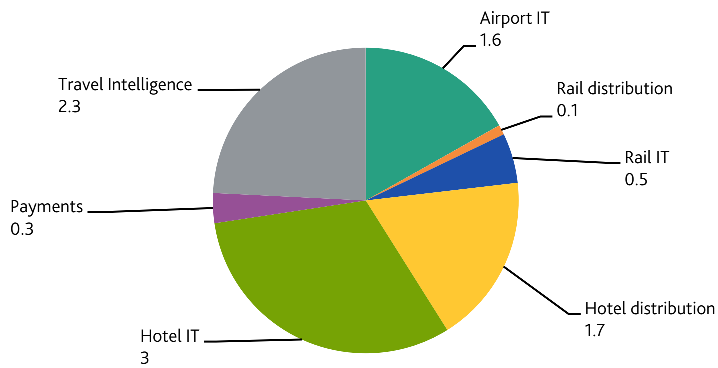
Thirdly, we would expect the company to benefit from an increasing share of business with low-cost carriers (LCCs). Recently, an increasing number of LCCs (mainly in Western markets) have opted to partly move towards indirect distribution models in order to reach out to the more profitable corporate segment. This has proven difficult to do only through direct distribution and Amadeus has recorded strong growth – albeit from a low base – of LCCs in their distribution business. As the low-cost carriers evolve from a pure-play low-cost model towards a more hybrid model combining direct and indirect distribution, we believe there is an increasing need for investments into IT Solutions to accompany these changes and we expect that Amadeus will benefit from this trend over the medium term. However, Amadeus currently has a modest market share globally within this segment, although it benefits from stronger positioning in Europe.

Amadeus' IT Solutions also has medium-term favourable growth prospects beyond IT provisions to airlines. In particular, the company is focusing on new segments including airports, hotels and railways, three segments the company estimates to have a market value for IT Solutions of EUR9.6 billion. Amadeus believe they can achieve a minimum of 10% market share over the next 10 years with a contribution margin between 40%-60%. In June, Amadeus signed an agreement with the airports in Munich and Copenhagen over the development and implementation of a new IT product portfolio.

EXHIBIT 7

IT Solutions has favourable medium-term growth prospects beyond airline IT

Market value new segments (€ billion)



Source: Amadeus

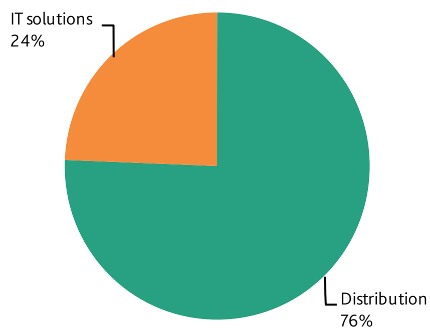
IT Solutions segment has a higher contribution margin than GDS

As of FY2012, IT Solutions represented 24% of Amadeus' total revenues. Its share of contribution (defined by the company as revenue for the relevant operating segment less operating direct costs plus direct capitalisations and incentives) was nonetheless much higher at 35%.

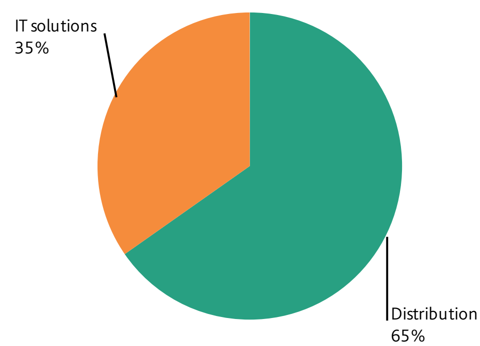
EXHIBIT 8

IT Solutions is more profitable than Distribution

Revenues



Contribution

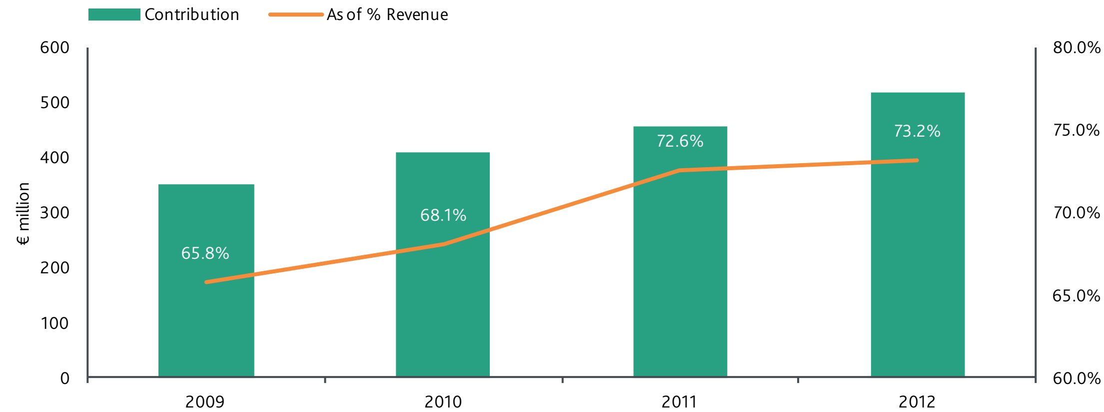


Source : Amadeus annual report 2012

IT Solutions benefits from a high degree of operational scalability. For example, the company's largely standardised Altea-platform has allowed for cost-synergies to be extracted as part of the development costs are shared with its customers. The marginal costs of adding a new client to the platform is small and has allowed for profitability to grow strongly over the past few years as an increasing number of airlines have signed up as clients. IT Solutions should therefore continue benefiting from a solid level of profitability as more transactions take place in line with the expected increase in the number of passengers travelling.

