Why Consolidation Is Taking Hold in Hospitality Technology

by John Rovani

Travel technology infrastructure companies and travel distribution players, both on and offline, have been actively consolidating since the start of the new millennium. Hospitality technology providers joined them in 2003.

In hospitality technology transactions that have drawn attention are: Pegasus Solutions and Unirez, VIP International and Lexington Services, SynXis Corporation and hubX, and the acquisition of Aloha (a POS and PMS provider) by Radiant Systems.

There were as many as 250 significant merger and acquisition transactions in the travel and hospitality technology market in the past four years. The common denominator is the presence of increasingly sophisticated software to track, allocate and manage inventory and prices and to secure bookings. So far, the companies in this niche have been small and their markets fragmented. Even so they represent mass in the marketplace and the ability to leverage enterprise-wide ERP financial and human resources, reporting, data mining, cost, revenue and yield management tools. Most importantly, they are also a source of innovated, new technology.

This new mass permits greater control of inventory and price, ensuring a more stable flow of higher-margin revenue and a base from which to try new approaches in the infrastructure and retail markets. Global distribution systems (GDS) – the big travel agency airline booking systems – already pursue this. Sabre and Amadeus are accomplished business application providers to hundreds of airlines. Some focus on the merchant model and others on owning, operating and providing end-to-end business solutions. Amadeus' investment in France's Optims hotel booking, property and yield/revenue management tools is an example of the latter.

Grow or die. That is true for the big GDS as well as for small players in niche markets. Standing still means shrinking. Downsizing to profitability is a very chancy strategy, as any airline knows. Merger and acquisition remains the best way to grow quickly, foster innovation and create a single, more powerful entity. If independent growth isn't an option, what is the strategy? Deciding to decide later is no strategy at all. Business moves far too fast not to have a firm idea of the next steps.

The Boston Business Journal wrote that companies in acquisition mode seek "a real, growing business, not just technology or a great idea; a large enough market to make it worthwhile; later-stage situations with products, customers, meaningful revenues; profitability or near-profitability with clear and rapid path to accretion…."

Higher prices are paid for companies that offer synergistic growth potential, a solid client base, good people, skills, technology and products, and consistent, diversified revenue streams with growing profits. Companies that fetch lower prices are those with shrinking or stagnating markets, technology or revenue; limited or low-revenue client lists and wild swings in revenue.

High-growth, scalable and profitable business-to-consumer companies typically bring premium valuations. Business-to-business providers are likely to see lower revenue and earnings growth potential than business-to-consumer counterparts. They will likely bring lower multiples. Companies lacking the revenues to grow or acquire will be attractive acquisitions only if they offer something – capacity, technology, a market niche or clients, perhaps a tax loss – attractive to a potential acquirer.

How is an acquisition offer or asking price calculated? Similar businesses often have different valuations. The basic question on value is: Can money be made and if so, how much?

What drives value? What will a potential acquirer consider before making an offer to purchase a company?

1. Cash Flow—Cash flow, not revenue, drives value. That doesn't necessarily mean profits, but the generation of cash that can be leveraged until it is needed to settle accounts. Profits are not absolutely necessary when determining value. Don't forget potential tax-loss benefits from an acquisition that involves high cash flow but little or no U.S. generally accepted accounting principles (GAAP) accounting profits.

2. **Revenues—**An acquirer wants to buy market share. However, even with limited revenues and prospects, a small business can be valuable if it has certain positive assets that are attractive to a buyer.

3. **Profits—**Profits coupled with cash flow are desirable as part of the value equation. The accretive effect of the accounting profits must be analyzed also. In terms of overall value, just as much depends on what the acquired company brings in terms of market share, technology and its unique niche.

4. **Technology—**Technology is a major value driver. Desirable elements include current programming languages, technology platforms, a useful selection of databases, the ability to deliver solutions remotely, scalability, reliability and ease of training and use. A good illustration is the recent Amadeus acquisition of Airline Automation, Inc., a supplier to airlines and hotels.

5. **Growth Prospects—**Logic says a company with high growth rates and large market potential will command much higher multiples than a mature company with level or shrinking revenues. An example is a company like online travel agency Expedia, which will command a far higher multiple because of market size and growth potential than will firms such as Unirez or Lexington Services, both of which are business-to-business firms with markets of limited scope.

