SABRE HOLDINGS CORP
Form 10-Q
August 14, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Quarterly Period Ended June 30, 2003.

OR

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Transition Period From ______________ To ______________

Commission file number 1-12175.

SABRE HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**75-2662240**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3150 Sabre Drive, Southlake, Texas	**76092**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code **(682) 605-1000**

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ý No o

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class A Common Stock, $.01 par value 143,590,655 as of August 8, 2003

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SABRE HOLDINGS CORPORATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SABRE HOLDINGS CORPORATION
CONSOLIDATED BALANCE SHEETS
(Unaudited) (In thousands)

	June 30, 2003	December 31, 2002
Assets		
Current assets		
Cash	$ 28,935	$ 21,176
Marketable securities	937,373	890,584

	June 30, 2003	December 31, 2002
Accounts receivable, net	364,812	298,498
Prepaid expenses and other current assets	89,449	85,657
Deferred income taxes	10,686	15,728
Total current assets	1,431,255	1,311,643
Property and equipment		
Buildings and leasehold improvements	318,816	156,034
Furniture, fixtures and equipment	44,809	43,578
Computer software and equipment	261,893	236,639
	625,518	436,251
Less accumulated depreciation and amortization	(222,987)	(196,179)
Total property and equipment	402,531	240,072
Investments in joint ventures	176,223	189,002
Goodwill and intangible assets, net	833,217	855,683
Other assets, net	165,405	160,131
Total assets	$ 3,008,631	$ 2,756,531
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	$ 180,225	$ 181,934
Accrued compensation and related benefits	38,059	54,770
Accrued subscriber incentives	66,338	69,132
Deferred revenues	52,204	46,252
Other accrued liabilities	182,542	147,826
Total current liabilities	519,368	499,914
Deferred income taxes	2,764	13,755
Pensions and other postretirement benefits	114,589	116,305
Other liabilities	35,257	38,914
Minority interests	10,891	10,300
Notes payable	444,856	435,765
Obligation under capital lease	167,126	
Commitments and contingencies		
Stockholders' equity		
Preferred stock: $0.01 par value; 20,000 shares authorized; no shares issued		
Class A common stock, $0.01 par value; 250,000 shares authorized; 145,728 and 145,164 shares issued at June 30, 2003 and December 31, 2002, respectively	1,458	1,451
Additional paid-in capital	1,285,254	1,276,662
Retained earnings	503,796	442,130
Accumulated other comprehensive loss	(15,718)	(16,024)
Less treasury stock at cost: 2,419 and 2,480 shares, respectively	(61,010)	(62,641)
Total stockholders' equity	1,713,780	1,641,578
Total liabilities and stockholders' equity	$ 3,008,631	$ 2,756,531

See Notes to Consolidated Financial Statements

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SABRE HOLDINGS CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited) (In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Revenues	$ 507,189	$ 536,748	$ 1,051,022	$ 1,086,105
Operating expenses				
Cost of revenues	324,622	279,077	636,369	572,909
Selling, general and administrative	130,081	140,103	245,786	262,004
Amortization of intangible assets	12,094	13,264	24,581	26,894
Total operating expenses	466,797	432,444	906,736	861,807
Operating income	40,392	104,304	144,286	224,298
Other income (expense)				
Interest income	3,973	7,565	8,379	14,567
Interest expense	(5,300)	(5,580)	(10,772)	(11,264)
Other, net	(29,945)	1,165	(29,511)	21,053
Total other income (expense)	(31,272)	3,150	(31,904)	24,356
Minority interests	36	(888)	(591)	(41)
Income before provision for income taxes	9,156	106,566	111,791	248,613
Provision for income taxes	2,340	38,601	40,096	93,261
Net earnings	$ 6,816	$ 67,965	$ 71,695	$ 155,352
Earnings per common share				
Basic	$ .05	$ .48	$ .50	$ 1.13
Diluted	$ .05	$ .47	$ .50	$ 1.10
Dividends per common share	$ .07		$ .07	

See Notes to Consolidated Financial Statements

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SABRE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
SIX MONTHS ENDED JUNE 30, 2003
(Unaudited) (In thousands)

Total

	Class A Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	
Balance at December 31, 2002	$ 1,451	$ 1,276,662	$ 442,130	$ (16,024)	$ (62,641)	$ 1,641,578
Issuance of 698 shares of Class A common stock pursuant to stock option, restricted stock incentive and stock purchase plans	7	(932)			1,631	706
Tax benefit from exercise of employee stock options		265				265
Stock based compensation for employees		9,259				9,259
Dividends			(10,029)			(10,029)
Comprehensive income:						
Net earnings			71,695			71,695
Unrealized loss on foreign currency forward contracts, net of deferred income taxes				(283)		(283)
Unrealized gain on investments, net of deferred income taxes				278		278
Unrealized foreign currency translation gain				311		311
Total comprehensive income						72,001
Balance at June 30, 2003	$ 1,458	$ 1,285,254	$ 503,796	$ (15,718)	$ (61,010)	$ 1,713,780

See Notes to Consolidated Financial Statements.

