Q2 2020 Earnings Call Script

August 7, 2020

Slide 1 – Title Slide

Good morning and welcome to the Sabre second quarter 2020 earnings conference call. As a reminder, please note today's call is being recorded.

I will now turn the call over to the Vice President of Investor Relations, Kevin Crissey. Please go ahead, sir.

Slide 2 – Forward-looking statements

<u>Kevin Crissey, VP of Investor Relations:</u>

Thanks, and good morning everyone. Thanks for joining us for our second quarter 2020 earnings call.

This morning we issued an earnings press release, which is available on our website at investors.sabre.com. A slide presentation, which accompanies today's prepared remarks, is also available during this call on the Sabre Investor Relations web page. A replay of today's call will be available on our website later this morning.

We would like to advise you that our comments contain forward-looking statements that represent our beliefs or expectations about future events, including the duration and effects of COVID-19, industry trends, cost savings and liquidity, among others. All forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the statements made on today's conference call. More information on these risks and uncertainties is contained in our earnings release issued this morning and our SEC filings, including our Form 10-Q filed on May 8, 2020 and our 2019 Form 10-K.

Throughout today's call, we will also be presenting certain non-GAAP financial measures. All references during today's call to EBITDA, Operating Loss and EPS have been adjusted to exclude certain items. The most directly comparable GAAP measures and reconciliations for non-GAAP measures are available in the earnings release and other documents posted on our website at investors.sabre.com.

Slide 3 – Today's presenters

Participating with me are Sean Menke, our President and Chief Executive Officer, and Doug Barnett, Executive Vice President and Chief Financial Officer. Dave Shirk, our

Executive Vice President and President, Travel Solutions, will be available for Q&A after the prepared remarks.

With that, I will turn the call over to Sean.

Slide 4 – Today's call

Sean Menke, President & CEO

Thanks, Kevin. Good morning everyone and thank you for joining us today.

These, without a doubt, are extraordinary times. The COVID-19 pandemic represents the greatest challenge ever faced by the global travel industry and our financial results continue to reflect this reality.

We have responded quickly and are aggressively managing that which is in our control. As COVID-19 started impacting bookings in Asia, we took immediate action to reduce expenses. As the impact of the virus spread, we made more significant cuts, including a large-scale furlough of about a third of our workforce and a capital raise of more than $1.1B dollars.

We have also been actively positioning Sabre to take advantage of opportunities on the other side of COVID-19, whenever that time comes. We made the difficult decision to align the size of our workforce to an expected smaller travel marketplace for the foreseeable future. We accelerated the strategic realignment of our agency-focused and airline businesses to provide a more seamless, holistic view of product alignment and connectivity to our customers' needs, and unlock cost efficiencies. Despite working remotely and balancing the significant personal impacts of the COVID-19 pandemic, we continued to win new customers, expand our footprint and sign key renewals. And, we continued to advance our technology transformation, including the acceleration of certain aspects to take advantage of this low volume environment. We are also making meaningful progress in our transition to Google Cloud.

I'd like to thank my Sabre teammates around the world. Like many, they have been challenged in both their personal and professional lives. During this period, they have responded in a positive and action-oriented way to help Sabre and our customers throughout the world. I am very grateful for their commitment.

Our second quarter results reflect the challenging environment presented. But before I turn it to Doug, let me comment and provide updates on:

- Booking trends and status of COVID-19 impact,
- Our business realignment,
- Commercial activity in Distribution and Airline IT and why we continue to believe in new growth opportunities in Hospitality IT,
- Advancements in our tech transformation, and

- Strategic initiatives as we look to the future.

Slide 5 – Q2 Bookings significantly impacted by COVID-19

Industry air net bookings troughed on a monthly basis in April, with all regions down more than 120% as cancellations outpaced new bookings. May was slightly better, but net bookings were still negative across all regions. June showed some additional improvement, with total air net bookings slightly positive. For the quarter, industry net bookings were down 110%.

As a result of this negative bookings environment and because cancellations were higher than expected, Sabre GDS revenue was negative in the quarter.

