

SABRE HOLDINGS CORP
Form 10-Q
August 06, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2004.

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)

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Delaware

(State or other jurisdiction of incorporation or organization)

75-2662240

(I.R.S. Employer Identification No.)

3150 Sabre Drive, Southlake, Texas

(Address of principal executive offices)

76092

(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 No

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

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 137,252,826 as of July 30, 2004

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SABRE HOLDINGS CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited) (In thousands)

	June 30, 2004		December 31, 2003	
Assets				
Current assets				
Cash	\$	31,702	\$	40,862
Marketable securities		988,782		881,749
Accounts receivable, net		373,680		348,988
Prepaid expenses		68,658		86,475
Deferred income taxes		18,836		10,237
Total current assets		1,481,658		1,368,311
Property and equipment				
Buildings and leasehold improvements		306,195		306,294
Furniture, fixtures and equipment		35,679		36,684
Computer software and equipment		308,735		275,664
		650,609		618,642
Less accumulated depreciation and amortization		(263,692)		(234,262)
Total property and equipment		386,917		384,380
Investments in joint ventures		182,556		181,142
Goodwill and intangible assets, net		861,102		888,198
Other assets, net		136,630		134,122
Total assets	\$	3,048,863	\$	2,956,153
Liabilities and stockholders' equity				
Current liabilities				
Accounts payable	\$	252,894	\$	202,615
Accrued compensation and related benefits		58,264		62,557
Accrued subscriber incentives		93,988		70,178
Deferred revenues		37,356		34,791
Other accrued liabilities		174,624		133,254
Total current liabilities		617,126		503,395
Deferred income taxes		7,188		4,420
Pensions and other postretirement benefits		139,070		133,404
Other liabilities		25,796		25,162

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Minority interests		6,278		6,463
Capital lease obligation		157,549		160,725
Public and other notes payable		432,265		442,476
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; 145,856 and 145,652 shares issued at June 30, 2004 and December 31, 2003, respectively		1,459		1,457
Additional paid-in capital		1,286,276		1,291,841
Retained earnings		576,440		495,372
Accumulated other comprehensive loss		(16,928)		(8,115)
Less treasury stock at cost: 7,986 and 4,322 shares, respectively		(183,656)		(100,447)
Total stockholders equity		1,663,591		1,680,108
Total liabilities and stockholders equity	\$	3,048,863	\$	2,956,153

See Notes to Consolidated Financial Statements

SABRE HOLDINGS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited) (In thousands, except per share amounts)

	Three Months Ended June 30,				Six Months Ended June 30,			
	2004		2003		2004		2003	
Revenues	\$	550,903	\$	507,189	\$	1,090,656	\$	1,051,022
Cost of revenues		307,777		318,303		619,292		629,908
Gross profit		243,126		188,886		471,364		421,114
Other operating expenses								
Selling, general and administrative		139,455		136,400		286,084		252,247
Amortization of intangible assets		15,228		12,094		27,349		24,581
Total other operating expenses		154,683		148,494		313,433		276,828
Operating income		88,443		40,392		157,931		144,286
Other income (expense)								
Interest income		3,306		3,973		6,541		8,379
Interest expense		(6,431)		(5,300)		(12,858)		(10,772)
Other, net		6,057		(29,909)		6,485		(30,102)
Total other income (expense)		2,932		(31,236)		168		(32,495)
Income before provision for income taxes		91,375		9,156		158,099		111,791
Provision for income taxes		32,438		2,340		56,125		40,096
Net earnings	\$	58,937	\$	6,816	\$	101,974	\$	71,695
Earnings per common share								
Basic	\$	.43	\$	.05	\$	.74	\$	.50
Diluted	\$	.42	\$	.05	\$	.73	\$	.50
Dividends per common share	\$	.075	\$	.07	\$	.15	\$	.07

See Notes to Consolidated Financial Statements

SABRE HOLDINGS CORPORATION

CONSOLIDATED CONDENSED STATEMENT OF STOCKHOLDERS EQUITY

SIX MONTHS ENDED JUNE 30, 2004

(Unaudited) (In thousands)

	Class A Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at December 31, 2003	\$ 1,457	\$ 1,291,841	\$ 495,372	\$ (8,115)	\$ (100,447)	\$ 1,680,108
Issuance of Class A common stock and treasury shares pursuant to:						
Stock option plans		(719)			8,767	8,048
Restricted stock plan	2	(11,342)			10,586	(754)
Employee stock purchase plan		(865)			4,373	3,508
Tax benefit from exercise of employee stock options		910				910
Stock based compensation for employees		6,433				6,433
Dividends			(20,906)			(20,906)
Purchase of treasury stock					(106,935)	(106,935)
Other		18				18
Comprehensive income:						
Net earnings			101,974			101,974
Unrealized loss on foreign currency forward and option contracts, net of deferred income taxes				(3,829)		(3,829)
Unrealized loss on investments, net of deferred income taxes				(2,368)		(2,368)
Unrealized foreign currency translation loss				(2,026)		(2,026)
Other				(590)		(590)
Total comprehensive income						93,161
Balance at June 30, 2004	\$ 1,459	\$ 1,286,276	\$ 576,440	\$ (16,928)	\$ (183,656)	\$ 1,663,591

See Notes to Consolidated Financial Statements.

