

Travel and Hospitality Tech Mergers and Acquisitions Hot Now. What's Next?



By John Rovani

Buy low and sell high.

Just keep doing that and you'll do just fine in business and investment. Most of us can't time it quite as well and for those folks, here are a few morsels of presumed wisdom in mergers and acquisitions (M&A).

As always, there's good news and bad news, no matter if you're buying or selling. If you're thinking of selling, the message is that multiples are high. If you're buying, the signs suggest patterns similar to the real estate boom. If you consider taking your time there will be bargains to be had. Next year, however, you might wish you'd bought at today's valuation multiples.

There's still plenty of activity and multiples continue to be high if you're the seller of a hot business with certain characteristics. These include: recurring revenue streams, long-term contracts with your clients, unique and proprietary (preferably patented) technology solutions or a large and diversified portfolio of clients who speak highly of your business. In general terms, typical publicly reported M&A valuation revenue multiple averages are as follows for the following types of companies:

| Business-to-business (B2B) travel technology is in the twos

| Business-to-consumer (B2C) travel technology is at four to five times revenues

| Online travel agencies are closer to five, and

| Online merchants command closer to six times earnings as a multiple.

Earnings before interest, tax, depreciation and amortization (EBITDA) multiples are always the preferred measure of true valuation. However, in a world filled with young companies possessing exciting new products and little history, other valuation measures will be considered. Revenue multiples are always more likely to be reported than EBITDA multiples.

In hospitality technology, M&A activity continues to increase and remains very focused. In the last year, most activity was concentrated in specialized product area providers that were recognized needs for larger players. Examples included reservation service providers such as SynXis, acquired by Sabre; yield management and property management system companies such as Optimis, acquired by Amadeus; and, Springer-Miller, acquired by PAR Technology; distribution with a variety of acquisitions by Cendant and Priceline.com and other product areas including kiosk software like Kinetics' acquisition by NCR and pager systems such as the JTECH acquisition by MICROS Systems).

One possible – but by no means absolute – interpretation might be that the industry could be in a hospitality technology price bubble. While it can't be specifically concluded, data shows that to be the case with the hospitality tech companies in the Hospitality Technology Index¹.

Performance of Hospitality Technology Stocks as compared to the S&P 500 and the NASDAQ 100 have outperformed both the NASDAQ 100 and the S&P 500 over the past six years. It is believed that the corresponding market cap increase for these companies means bigger war chests for M&A work and increased interest in exploring M&A deals.

The recent acquisition of Retek by Oracle after a bidding war with SAP demonstrated

increased interest in enterprise resource planning companies moving into specialized front and back office applications for retail technology. This could quickly spill into the hospitality sector.

It's an odd market right now,

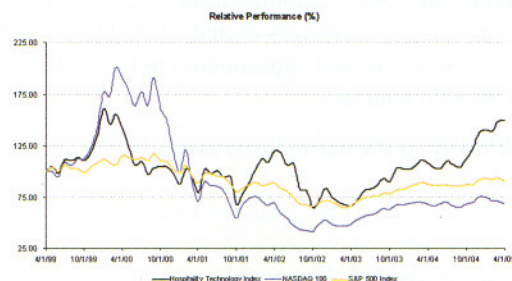
perhaps turning upside down from recent patterns. The consolidators – once the leading acquirers – are either being acquired such as Amadeus, or are experiencing temporary bumps in the road like Cendant, which just posted a first quarter 2005 financial loss. Some big players face increased competition from new entrants in electronic travel distribution (for example G2 SwitchWorks and ITA Software) that threaten their core cash cow businesses.

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Significant and far-reaching changes might be ahead.

Legg Mason analysts believe the airlines might be using a new deal with G2 SwitchWorks to drive down global distribution systems' (GDS) prices. The company said recently, "In what we believe to be a negotiating move on the part of the airline industry, G2 SwitchWorks ... signed agreements with seven U.S. airlines to provide travel distribution solutions. Five of the airlines pre-paid distribution fees for up to \$8 million tickets in ex-

Performance of Hospitality Technology Stocks as compared to the S&P 500 and the NASDAQ 100



change for discounted fees and a possible minority equity stake in the company. We believe this equity stake, which we would peg around \$25 million, is a cash infusion for a young business lacking capital.”

If that was a warning shot, then deep cutbacks should be expected in the resources available to fund acquisitions and consolidation by the GDS giants. Amadeus might stand down from acquisitions for a while, much as Worldspan did after it was acquired by private equity groups. Other past consolidators such as Pegasus (NASDAQ: PEGS) are themselves on the block, according to news reports.