EXHIBIT 9

IT Solutions profit margins increases with scale



Source: Amadeus annual reports

However, the lead time from when a new product is being developed until it contributes positively to operating profit is long. Amadeus may incur significant development costs during a start-up period as solutions are being implemented with customers. This is particularly true for customers choosing fewer solutions than the full package the Altea suite offers. As such, Amadeus may see that contract-wins need a pick-up period of some time before they contribute positively to operating profit. The company is currently increasing its investments into R&D among others in order to position itself for the entry into airport and hotels. This may therefore have a negative impact on profitability in the next 1-3 years.

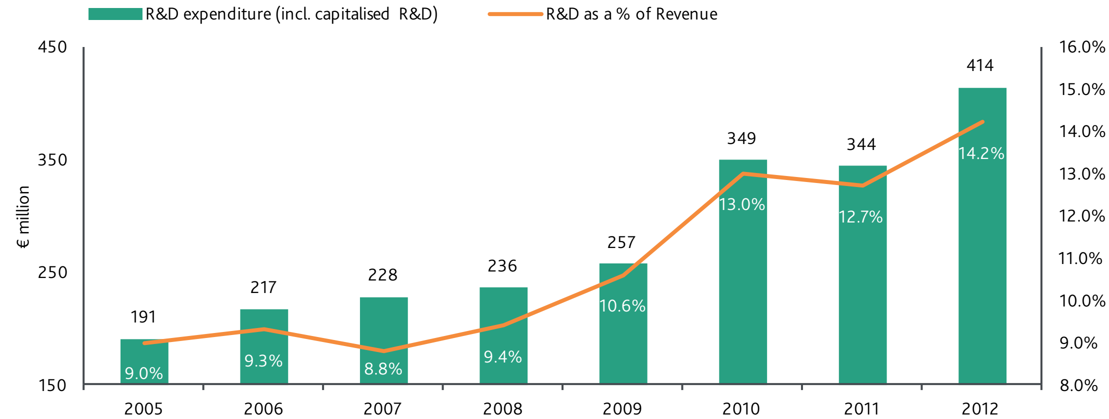
IT Solutions benefit from high barriers to entry

IT Solutions benefit from high barriers to entry. Notably, the contracts are of a long duration and typically last between 10-15 years. Furthermore, there is some protection in the long lead time from project start-up to implementation of Amadeus' IT Solutions as this ramp-up period may require significant resource commitment from the customer, thereby contributing to increased switching costs.

In order to establish and maintain a sophisticated platform, Amadeus has made significant investments into the relevant infrastructure, such as data-centres, and committed high amounts to R&D every year. We believe that the level of investment needed to operate a satisfactory system represents such a high cost that most airlines – given their slim profit-margins – would rather apply their resources on core business activities.

EXHIBIT 10

Significant level of investments represent a barrier to entry



Source: Amadeus and Moody's Research

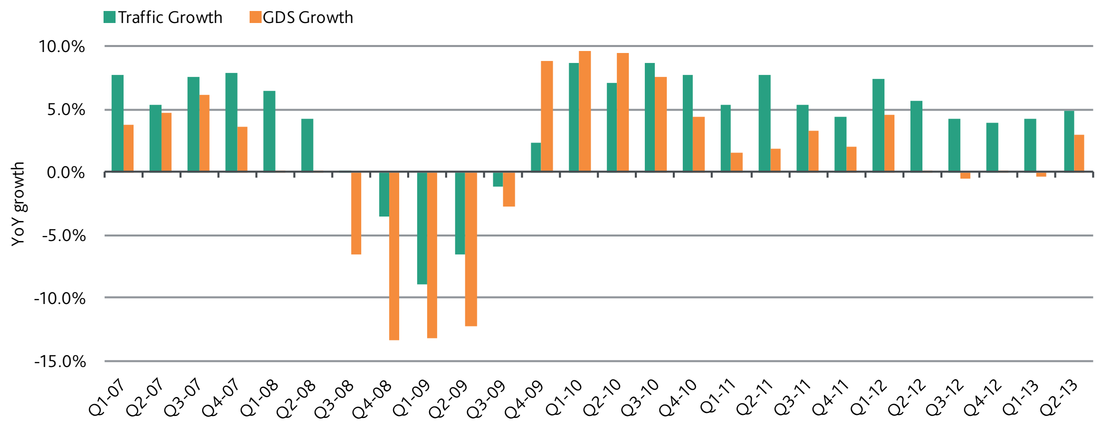
Lastly, we believe Amadeus' already strong competitive positioning within the segment constitutes a significant barrier to entry. In tandem with a continued increase in market shares, Amadeus will be benefiting from further economies of scale and other players may therefore find it challenging to take market shares away from Amadeus. Furthermore, airlines as a cohort does not constitute a very large group. For example, IATA counted 238 airline members as of August 2013. As of June 2013, 108 airlines signed up for its Altea platform, with contracted signings expected to take the number to 121 by 2015.