SABRE HOLDINGS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

	Six Months Ended June 30,	
	2004	2003
Operating Activities		
Net earnings	\$ 101,974	\$ 71,695
Adjustments to reconcile net earnings to cash provided by operating activities:		
Depreciation and amortization	64,415	61,736
Stock based compensation for employees	6,433	9,259
Deferred income taxes	(5,831)	(5,949)
Tax benefit from exercise of stock options	910	265
Loss on impaired intangible asset	3,198	
Gain on disposal of equipment	(903)	
Equity loss in joint ventures	7,621	3,849
Loss on refinancing of building		27,947
Other	(3,775)	1,180
Changes in operating assets and liabilities:		
Accounts receivable	(24,692)	(63,129)
Prepaid expenses	11,617	(3,492)
Other assets	12,804	19,158
Accrued compensation and related benefits	(4,293)	(16,711)
Accounts payable and other accrued liabilities	113,901	48,313
Pensions and other postretirement benefits	5,075	(1,716)
Other liabilities	(2,103)	(2,465)
Cash provided by operating activities	286,351	149,940
Investing Activities		
Additions to property and equipment	(35,908)	(39,589)
Business combinations, net of cash acquired		(11,868)
Investments in and loans to joint ventures	(32,934)	(10,068)
Purchases of marketable securities	(4,138,162)	(4,460,154)
Sales of marketable securities	4,030,234	4,414,602
Other investing activities	(5,000)	4,196
Cash used for investing activities	(181,770)	(102,881)
Financing Activities		
Proceeds from exercise of stock options and issuance of stock under employee stock purchase plan	10,802	706
Dividends paid	(20,906)	(10,029)
Purchases of treasury stock	(101,925)	
Payment to refinance building		(27,947)
Other financing activities, net	(1,712)	(2,030)
Cash used for financing activities	(113,741)	(39,300)
Increase (decrease) in cash	(9,160)	7,759
Cash at beginning of period	40,862	21,176
Cash at end of period	\$ 31,702	\$ 28,935

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 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, marketing travel products and providing distribution and technology solutions for the travel industry. We operate in multiple travel distribution channels: the travel agency channel, the consumer-direct channel and the corporate or business-direct channel. Through our *Sabre*®(1) global distribution system (the *Sabre* system or *Sabre* GDS) subscribers can access information about, and can book reservations for, among other things, airline trips, hotel stays, car rentals, cruises and tour packages. Our *Sabre Travel Network* business operates the *Sabre* GDS and markets and distributes travel-related products and services through the travel agency and corporate channels. We engage in consumer-direct and business-direct travel marketing and distribution through our *Travelocity*® business. 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.

During the fourth quarter of 2003, we realigned our *GetThere*® business segment, which engaged in business direct travel services and had previously been operated as a separate business segment, within our other three segments. This realignment resulted in *GetThere* products, services and operations being integrated into the remaining three segments. Accordingly, *GetThere* is no longer reported as a separate segment. Disaggregated information relating to the financial performance of our business segments for the three and six months ended June 30, 2004 and 2003 is presented in Note 7 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, 2004 are not necessarily indicative of results that may be expected for any other interim period or for the year ended December 31, 2004. Our quarterly financial data should be read in conjunction with our consolidated financial statements for the year ended December 31, 2003 (including the notes thereto), set forth in Sabre Holdings Corporation's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 27, 2004.

We consolidate all of our majority-owned subsidiaries and companies that are not variable interest entities over which we exercise control through majority voting rights. We would also consolidate all variable interest entities of which we are the primary beneficiary. However, no entities are currently consolidated due to control through operating, financing agreements, or other arrangements (including variable interests held in variable interest entities).

(1) Assured Vantage, Basic Booking Request, Direct Connect, eMergo, eVoya, GetThere, Jurni Network, Nexion, Sabre, Sabre Airline Solutions, Sabre Exclusives, Sabre Holdings, Sabre Travel Network, SabreSonic, Site 59, Site59.com, TotalTrip, Travelocity, Travelocity Business, Travelocity.ca, Travelocity.com, Turbo Sabre and World Choice Travel are trademarks of affiliates of Sabre Holdings Corporation. All other trademarks are the property of their respective owners. ©2004 Sabre Holdings Corporation. All rights reserved.

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 that we do not control but over which we exert significant influence using the equity method, with our share of their results classified as revenues. 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, write-downs of investments carried at cost have been insignificant to our results of operations.

Reclassifications Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation. These reclassifications are not material, either individually or in the aggregate, to our financial statements.

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,	
	2004	2003	2004	2003
Denominator for basic earnings per common share weighted-average shares	137,397	142,367	138,309	142,339
Dilutive effect of stock awards and options	2,583	741	1,497	480
Denominator for diluted earnings per common share adjusted weighted-average shares	139,980	143,108	139,806	142,819

Options to purchase approximately 13,512,386 and 15,628,627 weighted-average shares of our common stock were outstanding during the three and six month periods ending June 30, 2004, but were excluded from the computation of diluted earnings per share because the effect would be anti-dilutive. For the corresponding periods in 2003, anti-dilutive options to purchase approximately 16,428,401 and 17,644,523 weighted-average shares of our common stock were excluded from the computation of diluted earnings per share. The decrease in the weighted-average shares for the three and six month periods ending June 30, 2004 versus 2003 is due to our share repurchase programs.

