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## Research Update:

# DRAFT: Spain-Based Amadeus IT Group S.A. 'BBB/A-2' Ratings Affirmed; Outlook Positive

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**DRAFT**

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# DRAFT: Spain-Based Amadeus IT Group S.A. 'BBB/A-2' Ratings Affirmed; Outlook Positive

S&PGR Affirms Spain-Based Amadeus IT Group 'BBB/A-2' Rtg

## Overview

- Spain-based Amadeus IT Group S.A. (Amadeus) is a major transaction processor for the travel and tourism industry, which provides solutions to travel providers (including airlines, hotels, and rail operators) and travel agencies (both online and offline).
- In our view, the group has consistently delivered solid operating performance--its metrics for year end 2016 and the first quarter of 2017 were stronger than anticipated. We are therefore affirming our 'BBB/A-2' ratings.
- We anticipate that the group will undertake a sizable extraordinary shareholder distribution by year-end 2017, unless it sees an attractive acquisition opportunity.
- The positive outlook reflects our expectation that we could raise the ratings over the next 12 months if Amadeus' pace of leveraged acquisitions or shareholder remuneration remains roughly in line with our expectations and it maintains S&P Global Ratings-adjusted leverage metrics around 1.5x and funds from operations to debt above 45%.

## Rating Action

On July 18, 2017, S&P Global Ratings affirmed its 'BBB' long-term and 'A-2' short-term corporate credit ratings on Spain-based Amadeus IT Group S.A. The outlook remains positive.

We also affirmed our 'BBB' issuer ratings on the group's senior unsecured debt.

## Rationale

Amadeus continues to deliver strong operating performance and its credit metrics have improved slightly during 2016 and into 2017. For year-end 2016, Amadeus' S&P Global Ratings-adjusted debt to EBITDA improved to 1.5x from 1.6x in 2015 and funds from operations (FFO) to debt to 46% from 45.7%. In terms of profitability, adjusted EBITDA margin improved 160 basis points to 31.7%, mostly because of an increase in average pricing in the IT solutions segment due to successful upselling strategy and additional contribution to margins from the New Business Unit (NBU), including Airport IT and Payments. That said, competitive pressures weighed on margins in the Global Distribution System (GDS) segment.

During the first quarter of 2017, results continued to strengthen as a result of the consolidation of Navitaire, and the positive evolution of GDS and IT solutions. Overall revenue growth grew by 11.7%. In the GDS segment, revenue grew by 11.4% through volume growth and expansionary average revenue per booking, combined with a further gain in market share. In IT solutions, the number of passengers boarded increased by nearly 25% year on year, mostly on account of Navitaire, but also driven by organic growth of about 7%, and hindered by the timing of Easter. Margins remained broadly stable.

Given the group's relatively low reported net leverage (1.1x as of March 31, 2017) and sizable cash balances (about €815 million as of May 31, 2017), we expect the group to undertake a sizable extraordinary shareholder distribution by year-end 2017, unless it sees an attractive acquisition opportunity. This would weaken the current credit metrics, and so prevent the company from achieving metrics that we would consider commensurate with a 'BBB+' long-term credit rating. Until the magnitude of any potential distribution is made clear, we are therefore refraining from raising the rating.

Our assessment of Amadeus' business risk profile takes into account the company's solid market position as an IT service provider to the global travel industry. It has market-leading positions in Europe and several emerging markets. In essence, a GDS like Amadeus acts as an intermediary between travel suppliers (including airlines, hotels, and car rental companies) and travel agencies, online travel agencies, and corporations. As such, it gathers inventory information (such as airline seats and hotel rooms) from those suppliers.

Amadeus generates revenues from booking fees paid by travel suppliers and sellers, as well as from technology solutions that enhance core operations to travel businesses such as analytics, inventory, revenue management, departure control, and payments. Although the GDS market is substantially consolidated--it has just three major players--the market is highly competitive, and some of its customers (in particular commercial airlines) continue to exert pressure on fees and push for alternative distribution platforms. For example, International Airlines Group (IAG) recently announced that it plans to add a €9.5 surcharge to bookings made through the indirect channel from November 2017 onward. This has drawn attention to the debate over the role of GDS'.

In recent years, Amadeus has proved that it can even achieve growth in this context. Ultimately, such surcharges have a favorable impact on profit because the bookings that remain in the system are typically long-haul bookings that are more profitable and carry higher prices. In addition, discounts for full content deals are eliminated. Lufthansa implemented a similar surcharge about 18 months ago, and we expect Air France-KLM (AF-KLM) to add a similar surcharge when its contract expires in 2018. We do not currently anticipate that these surcharges will have a significant impact on profitability.

Amadeus' IT business is growing faster as airlines seek to cut costs and

increase productivity by outsourcing the managing of IT infrastructure to Amadeus. In our view, this segment is becoming increasingly relevant to Amadeus' overall performance and the recent acquisition of Navitaire has strengthened Amadeus' business risk profile. Acquiring Navitaire enabled Amadeus to expand into the low-cost-carrier and hybrid markets, expanded its geographic reach in the Americas, and also offered integration opportunities for both the Altéa and New Skies customers. These customers can access new solutions in the revenue management and e-commerce areas.

We also expect new lines of business, particularly hospitality and Airline IT, to continue to drive performance. We expect InterContinental Hotels Group to migrate to its new central reservation system and property management system in the last quarter of 2017. A successful migration of such a large and complex group should encourage other hotel chains to join this platform.