A strong presence in IT Solutions mitigates overall high business risk in distribution

The travel distribution industry has a high degree of business risk, notably the risk of GDSs being bypassed in the value chain. This has predominantly been fuelled by the success of LCCs which have traditionally shied from direct distribution. However, we also note that airlines have been increasingly successful in attracting customers directly to their own platforms and, as such, contributed to a disintermediation-trend which is likely to continue. The GDS industry is growing at a slower pace than RPK-growth and the industry's share of total bookings therefore continues to decline (although they retain around 60% of the total value as per IATA). IATA is seeking to implement a new model of distribution (NDC). While still lacking details with high uncertainty on the ability to develop an investment and business model for such, we believe the NDC could represent a disruptive change for the GDS industry should it lead to a bypass of the GDS's.

EXHIBIT 11

The GDS-industry is growing slower than traffic because of disintermediation



Source: Amadeus & Moody's research

Secondly, GDS providers, travel agencies and airlines are all part of the same supply chain and each one can gain market share or pricing power from another. As such, Amadeus may in its distribution-franchise be subject to pricing-pressure as contracts are being renegotiated.

Thirdly, we note that Amadeus – in line with its peers – has a high degree of customer concentration where its top five customers represent a substantial portion of its revenues (around 27%-28% of annual revenues over 2007-09). As such, we consider they may be vulnerable towards the loss of contracts which could occur through contracts not being renewed or as consequence of consolidation among its customers (airlines or large travel agencies).

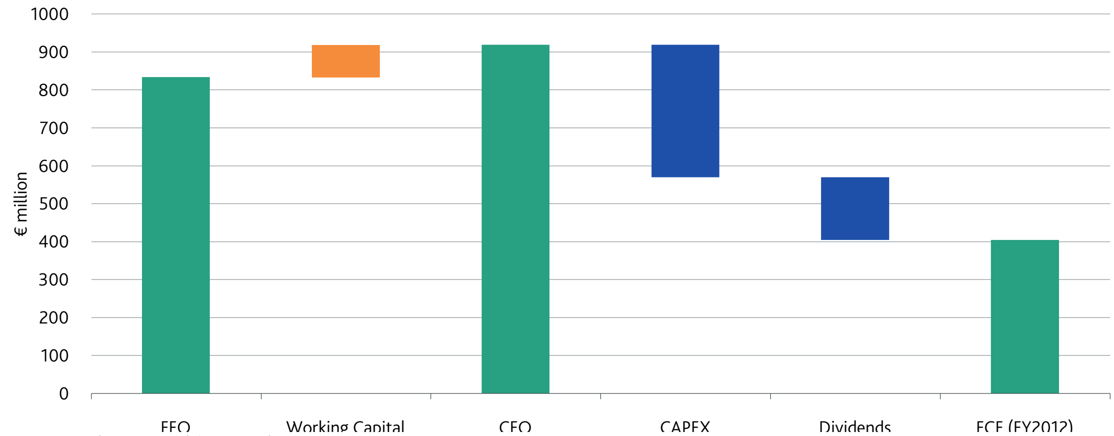
Whilst client concentration within IT Solutions is even higher than for the group as a whole, we nonetheless believe the increasing importance of IT Solutions will mitigate the inherent risks related to the distribution activity as it offers a second leg of operations. IT Solutions also offers the possibility of capturing new types of customers such as airports and hotels which reduces the concentration to airlines as the end-customer.

Event risk somewhat higher in Solutions

In between them, the three GDS's – Amadeus, Sabre and Travelport – dominate the accessible market of indirect travel distribution. Consequently, we believe further consolidation within distribution to be highly unlikely because of potential anti-trust concerns. Acquisitive activity, if any, is therefore likely to arise in IT Solutions. We would not expect Amadeus to embark upon large debt-financed acquisitions, but rather complement its existing profile with small free cash flow financed bolt-on acquisitions. Amadeus has very solid free cash flow, which amounted to around €400 million in 2012.

EXHIBIT 12

Potential acquisitions are expected to be funded by the company's solid free cash flows



Source: Amadeus & Moody's Research

Whereas we would expect free cash flows to come down somewhat over the next two years because of capex increases, we nevertheless believe the company should generate sufficient funds to finance potential acquisitions with internally generated funds. However, acquisition multiples in this type of industry tend to be high.

Moody's Related Research

Credit Opinions:

» Amadeus IT Holding, S.A.

» Travelport LLC

» Sabre Holdings Corporation

Rating Methodology:

» Global Business & Consumer Service Industry Rating Methodology, October 2010 (127102)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Rate this Research

Report Number: 158193

Author
Knut Slatten

Editor
Shem Pennant

Production Associate
Masaki Shiomi

MOODY'S
INVESTORS SERVICE