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 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, 2004 and 2003, as if we had accounted for such compensation at fair value (in thousands, except per share data):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2004		2003		2004		2003	
Net earnings as reported	\$	58,937	\$	6,816	\$	101,974	\$	71,695
Add stock compensation expense determined under intrinsic value method, net of income taxes		1,889		2,849		3,972		5,719
Less total stock-based employee compensation expense determined under fair value based method for all awards, net of income taxes		(7,978)		(10,062)		(16,266)		(21,616)
Pro forma net earnings (loss)	\$	52,848	\$	(397)	\$	89,680	\$	55,798
Net earnings per common share, as reported:								
Basic	\$	.43	\$	.05	\$	.74	\$	.50
Diluted	\$	.42	\$	.05	\$	.73	\$	.50
Net earnings (loss) per common share, pro forma:								
Basic	\$	.38	\$	(.00)	\$	.65	\$	.39
Diluted	\$	.38	\$	(.00)	\$	.64	\$	.39

3. Significant Events

Contract Settlements In the first quarter of 2003, we recognized revenue of approximately \$36 million, representing settlements from two travel agency subscribers (who were affiliated with each other and were acquired by a competitor of ours) in exchange for allowing them to cancel their existing subscriber agreements.

Cost Reductions In an effort to reduce our operating expenses and better align expenses with revenue targets for 2004 and future years, we reduced our workforce and recorded a charge of approximately \$18 million for severance, salaries and benefits in the fourth quarter of 2003. The remaining liability for this charge as of June 30, 2004 was approximately \$3 million, of which approximately half is at the corporate level and the remainder relates to our

business units.

In the fourth quarter of 2003, we also consolidated our operations (including integrating the products, services and operations of our GetThere business unit into our other three business units) and closed additional facilities in the United States. These actions resulted in an approximately \$17 million charge, consisting of write-offs of leasehold improvements and other facility-related assets, employee relocation expenses and lease termination costs. The remaining liability for this charge as of June 30, 2004 was approximately \$2 million, which relates entirely to corporate level charges.

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The following table summarizes the liabilities included in the balance sheets at December 31, 2003 and June 30, 2004 and the amounts paid during the six-month period (in thousands):

	Severance		Facilities		Total	
Remaining liability at December 31, 2003	\$	7,941	\$	4,264	\$	12,205
Amounts paid through June 30, 2004		(5,000)		(2,129)		(7,129)
Remaining liability at June 30, 2004	\$	2,941	\$	2,135	\$	5,076

Amendment to AOL Agreement On January 21, 2004, we revised the terms of and extended our agreement with America Online (AOL) through March 2006. Travelocity continues to be the exclusive reservations engine for AOL s Internet properties under the revised agreement. Under the revised terms of the agreement, we benefit from more strategically aligned terms for placement within AOL s brands. Further, we are obligated for fixed payments of up to \$28 million over the two-year term of the agreement. These fixed payments, along with the unamortized portion of fixed payments previously paid under the original contract, are being expensed on a straight-line basis over the remaining term of the extended agreement. For 2004, this expense will be approximately \$23 million, of which approximately \$6 million and \$12 million was recognized for the three and six months ended June 30, 2004, respectively. Additionally, in exchange for lower fixed annual payments, we agreed to a reduced share of advertising revenues generated through the AOL properties. The agreement also contains a productivity component, whereby AOL is paid a percentage of the transaction revenue generated through the AOL network.

WNS Agreement On January 30, 2004, we entered into a multi-year master services agreement with WNS North America, Inc. (WNS). Under the agreement, throughout 2004 we will outsource to WNS an increasing portion of our Travelocity contact center operations, primarily front-line customer service calls and back-office fulfillment. By the end of the first quarter of 2005, WNS should be handling Travelocity s front-line customer service calls and emails, as well as some mid-office and back-office functions. WNS will transition these day-to-day operations of the customer service functions to its contact centers. Travelocity employees will continue to handle sales calls, as well as advanced customer service issues and quality control. We do not expect severance and related costs incurred due to this agreement to be significant.

For 2004, we have minimum commitments to WNS of \$18 million, of which approximately \$5 million and \$9 million was recognized during the three and six months ended June 30, 2004, respectively. Thereafter, we are committed to minimum payments based on a calculation that considers both current and historical transaction volumes compared to thresholds established in the agreement. For 2005 through 2010, the starting thresholds for calculating our commitment for each year ranges from approximately \$17 million to \$31 million, and actual commitments could be lower than these amounts, depending on call volumes. Additionally, we committed to lend up to \$10 million to WNS for transitional assistance. As of June 30, 2004, we have loaned \$5 million to WNS. Amounts borrowed by WNS accrue interest at 5%, payable quarterly, and the principal will be due in three annual payments beginning in 2009.

Relocation of Certain Operations In April 2004, we announced to affected employees that we will transition certain operations to Latin America. The transition will occur over the remainder of 2004 and in the first half of 2005. Severance, retention and other related costs associated with the plan are currently estimated to be in the range of \$6

million to \$8 million, and will primarily be recognized in the fourth quarter of 2004 and in the first half of 2005 as operations are transitioned.