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SABRE HOLDINGS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (In thousands)

	Six Months Ended June 30,	
	2003	**2002**
Operating Activities		
Net earnings	$ 71,695	$ 155,352
Adjustments to reconcile net earnings to cash provided by operating activities:		
Depreciation and amortization	61,736	57,173
Stock compensation	9,259	22,355
Deferred income taxes	(5,292)	53,621
Tax benefit from exercise of stock options	265	9,246
Minority interests	591	41
Gain on sale of former headquarters building		(18,308)
Loss on refinancing of building	27,947	
Other	4,438	(12,333)
Changes in operating assets and liabilities:		
Accounts receivable	(63,129)	(64,952)
Prepaid expenses	(3,492)	(22,896)

	Six Months Ended June 30,	
Other assets	(512)	(7,371)
Accrued compensation and related benefits	(16,711)	(18,958)
Accounts payable and other accrued liabilities	48,313	24,180
Pensions and other postretirement benefits	(1,716)	(10,256)
Other liabilities	(2,465)	(19,324)
Cash provided by operating activities	130,927	147,570
Investing Activities		
Additions to property and equipment	(39,589)	(28,675)
Business combinations, net of cash acquired	(11,868)	(477,330)
Proceeds from sale of former headquarters building		80,000
Proceeds from sale of minority interest in Sabre Pacific		23,466
Proceeds from exercise of Travelocity.com stock options		33,658
Purchases of marketable securities	(4,460,154)	(1,617,380)
Sales of marketable securities	4,414,602	1,392,790
Other investing activities, net	13,141	30,320
Cash used for investing activities	(83,868)	(563,151)
Financing Activities		
Proceeds from issuance of common stock	706	433,257
Dividends paid	(10,029)	
Payment to refinance building	(27,947)	
Other financing activities, net	(2,030)	(16,234)
Cash provided by (used for) financing activities	(39,300)	417,023
Increase in cash	7,759	1,442
Cash at beginning of period	21,176	18,855
Cash at end of period	$ 28,935	$ 20,297

See Notes to Consolidated Financial Statements

SABRE HOLDINGS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General Information

Sabre Holdings Corporation ("Sabre Holdings") is a Delaware holding company. Sabre Inc. is the principal operating subsidiary and sole direct subsidiary of Sabre Holdings. Sabre Inc. or its direct or indirect subsidiaries conduct all of our businesses. In this Quarterly Report on Form 10-Q, references to the "company", "we", "our", "ours" and "us" refer to Sabre Holdings and its consolidated subsidiaries unless otherwise stated or the context otherwise requires.

We are a world leader in travel commerce, retailing travel products and providing distribution and technology solutions for the travel industry. Through our *Sabre*® global distribution system ("*Sabre* system" or "*Sabre* GDS") subscribers can access information about, and can book reservations for, airline trips, hotel stays, car rentals, cruises and tour packages, among other things. Our Sabre Travel Network business operates the *Sabre* GDS and markets and distributes travel-related products and services through the travel agency channel. We engage in consumer-direct and business-direct travel services and distribution through Travelocity and engage in business-direct travel services through GetThere. In addition, our Sabre Airline Solutions business is a leading provider of technology and services, including development and consulting services, to airlines and other travel providers. Disaggregated information relating to our business segments is presented in Note 6 to the Consolidated Financial Statements.

2. Summary of Significant Accounting Policies

Basis of Presentation The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, these financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position, results of operations and cash flows for the periods indicated. The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Operating results for the three and six months ended June 30, 2003 are not necessarily indicative of results that may be expected for any other interim period or for the year ended December 31, 2003. Our quarterly financial data should be read in conjunction with our consolidated financial statements for the year ended December 31, 2002 (including the notes thereto), set forth in Sabre Holdings Corporation's Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on March 17, 2003.