Amadeus' operating profitability, measured by EBITDA, demonstrates relatively low volatility, and its margins of consistently above 30% are markedly stronger than for main peers, Sabre Holding and Travelport. Our expectation that Amadeus will maintain its EBITDA margins is based on its sound track record of successfully integration acquisitions and capitalizing on efficiency gains. We also expect the recent announcements by IAG, and likely AF-KLM to follow, to support margins, although bookings are likely to decline somewhat. In addition, the company benefits from high barriers to entry in global travel distribution systems and IT services, which operate under medium- to long-term contracts.

Our view of Amadeus' financial risk profile reflects its ability to consistently generate solid free operating cash flows, tempered by relatively high dividend distributions.

In 2017, we anticipate that credit metrics will weaken slightly given that we forecast extraordinary shareholder returns. That said, metrics are likely to return to 2016 levels in 2018. We anticipate that strong profitability, a relatively flexible operating cost structure, and favorable working capital movements will enable Amadeus to continue generating solid cash flows over the next 12-24 months.

In our base-case scenario for 2017-2018, we assume:

- Amadeus will follow a trend of increase in passenger volumes, fueled by world GDP growth.
- Global GDP growth, excluding China, forecast at 3.1% in 2017 and 2018.
- Revenue growth of about 5% over the next 12-24 months, supported by continued volume growth and market-share gains in the company's GDS segment and growth in its IT solutions segment of 6%-8%, fueled by migrations and new products.
- Relatively stable EBITDA margins as the increased weight of IT Solutions segment, which bears higher margins, is partially offset by ongoing commercial pressures from rivals in the GDS segment;
- Expected revenues of €4.65 billion-€4.9 billion in 2017 and 2018 and annual capital expenditure (capex) of about 13%-15% of expected revenues.

- A dividend payout of about 50% of net income, at the higher end of Amadeus' public guidance. For 2017, we expect about €1 billion in dividend distribution, including extraordinary shareholder returns.

Based on these assumptions, we arrive at the following credit measures:

- Adjusted leverage metrics of 1.6x-1.8x in 2017, improving toward 1.4x-1.6x in 2018;
- Adjusted FFO to debt of about 38%-42% in 2017, improving toward 44%-48% in 2018; and
- Adjusted discretionary cash flows to debt of about 11.5%-15.5% in 2017, improving toward 12.5%-16.5% in 2018.

Amadeus' financial policy constrains its rating. This reflects our belief that the group's debt-financed acquisitions and returns to shareholders could increase the current leverage profile from the stated 1.0x-1.5x target, excluding our adjustments.

We assess Amadeus' management and governance as strong. This mainly reflects our view of the group's sound track record in planning, strategy, and execution, as well as the experience of its broad management team.

## **Liquidity**

We have revised our assessment of Amadeus' liquidity to strong from adequate to reflect the company's track record of prudent liquidity management, including sizable cash balances, limited debt maturities, and our expectation that it will report healthy cash flow from operations over the next 12-24 months. Our assessment incorporates the following expectations and assumptions:

- Liquidity sources will exceed uses by more than 1.5x over the next 12-24 months;
- Liquidity sources less uses will remain positive, even if EBITDA falls by 30%;
- The company can absorb high-impact, low-probability events, without refinancing, given its sizable cash balances; and
- The company has well-established and solid relationships with banks and a sound standing in both equity and debt capital markets.

We anticipate the company will have the following principal liquidity sources over the next 12 months:

- Cash and equivalents of about €475 million, as of March 31, 2017;
- Available revolving credit facilities of €1 billion maturing in 2020 and 2021;
- Our expectation of about €1.4 billion of FFO; and
- New bond of €500 million issued in May that matures in 2019.

We anticipate the company will have the following principal liquidity uses over the same period:

- Reported short-term financial liabilities of about €465 million;

- Capex of about €640 million; and
- Our estimate of about €1 billion in dividends, including extraordinary distribution to shareholders.

In addition, Amadeus has ample headroom under the two financial covenants (maximum leverage of 3.0x and minimum interest coverage of 3.0x), which offer material leeway for operating underperformance or acquisition activity.

## Outlook

The positive outlook reflects our expectation that we may raise the corporate credit rating on Amadeus over the next 12 months if the company's good operating performance, revenue, and EBITDA expansion continue and it successfully counters the ongoing disintermediation pressures. Any upgrade would depend on Amadeus adhering to its stated financial policy.

### Upside scenario

We could raise the rating if we expect that Amadeus' pace of leveraged acquisitions or shareholder remuneration will remain roughly in line with our expectations. This would mean that adjusted leverage metrics remain about 1.5x and FFO to debt above 45% on a sustainable basis. We would also look for continued organic growth, at least stable profitability, and improved market share (through new product offering, for example) and to see that the company was successfully countering ongoing disintermediation pressures.

### Downside scenario

We could revise the outlook to stable if Amadeus' operating performance and growth underperform our base-case scenario because of increased competition, such that the company's revenue growth trajectory and margin profile are permanently weakened. Additionally, we could revise our outlook or lower the rating if the company adopts a more-aggressive financial policy that pushes adjusted leverage metrics toward 2.5x or discretionary cash flows to debt below 15% on a sustained basis.

## Ratings Score Snapshot

Corporate Credit Rating: BBB/Positive/A-2

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb+

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Negative (-1 notch)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

## Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Leisure And Sports Industry, March 5, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Technology Software And Services Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

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