Revolving Credit Agreement On June 15, 2004, we replaced a \$300 million revolving credit agreement that was set to expire on September 14, 2004, with a new \$300 million, senior unsecured revolving credit agreement that expires June 15, 2009. Under certain conditions, we can request an additional \$100 million in credit under this new agreement. Interest on this agreement is variable, based on either the London Interbank Offered Rate (LIBOR) or the prime rate, at our discretion, and is sensitive to our credit rating. The LIBOR margin at our current credit rating is equal to 0.50%, which translates to a total borrowing rate of approximately 2.5% in the current interest rate environment. As of June 30, 2004 there are no borrowings outstanding under this agreement. Under this agreement, we are subject to covenants that could, among other things, restrict our ability to incur additional debt and that limit our ability to pay dividends or repurchase our stock in excess of \$150 million per fiscal year (unless, after giving effect to such dividends and/or repurchases, we have more than \$400 million in cash and marketable securities

domiciled in the United States). A copy of the Revolving Credit Agreement is included as Exhibit 10.1 to this filing. As of June 30, 2004 we are in compliance with all covenants under this agreement including the following financial covenants:

	Requirement	Level at June 30, 2004
Consolidated Leverage Ratio (Debt to EBITDA)	3 to 1 maximum	2 to 1
Consolidated Net Worth	\$1.4 billion	\$1.7 billion

4. Pension and Other Post Retirement Benefit Plans

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. Our measures of accumulated postretirement benefit obligation and net periodic cost presented for the three and six months ended June 30, 2004 do not reflect the effects of the Act as we have not yet concluded whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act. The effects of the Act are required to be recorded for fiscal periods beginning after June 15, 2004. Accordingly, we will record the effects of the Act on our U.S.-based plans during the third quarter of 2004.

The components of net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans for the three and six months ended June 30, 2004 and 2003 are presented in the tables below (in thousands).

	Three Months Ended June 30,				Six Months Ended June 30,			
	2004		2003		2004		2003	
Pension Benefits								
Components of net periodic benefit cost:								
Service cost	\$	982	\$	2,635	\$	2,286	\$	4,173
Interest cost		3,220		10,792		8,223		15,855
Expected return on plan assets		(3,378)		(12,427)		(8,986)		(17,905)
Amortization of transition asset		(3)		(1)		(8)		(6)
Amortization of prior service cost		(8)		13		36		28
Amortization of net loss		699		2,099		1,405		2,632
Net periodic benefit cost		1,512		3,111		2,956		4,777
Settlement gain				(126)				
Total net periodic benefit cost	\$	1,512	\$	2,985	\$	2,956	\$	4,777

	Three Months Ended June 30,				Six Months Ended June 30,			
	2004		2003		2004		2003	
Other Benefits								
Components of net periodic benefit cost:								
Service cost	\$	788	\$	597	\$	1,583	\$	1,496
Interest cost		1,859		1,775		3,730		3,523
Amortization of transition asset		3		3		7		7
Amortization of prior service cost		78		68		159		148
Amortization of net loss		679		833		1,375		1,283
Net periodic benefit cost		3,407		3,276		6,854		6,457

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Total net periodic benefit cost	\$	3,407	\$	3,276	\$	6,854	\$	6,457
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We made contributions to fund our defined benefit pension plans of \$5 million and \$15 million during the three months ended June 30, 2004 and 2003, respectively. We are evaluating making additional contributions during the remainder of 2004.

5. Income Taxes

The provision for income taxes relating to continuing operations differs from amounts computed at the statutory federal income tax rate as follows (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2004		2003		2004		2003	
Income tax provision at statutory federal income tax rate	\$	31,982	\$	3,205	\$	55,335	\$	39,127
State income taxes, net of federal benefit		420		(447)		2,200		2,402
Other, net		36		(418)		(1,410)		(1,433)
Total provision for income taxes	\$	32,438	\$	2,340	\$	56,125	\$	40,096

6. Derivatives

Travelocity received certain vested warrants from Hotels.com in connection with an affiliation agreement entered into during 2000. In March 2001, we extended our affiliation agreement with Hotels.com through July 31, 2005 and expanded the scope of the Hotels.com relationship. In connection with the expanded and extended agreement, we received additional vested Hotels.com warrants with a fair value of approximately \$30 million on the date of receipt. We were recognizing this amount as revenue over the extended term of the agreement, which amounted to approximately \$2 million and \$4 million during the three and six months ended June 30, 2003, respectively. During the three and six months ended June 30, 2003, respectively, we also recognized approximately \$5 million and \$7 million of revenue for performance warrants earned under this agreement. This agreement was terminated in the third quarter of 2003 and we recognized the remaining deferred balance of approximately \$8 million related to these warrants at that time.

We are a party to certain foreign currency forward and option contracts. We have designated these instruments as cash flow hedges. Amounts reclassified from other comprehensive income to earnings due to the settlement of forward and option contracts were \$2 million and \$3 million during the three months ended June 30, 2004 and 2003, respectively and \$6 million for both the six months ended June 30, 2004 and 2003. No hedging ineffectiveness was recorded in earnings relating to the forwards or options during 2004 or 2003. The estimated fair values of the foreign currency forward and option contracts were \$4 million and \$10 million at June 30, 2004 and December 31, 2003, respectively.