We consolidate all of our majority-owned subsidiaries and companies over which we exercise control through majority voting rights. No entities are currently consolidated due to control through operating or financing agreements.

The consolidated financial statements include our accounts after elimination of all significant intercompany balances and transactions. We account for our interests in joint ventures and investments in common stock of other companies which we do not control but over which we exert significant influence using the equity method. Investments in the common stock of other companies over which we do not exert significant influence are accounted for at cost. We periodically evaluate for impairment equity and debt investments in entities accounted for at cost

by reviewing updated financial information provided by the investee, including valuation information from new financing transactions by the investee and information relating to competitors of investees when available. If we determine that a cost method investment is impaired, the carrying value of the investment is reduced to its estimated fair value. To date, writedowns of investments carried at cost have been insignificant to our results of operations.

Reclassifications Certain reclassifications have been made to the 2002 financial statements to conform to the 2003 presentation. These reclassifications are not material, either individually or in the aggregate, to our financial statements.

Accounts Receivable We generate a significant portion of our revenues and corresponding accounts receivable from services provided to the commercial air travel industry. As of June 30, 2003, approximately 69% of our accounts receivable were attributable to these customers. Our other accounts receivable are generally due from other participants in the travel and transportation industry.

We evaluate the collectibility of our accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us (e.g., bankruptcy filings, failure to pay amounts due to us or others), we record a specific reserve for bad debts against amounts due to reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize reserves for bad debts based on past write-off history (average percentage of receivables written off historically) and the length of time the receivables are past due.

From 2001 through the second quarter 2003, the commercial air travel industry in particular, and the travel and transportation industry in general, was adversely affected by a decline in travel resulting from several factors, including a softening economy, the aftermath of the terrorist attacks in the United States on September 11, 2001, the war in Iraq and by travelers' fear of exposure to contagious diseases such as Severe Acute Respiratory Syndrome ("SARS"). Our airline customers are negatively affected by the continuing lower levels of travel activity. Several major domestic air carriers are experiencing liquidity problems. Some airlines have sought bankruptcy protection and others may consider bankruptcy relief. We believe that we have appropriately considered the effects of these factors, as well as any other known customer liquidity issues, on the ability of our customers to pay amounts owed to us. However, if decreased demand for commercial air travel continues or worsens, the financial condition of our customers may be adversely impacted. If we begin, or estimate that we will begin, to experience higher than expected defaults on amounts due us, our estimates of the amounts which we will ultimately collect could be reduced by a material amount. Our allowance for bad debts was $26.4 million at June 30, 2003 and $34.5 million at December 31, 2002.

Booking Fee Cancellation Reserve We record revenue for airline travel reservations processed through the *Sabre* system at the time of the booking of the reservation. However, if the booking is canceled in a later month, the booking fee must be refunded to the customer (less a small cancellation fee). We record revenue net of an estimated amount reserved to account for future cancellations. This reserve is calculated based on historical cancellation rates. In estimating the amount of future cancellations that will require us to refund a booking fee, we assume that a significant percentage of cancellations are followed by an immediate re-booking, without loss of revenue. This assumption is based on historical rates of cancellations/re-bookings and has a significant impact on the amount reserved. If circumstances change, such as higher than expected cancellation rates or changes in booking behavior, our estimates of future cancellations could be increased by a material amount and our revenue decreased by a corresponding amount. At June 30, 2003 and December 31, 2002 our booking fee cancellation reserves were approximately $17.6 million and $18.4 million, respectively. During the first half of 2003, the cancellation reserve

declined by $0.8 million due to declining booking volumes. This reserve is sensitive to changes in booking levels. For example, if during the first half of 2003 booking volumes had been 10% lower, the reserve balance would have been reduced by an additional $1.8 million.

Business Combinations Our acquisitions of other companies have been accounted for using the purchase method of accounting. The amounts assigned to the identifiable assets and liabilities acquired in connection with these acquisitions were based on estimated fair values as of the date of the acquisition, with the remainder recorded as goodwill. The fair values were determined by our management, generally based upon information supplied by the management of the acquired entities and valuations prepared by independent valuation experts. The valuations have been based primarily upon future cash flow projections for the acquired assets, discounted to present value using a risk-adjusted discount rate. For certain classes of intangible assets, the valuations have been based upon estimated cost of replacement. In connection with these acquisitions, we have recorded a significant amount of intangible assets, including goodwill.