6. **Revenue Attributes—**The best revenues are recurring, reliable and consistent over the long term, supported by a steady backlog. The customer base ought to be made up of long-term contracts spread over a variety of industries, businesses or organizations.

7. **Margins—**What do earnings look like before interest, taxes, depreciation and amortization (EBITDA)? Do gross profit margins compare favorably to the industry as a whole?

8. **Balance Sheet—**A company's balance sheet should always be reviewed in detail for what is there and for what might be missing. Balance sheets should be inspected for additional value such as cash, excess working capital and non-operational assets. Net operating loss carry-forwards are often missed. Some buyers will recognize this off-balance-sheet value while others will not.

9. **People—**People are the company, but for stability and growth there must be a detailed succession plan for qualified new leaders, some of whom might not be the founder's relatives. Companies need well-rounded teams with a variety of appropriate skills. Key players must be identified and given the necessary incentives for retention, including the training and education they will need.

Next in line to join the consolidation game will be companies that manipulate and analyze data, including hotel/restaurant unit reporting providers, yield, channel and customer relationship management firms and perhaps property management and point-of-sale system vendors.

The trend is a natural development in an industry populated by literally hundreds of small to medium-sized companies in pursuit of market fragments. It's time to rationalize and to grow fewer, larger and stronger enterprises.

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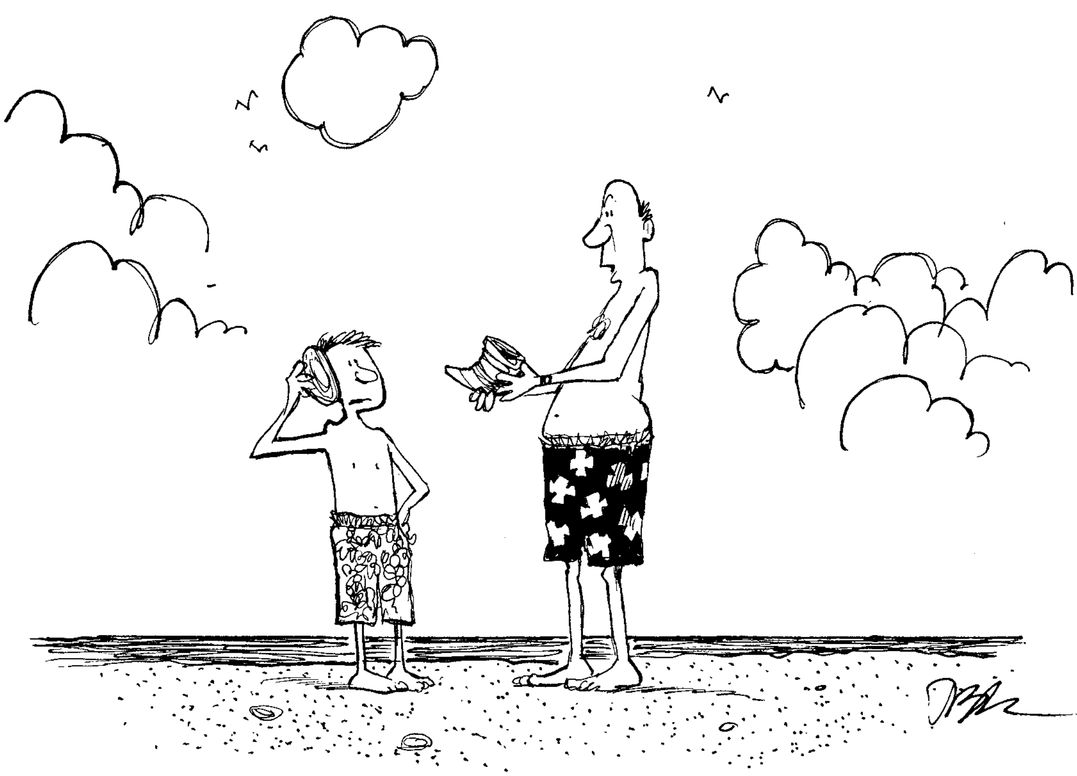

"...Hold on....It's an IM from work. .....Sorry, Tyler, but I have to take this."