We are also a party to certain interest rate swap contracts. We have designated the swaps as fair value hedges of our public notes payable and capital lease obligation. No hedging ineffectiveness was recorded in earnings relating to our interest rate swaps during 2004 or 2003. The estimated fair values of the interest rate swaps were a net liability of \$3 million at June 30, 2004 and a net asset of \$9 million at December 31, 2003.

7. Business Segments

We are a world leader in travel commerce, marketing travel products and providing distribution and technology solutions for the travel industry. We operate in multiple travel distribution channels: the travel agency channel, the consumer-direct channel and the corporate or business-direct channel. Through our *Sabre* global distribution system (the *Sabre* system or *Sabre* GDS) subscribers can access information about, and can book reservations for, among other things, airline trips, hotel stays, car rentals, cruises and tour packages. Our Sabre Travel Network business operates the *Sabre* GDS and markets and distributes travel-related products and services through the travel

agency and corporate channels. We engage in consumer-direct and business-direct travel marketing and distribution through our Travelocity business. 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.

During the fourth quarter of 2003, we realigned our GetThere business segment, which engaged in business direct travel services and had previously been operated as a separate business segment, within our other three segments. This realignment resulted in *GetThere* products, services and operations being integrated into the remaining three segments. Accordingly, GetThere is no longer reported as a separate segment. The segment information presented below is based on the new segment definition for all periods presented.

Our reportable segments are strategic business segments that offer different products and services and are managed separately because each business requires different market strategies. The accounting policies of the segments are the same as those used in our consolidated results. We account for significant intersegment transactions as if the transactions were to third parties, that is, at estimated current market prices. The majority of the intersegment revenues and cost of revenues are between Travelocity and Sabre Travel Network, consisting mainly of incentives and marketing fees paid by Sabre Travel Network to Travelocity for bookings made through the *Sabre* GDS, data processing fees paid by Travelocity to Sabre Travel Network for bookings made through the *Sabre* GDS, and fees paid by Sabre Travel Network to Travelocity for corporate trips booked through Travelocity's online booking technology. In addition, Sabre Airline Solutions pays fees to Travelocity for airline trips booked through Travelocity's online booking technology.

Personnel and related costs for the corporate headquarters, certain legal and professional fees and other corporate charges are allocated to the segments through a management fee based on the relative size of the segments and usage of corporate resources or services. Depreciation expense on the corporate headquarters buildings and related facilities costs are allocated to the segments through a facility fee based on headcount. Benefits expense, including pension expense, postretirement benefits, medical insurance and workers' compensation, are allocated to the segments based on headcount. Unallocated corporate expenses include costs associated with the corporate headquarters buildings that were not allocated to the reportable segments as well as certain other corporate charges maintained at the corporate level.

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The segment operating results are presented on a basis that excludes certain adjusting items that are summarized below, except where noted. This presentation is consistent with the manner in which our management assesses the operating performance of our business segments. Selected information for our three reportable segments for the three and six months ended June 30, 2004 and 2003 follows (in thousands).

	Three Months Ended June 30,				Six Months Ended June 30,			
	2004		2003		2004		2003	
Revenues from external customers, excluding adjusting items:								
Sabre Travel Network	\$	393,477	\$	378,289	\$	797,049	\$	767,750
Travelocity		97,474		72,979		180,981		136,482
Sabre Airline Solutions		60,511		56,596		120,247		114,181
Total	\$	551,462	\$	507,864	\$	1,098,277	\$	1,018,413
Intersegment revenues:								
Sabre Travel Network	\$	7,688	\$	6,714	\$	15,227	\$	13,356
Travelocity		34,850		28,417		69,584		56,833
Total	\$	42,538	\$	35,131	\$	84,811	\$	70,189
Equity in net income of equity method investees:								
Sabre Travel Network	\$	6,222	\$	2,761	\$	5,947	\$	4,878
Travelocity		(6,781)		(3,436)		(13,568)		(8,727)
Total	\$	(559)	\$	(675)	\$	(7,621)	\$	(3,849)
Segment revenues, excluding adjusting items:								
Sabre Travel Network	\$	407,388	\$	387,764	\$	818,223	\$	785,984
Travelocity		125,542		97,960		236,997		184,588
Sabre Airline Solutions		60,511		56,596		120,247		114,181
Elimination of intersegment revenues		(42,538)		(35,131)		(84,811)		(70,189)
Total	\$	550,903	\$	507,189	\$	1,090,656	\$	1,014,564
Revenue adjusting item:								
Sabre Travel Network settlement revenue from canceled subscriber contracts	\$		\$		\$		\$	36,458
Consolidated revenues:								
Sabre Travel Network	\$	407,388	\$	387,764	\$	818,223	\$	822,442
Travelocity		125,542		97,960		236,997		184,588
Sabre Airline Solutions		60,511		56,596		120,247		114,181
Elimination of intersegment revenues		(42,538)		(35,131)		(84,811)		(70,189)
Total	\$	550,903	\$	507,189	\$	1,090,656	\$	1,051,022