Long-Lived Assets and Goodwill We evaluate our goodwill for impairment on an annual basis or whenever indicators of impairment exist. The evaluation is based upon a comparison of the estimated fair value of the unit of our business to which the goodwill has been assigned to the sum of the carrying value of the assets and liabilities of that unit. The fair values used in this evaluation are estimated based upon discounted future cash flow projections for the unit. These cash flow projections are based upon a number of assumptions, including future booking volume levels, price levels, commission rates, rates of growth in our consumer and corporate direct booking businesses, rates of increase in operating expenses, discount rates, price-to-earnings multiples, etc. To date, we have not recorded a significant impairment of our goodwill. Intangible assets deemed to have indefinite lives are subject to impairment tests annually or when changes in circumstances indicate that the carrying value may not be recoverable. If the carrying value of an indefinite lived intangible asset exceeds its fair value, as generally estimated using a discounted future net cash flow projection, the carrying value of the asset is reduced to its fair value.

We believe that assumptions we have made in projecting future cash flows for the evaluations described above are reasonable. However, if future actual results do not meet our expectations, we may be required to record an impairment charge, the amount of which could be material to our results of operations.

Amortization expense relating to intangible assets subject to amortization totaled approximately $12.1 million and $13.3 million during the three months ended June 30, 2003 and 2002, respectively, and approximately $24.6 million and $26.9 million during the six months ended June 30, 2003 and 2002, respectively. Amortization expense for the six months ended June 30, 2002 includes a charge of $2.7 million incurred during the first quarter of 2002 for the write-down of a non-compete agreement that was determined to be unrecoverable. The goodwill balance was approximately $822 million and $820 million at June 30, 2003 and December 31, 2002. Of these balances, approximately $94 million consisted of goodwill related to our investments in joint ventures, which is included in investments in joint ventures in the accompanying balance sheet.

Earnings Per Share Basic earnings per share excludes any dilutive effect of any stock awards or options. The number of shares used in the diluted earnings per share calculations includes the dilutive effect of any stock awards or options.

The following table reconciles weighted average shares used in computing basic and diluted earnings per common share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Denominator for basic earnings per common share weighted-average shares	142,367	142,595	142,339	138,068
Dilutive effect of stock awards and options	741	2,711	480	2,933
Denominator for diluted earnings per common share adjusted weighted-average shares	143,108	145,306	142,819	141,001

Options to purchase approximately 1,223,438 and 1,029,335 weighted-average shares of our common stock were outstanding during the three and six month periods ending June 30, 2003, respectively, but were excluded from the computation of diluted earnings per share because the effect would be anti-dilutive.

Stock Awards and Options We account for stock awards and stock option grants using the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations. Generally, no compensation expense is recognized for stock option grants to employees if the exercise price is at or above the fair market value of the underlying stock on the date of grant. Compensation expense relating to other stock awards is recognized over the period during which the employee renders service to us necessary to earn the award.

The total charge for stock compensation expense recorded in accordance with APB 25 and included in wages, salaries and benefits expense was $4.6 million and $20.3 million for the three-months ended June 30, 2003 and 2002, respectively, and $9.3 million and $23 million for the six months ended June 30, 2003 and 2002, respectively. Of this expense, $3.2 million and $19.6 million for the three-month periods ending June 30, 2003 and 2002, respectively, and $6.4 million and $20.1 million for the six month periods ending June 30, 2003 and 2002, respectively, relates to the recognition of compensation expense for vested and unvested employee stock options converted to options to purchase Sabre Holdings' common stock in connection with acquisitions of other companies. At June 30, 2003 and December 31, 2002, unamortized deferred stock compensation relating to acquisitions that we have made totaled approximately $18.4 million and $24.8 million, respectively.

In order to provide more prominent and frequent disclosures about the effects of stock-based compensation as required under SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the following table summarizes the pro forma effect of stock-based

compensation on our net earnings and net earnings per share for the three and six months ended June 30, 2003 and 2002 (in thousands, except per share data):

Three Months Ended June 30,		Six Months Ended June 30,	
2003	2002	2003	2002

	Three Months Ended June 30,		Six Months Ended June 30,	
Net earnings as reported	$ 6,816	$ 67,965	$ 71,695	$ 155,352
Add stock compensation expense determined under intrinsic value method, net of income taxes	2,849	12,825	5,719	14,545
Less total stock-based employee compensation expense determined under fair value based method for all awards, net of income taxes	10,062			