While Worldspan's story is more complicated, the essential fact is that investors sought a quick return on their investment. The result included large-scale cutbacks and reduced business activity with the possible intent of reselling quickly. This pattern might be repeated elsewhere.

There are other indicators that the market might not sustain higher share or equity prices for much longer.

Fuel prices are increasing. The cost of oil is above \$50 a barrel and the gloomsayers are predicting \$100 per barrel within 18 to 24 months. Discretionary spending on things like travel, entertainment, restaurant meals, many online purchases, new furniture and automobiles will quickly slow as jobs disappear and marginal enterprises fold.

For example, airlines do their budgeting and pricing at \$35 a barrel. They start to hurt at \$40. At \$50, no airline, not even the vaunted Southwest can make a profit. The only hope is that there's enough cash or assets to leverage to ride things out until fares go up or oil comes back down.

The prospects for financially-troubled airlines get far worse with every dollar hike in the price of oil. However, many of the airlines are reporting average monthly load factors in excess of 70 percent in recent months and the general wisdom says at average loads of 70 percent and up, demand starts to outstrip capacity. The problem is that with high-priced oil, airlines can't charge enough per revenue passenger mile to make a profit even when the planes are full. The situation will get worse if the oil situation

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continues to deteriorate.

It's also no secret that inflation is creeping upward, and the Federal Reserve Board of Governors continues its pattern of increases in the discount rate, bumping up the recent favorably low price of money. In theory, that checks inflation and makes the U.S. dollar and debt more attractive to investors, but it also means tighter belts, thinner wallets and less to spend on the discretionary side.

The economy is slowing and unemployment, low by most standards, remains stubbornly high by U.S. standards at around five percent. GDP growth remains low and if the economy isn't expanding at a reasonable rate, discretionary spending is the first area affected.

Ominously, the stock market is drifting sideways to lower, bumping up and down day to day. The Dow-Jones Industrial Average, for example, reached 10,800 a few weeks ago, and has recently tracked at 600 to 700 points below that. While that's a good number compared to a few years ago — nobody remembers when it was at 5,000 or 6,000 — it now falls into the “what have you done for me lately?” category. Confidence is eroded, the economy takes a hit and only those with steel nerves and significant needs will make daring acquisitions.

There are some givens in the landscape. End-users are looking for products that bridge legacy and new technology, with corresponding features and functions that leverage the Web and economies of scale. One of the consequences is that the market is highly fragmented, and the players are in pursuit of market share in

these specialized areas rather than at the broader systems level.

Suppliers are going directly to consumers with initiatives intended to reduce the effectiveness and cost of doing business through intermediary providers like Expedia/IAC, Travelocity/Sabre and Amadeus/Opodo. Airlines and hoteliers typically offer bonus frequent flyer mileage/stay points or other incentives with no service charges to those who will book direct on the supplier's Web site rather than through an intermediary. The merchant model is in jeopardy of losing its luster as its access to travel and hospitality inventory is reduced by the suppliers' activities.

The M&A market in travel and hospitality technology is likely to continue with new players such as Google, AOL and Yahoo as these portals and meta-search players seek to play in distribution. However, we are in a more mature phase of M&A. From the seller's perspective, there may be fewer acquirer options causing the multiples to gradually come down at the end of a cycle within the next 12 to 18 months.

Despite this and for now, multiples for travel and hospitality technology providers remain high, but the question is how long this will remain given present trends. Would-be sellers or acquirers need to be aware of the prevailing conditions in the market. Once the partners are picked, the dance inevitably must end and valuation multiples must come down. Hence, sell high and buy low continues to make a lot of sense for those who can afford to time things appropriately.

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¹ Hospitality Technology Index includes the following companies: Agilysys Inc. (AGYS), JDA Software Group Inc. (JDAS), Micros Systems, Inc. (MCRS), NCR Corp. (NCR), Par Technology Corp. (PTC) Pegasus Solutions Inc. (PEGS), and Radiant Systems Inc. (RADS).

Hospitality Upgrade

The Technology Source

HTNG at HITEC
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Centralized Systems

Next Generation or Lost Generation?



Check your Ego!

A review of the industry's first-ever Vendor Summit

The Future Destination

Our interview with Shannon Knox, VP of Technology for Destination Hotels & Resorts

Take this E-mail and Shove It

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