7. Segment Reporting (Continued)

A summary of the adjusting items and reconciliation to consolidated operating income is set forth below (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2004		2003		2004		2003	
Segment operating income (loss) excluding adjusting items:								
Sabre Travel Network	\$	89,308	\$	60,706	\$	173,794	\$	145,619
Travelocity		9,643		(10,898)		8,178		(20,451)
Sabre Airline Solutions		5,593		4,632		4,971		10,284
Net corporate allocations		(41)		(159)		629		1,474
Total	\$	104,503	\$	54,281	\$	187,572	\$	136,926
<i>Impact of adjusting items on operating income (increase) / decrease:</i>								
Sabre Travel Network:								
Settlement revenue from canceled subscriber contract	\$		\$		\$		\$	(36,458)
Other intangibles amortization		7,349		3,144		11,517		6,240
Stock compensation				182				367
Restructuring expenses				(288)				(288)
Total Sabre Travel Network		7,349		3,038		11,517		(30,139)
Travelocity:								
Other intangibles amortization		7,390		8,461		14,852		17,362
Stock compensation		1,318		2,980		3,255		5,958
Restructuring expenses				(37)				(37)
Total Travelocity		8,708		11,404		18,107		23,283
Sabre Airline Solutions:								
Stock compensation				32				65
Restructuring expenses				(231)				(231)
Total Sabre Airline Solutions				(199)				(166)
Corporate:								
Other		3		16		17		32
Restructuring expenses				(370)				(370)
Total Corporate		3		(354)		17		(338)
Total operating income adjusting items	\$	16,060	\$	13,889	\$	29,641	\$	(7,360)
Consolidated operating income (loss):								
Sabre Travel Network	\$	81,959	\$	57,668	\$	162,277	\$	175,758
Travelocity		935		(22,302)		(9,929)		(43,734)

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Sabre Airline Solutions		5,593		4,831		4,971		10,450
Net Corporate Allocations		(44)		195		612		1,812
Total	\$	88,443	\$	40,392	\$	157,931	\$	144,286

8. Supplemental Guarantor/Non-Guarantor Financial Information

Certain obligations of Sabre Holdings Corporation (Sabre Holdings) have been solely guaranteed by its 100% owned operating subsidiary, Sabre Inc. There are currently no restrictions on Sabre Holdings' ability to obtain funds from Sabre Inc. in the form of a dividend or loan other than typical dividend requirements under Delaware law. Additionally, there are no significant restrictions on Sabre Inc.'s ability to obtain funds from its direct or indirect subsidiaries other than those that would exist under state or foreign law. Sabre Inc. is the sole direct subsidiary of Sabre Holdings. All other subsidiaries are direct or indirect subsidiaries of Sabre Inc. These other subsidiaries are all included in the non-guarantor financial statements. The following financial information presents condensed consolidating balance sheets, statements of income and statements of cash flows for Sabre Holdings, Sabre Inc. and non-guarantor subsidiaries. The information has been presented as if Sabre Holdings accounted for its ownership of Sabre Inc., and Sabre Inc. accounted for its ownership of the non-guarantor subsidiaries, using the equity method of accounting. Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation. These reclassifications are not material, either individually or in the aggregate, to our financial statements.

Sabre Inc. conducts the domestic operations of both the Sabre Travel Network and Sabre Airline Solutions segments. The operations of the Travelocity segment, as well as the principal international operations of the Sabre Travel Network segment, are conducted by the non-guarantor subsidiaries.

Sabre Inc. and certain non-guarantor subsidiaries are parties to various intercompany agreements that affect the amount of operating expenses reported in the following condensed consolidating statements of income. Among other things, fees are paid by Sabre Inc. to a non-guarantor subsidiary relating to the use of trademarks, tradenames, etc. owned by a non-guarantor subsidiary; incentive and marketing payments are made by Sabre Inc. to non-guarantor subsidiaries relating to the use and distribution of the *Sabre* system; and payments are made by non-guarantor subsidiaries to Sabre Inc. for access to the *Sabre* system under the terms of these agreements. During the three months ended June 30, 2004 and 2003, Sabre Inc. recognized operating expenses in connection with these agreements totaling approximately \$62 million and \$81 million, respectively. During the six months ended June 30, 2004 and 2003, Sabre Inc. recognized operating expenses in connection with these agreements totaling approximately \$120 million and \$153 million, respectively. These amounts, and the corresponding amounts recognized by the non-guarantor subsidiaries are eliminated in consolidation.

UNAUDITED CONSOLIDATING CONDENSED BALANCE SHEETS

JUNE 30, 2004

(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Assets					
Current assets					
Cash and marketable securities	\$	\$ 998,700	\$ 21,784	\$	\$ 1,020,484
Accounts receivable trade, net		280,054	93,626		373,680
Intercompany accounts receivable (payable)		(204,593)	204,593		
Prepaid expenses and other current assets		32,004	36,654		68,658
Deferred income taxes		17,417	1,419		18,836
Total current assets		1,123,582	358,076		1,481,658
Property and equipment, net		343,804	43,113		386,917
Investments in joint ventures		3,459	179,097		182,556
Goodwill and intangible assets, net		9,289	851,813		861,102
Investments in subsidiaries	640,543	1,307,595		(1,948,138)	
Intercompany notes	1,446,722	(1,446,722)			
Other assets, net	7,527	64,621	64,482		136,630
Total assets	\$ 2,094,792	\$ 1,405,628	\$ 1,496,581	\$ (1,948,138)	\$ 3,048,863
Liabilities and stockholders equity					
Current liabilities					
Accounts payable	\$ 5,043	\$ 145,105	\$ 102,746	\$	\$ 252,894
Accrued compensation and related benefits		46,752	11,512		58,264
Other accrued liabilities	7,462	207,277	91,229		305,968
Total current liabilities	12,505	399,134	205,487		617,126
Deferred income taxes	(235)	48,901	(41,478)		7,188
Pensions and other postretirement benefits		138,183	887		139,070
Other liabilities	1,742	21,318	2,736		25,796
Minority interests			6,278		6,278
Capital lease obligation		157,549			157,549
Public and other notes payable	417,189		15,076		432,265
Stockholders equity	1,663,591	640,543	1,307,595	(1,948,138)	1,663,591
Total liabilities and stockholders equity	\$ 2,094,792	\$ 1,405,628	\$ 1,496,581	\$ (1,948,138)	\$ 3,048,863

UNAUDITED CONSOLIDATING CONDENSED BALANCE SHEETS

DECEMBER 31, 2003

(in thousands)

	Sabre Holdings		Sabre Inc.		Non-Guarantor Subsidiaries		Eliminating Entries		Sabre Consolidated	
Assets										
Current assets										
Cash and marketable securities	\$		\$	889,638	\$	32,973	\$		\$	922,611
Accounts receivable trade, net				254,656		94,332				348,988
Intercompany accounts receivable (payable)				(121,476)		121,476				
Prepaid expenses				42,478		43,997				86,475
Deferred income taxes				8,736		1,501				10,237
Total current assets				1,074,032		294,279				1,368,311
Property and equipment, net				345,930		38,450				384,380
Investments in joint ventures				3,994		177,148				181,142
Goodwill and intangible assets, net				10,269		877,929				888,198
Investments in subsidiaries		572,696		1,260,428				(1,833,124)		
Intercompany notes		1,529,296		(1,529,296)						
Other assets, net		17,057		79,210		37,855				134,122
Total assets	\$	2,119,049	\$	1,244,567	\$	1,425,661	\$	(1,833,124)	\$	2,956,153
Liabilities and stockholders equity										
Current liabilities										
Accounts payable	\$	2,926	\$	124,189	\$	75,500	\$		\$	202,615
Accrued compensation and related benefits				50,554		12,003				62,557
Other accrued liabilities		7,474		140,814		89,935				238,223
Total current liabilities		10,400		315,557		177,438				503,395
Deferred income taxes		(24)		41,022		(36,578)				4,420
Pensions and other postretirement benefits				132,689		715				133,404
Other liabilities		1,165		21,878		2,119				25,162
Minority interests						6,463				6,463
Capital lease obligation				160,725						160,725
Public and other notes payable		427,400				15,076				442,476
Stockholders equity		1,680,108		572,696		1,260,428		(1,833,124)		1,680,108
Total liabilities and stockholders equity	\$	2,119,049	\$	1,244,567	\$	1,425,661	\$	(1,833,124)	\$	2,956,153

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE SIX MONTHS ENDED JUNE 30, 2004

(in thousands)

	Sabre Holdings		Sabre Inc.		Non-Guarantor Subsidiaries		Eliminating Entries		Sabre Consolidated	
Revenues	\$		\$	766,518	\$	574,156	\$	(250,018)	\$	1,090,656
Operating expenses		2,293		659,765		520,685		(250,018)		932,725
Operating income (loss)		(2,293)		106,753		53,471				157,931
Other income (expense)										
Interest income		50,047		4,883		5,335		(53,724)		6,541
Interest expense		(8,316)		(57,648)		(618)		53,724		(12,858)
Income (loss) from subsidiaries		75,995		40,311				(116,306)		
Other, net				6,228		257				6,485
Total other income (expense)		117,726		(6,226)		4,974		(116,306)		168
Income before provision for income taxes		115,433		100,527		58,445		(116,306)		158,099
Provision for income taxes		13,459		24,532		18,134				56,125
Net income	\$	101,974	\$	75,995	\$	40,311	\$	(116,306)	\$	101,974

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE SIX MONTHS ENDED JUNE 30, 2003

(in thousands)

	Sabre Holdings		Sabre Inc.		Non-Guarantor Subsidiaries		Eliminating Entries		Sabre Consolidated	
Revenues	\$		\$	786,115	\$	527,927	\$	(263,020)	\$	1,051,022
Operating expenses		1,750		700,361		467,645		(263,020)		906,736
Operating income (loss)		(1,750)		85,754		60,282				144,286
Other income (expense)										
Interest income		37,304		5,593		9,103		(43,621)		8,379
Interest expense		(8,654)		(44,145)		(1,594)		43,621		(10,772)
Income (loss) from subsidiaries		53,975		45,617				(99,592)		
Other, net				(27,133)		(2,969)				(30,102)
Total other income (expense)		82,625		(20,068)		4,540		(99,592)		(32,495)
Income before provision for income taxes		80,875		65,686		64,822		(99,592)		111,791
Provision for income taxes		9,180		11,711		19,205				40,096
Net income	\$	71,695	\$	53,975	\$	45,617	\$	(99,592)	\$	71,695

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED JUNE 30, 2004

(in thousands)

	Sabre Holdings		Sabre Inc.		Non-Guarantor Subsidiaries		Eliminating Entries		Sabre Consolidated	
Revenues	\$		\$	375,303	\$	305,535	\$	(129,935)	\$	550,903
Operating expenses		1,027		322,995		268,373		(129,935)		462,460
Operating income (loss)		(1,027)		52,308		37,162				88,443
Other income (expense)										
Interest income		24,282		2,370		2,921		(26,267)		3,306
Interest expense		(4,166)		(28,214)		(318)		26,267		(6,431)
Income (loss) from subsidiaries		46,363		27,076				(73,439)		
Other, net				6,578		(521)				6,057
Total other income (expense)		66,479		7,810		2,082		(73,439)		2,932
Income before provision for income taxes		65,452		60,118		39,244		(73,439)		91,375
Provision for income taxes		6,515		13,755		12,168				32,438
Net income	\$	58,937	\$	46,363	\$	27,076	\$	(73,439)	\$	58,937

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED JUNE 30, 2003

(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Revenues	\$	\$ 365,948	\$ 277,007	\$ (135,766)	\$ 507,189
Operating expenses	1,104	359,565	241,894	(135,766)	466,797
Operating income (loss)	(1,104)	6,383	35,113		40,392
Other income (expense)					
Interest income	18,554	2,336	4,504	(21,421)	3,973
Interest expense	(4,272)	(21,696)	(753)	21,421	(5,300)
Income (loss) from subsidiaries	(1,865)	25,779		(23,914)	
Other, net		(27,798)	(2,111)		(29,909)
Total other income (expense)	12,417	(21,379)	1,640	(23,914)	(31,236)
Income (loss) before provision for income taxes	11,313	(14,996)	36,753	(23,914)	9,156
Provision for income taxes	4,497	(13,131)	10,974		2,340
Net income (loss)	\$ 6,816	\$ (1,865)	\$ 25,779	\$ (23,914)	\$ 6,816

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2004

(in thousands)

	Sabre Holdings	Sabre Inc.	Non-Guarantor Subsidiaries	Eliminating Entries	Sabre Consolidated
Operating Activities					
Net earnings (loss)	\$ 101,974	\$ 75,995	\$ 40,311	\$ (116,306)	\$ 101,974
Adjustments to reconcile net earnings to cash provided by operating activities:					
Depreciation and amortization		28,685	35,730		64,415
Stock based compensation for employees		2,969	3,464		6,433
Deferred income taxes		(802)	(5,029)		(5,831)
Tax benefit from exercise of stock options	910				910
(Gain) loss on disposal of equipment		(923)	20		(903)
(Income) loss from subsidiaries	(75,995)	(40,311)		116,306	
Loss on impaired intangible asset			3,198		3,198
Equity loss in joint ventures			7,621		7,621
Other	(837)	2,407	(5,345)		(3,775)
Changes in operating assets and liabilities	(26,052)	190,222	(51,861)		112,309
Cash provided by operating activities		258,242	28,109		286,351
Investing Activities					
Additions to property and equipment		(25,752)	(10,156)		(35,908)
Purchases of marketable securities		(4,139,824)	1,662		(4,138,162)
Sales of marketable securities		4,030,234			4,030,234
Investments in and loans to joint ventures			(32,934)		(32,934)
Other investing activities			(5,000)		(5,000)
Cash used for investing activities		(135,342)	(46,428)		(181,770)
Financing Activities					
Proceeds from issuance of common stock	10,802				10,802
Dividends paid	(20,906)				(20,906)
Contributions from affiliates, net (1)	112,029		9,679	(121,708)	
Distributions to affiliates, net (1)		(121,708)		121,708	
Purchases of treasury stock	(101,925)				(101,925)
Other financing activities, net		(824)	(888)		(1,712)
Cash provided by (used for) financing activities		(122,532)	8,791		(113,741)
Increase (decrease) in cash		368	(9,528)		(9,160)
Cash at beginning of period		10,969	29,893		40,862
Cash at end of period	\$	\$ 11,337	\$ 20,365	\$	\$ 31,702

(1) Affiliate, for purposes of this footnote, refers to the various direct and indirect ownership relationships that exist within the Sabre Inc. and Non-Guarantor categories.

UNAUDITED CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2003

(in thousands)

	Sabre Holdings		Sabre Inc.		Non-Guarantor Subsidiaries		Eliminating Entries		Sabre Consolidated	
Operating Activities										
Net earnings (loss)	\$	71,695	\$	53,975	\$	45,617	\$	(99,592)	\$	71,695
Adjustments to reconcile net earnings to cash provided by operating activities:										
Depreciation and amortization				25,660		36,076				61,736
Stock based compensation for employees				2,608		6,651				9,259
Deferred income taxes										