Slide 6 – Net bookings positive in all regions in July

Looking at the industry data on a weekly basis, you can see net bookings moved positive in all regions for all of July. North America started showing the strongest indications of recovery toward the end of June. This trend reversed due to the increase in the number of reported COVID cases in some states and further travel restrictions, but has level and begun a slight growth trajectory again. We have relatively less exposure to EMEA and the rest of the world, where the recovery has been slower.

As you would suspect, we spend a significant amount of time reviewing the marketing schedules submitted by airlines around the world and analyze the changes by region. We specifically monitor the current month, as well as the following.

Looking ahead, airline published schedules suggest a smaller year-over-year decline in capacity in Q3, compared to Q2. Although the scheduled capacity loaded for sale is trending positively and continues to improve, albeit slowly. Airline marketing schedules filed earlier this week for the month of August show global capacity down approximately 47%, versus a 72% - 56% decline during the period of May through July. It is important to note that airlines continue to aggressively manage near-term operational capacity through flight cancellations and consolidation that reduces the actual capacity flown versus the marketing schedule.

Slide 7 – Significant cancellations, but trends stabilized mid-Q2

Drilling into daily trends, cancellation activity peaked towards late March as COVID-19 restrictions went into place. Accordingly, there was a high level of cancellation activity in April. Once the cancellation activity was flushed through in May, cancellation volumes leveled off and have improved steadily since. Doug will provide more detail on our cancellation exposure later.

Slide 8 – Most significant improvement in Hospitality

On slide 8, you can see the year-over-year improvement in air bookings and passengers boarded since late March. Importantly, you can also see stronger hotel performance, with new central reservation system transactions down about 60% year-over-year last week. We believe this is a reflection of travelers being willing to drive for vacations closer to home.

Sometimes overlooked, Sabre is the leader in CRS third-party Hospitality IT with over 40,000 properties on our central reservation system and 108 million transactions processed last year, and we do business with over 40% of the world's leading hotel brands.

Because of our large footprint in Hospitality, we expect to continue to benefit as hotel transactions lead the travel industry's recovery.

Slide 9 – Business realignment provides better customer experience & cost efficiencies

The COVID-19 pandemic has caused major shifts in the travel ecosystem. We recently announced a strategic business realignment, combining airline and agency-focused businesses with important leadership changes. More specifically, we moved from a business unit alignment to a functional alignment.

This new functional structure is more consistent with other best-in-class technology companies. Our new functional areas are:

- Product management and marketing,
- Global product development,
- Agency and airline-focused sales and account management, and
- Professional services, consulting and support.

This new organizational structure became effective in early July, and we announced updated leadership for each of these areas. The leaders report to Dave Shirk and are responsible for delivering the next generation of retailing, distribution and fulfillment solutions.

The expected benefits of our functional structure are a more seamless customer experience and the ability to unlock cost efficiencies. We believe the realigned leadership focus areas, from product development and marketing to sales and professional services, will allow us to go-to-market and operate more effectively.

As part of this realignment, we have right-sized our global organization with a reduction in workforce. Inclusive of the voluntary severance and early retirement programs, our organization is about 15% smaller than 2019 year-end.

Slide 10 – Commercial update

Let me switch gears and provide a commercial update. Even with the current COVID-19-induced challenges, we continue to win new business and sign key renewals.

More specifically, on Distribution, we are happy to announce that Finnair is again being distributed on a worldwide basis through the Sabre GDS, and we can share that distribution of Lufthansa content has continued uninterrupted while positive progress continues with our negotiations for a new agreement. We also renewed key agreements with United, Emirates, Copa and Air New Zealand, and we announced a new distribution agreement with Royal Air Philippines. In addition, we signed new agency business in the quarter that we expect will result in incremental share gain.

For SabreSonic, our full-service airline reservations system, we had two important new wins. First, we announced a new PSS deal with Pacific Airlines, which was formerly known as JetStar Pacific. We've been talking about the opportunities we see, particularly with low-cost carriers who need to upgrade to a full-service reservation system, as we believe one of our competitors has entered a heavy renewal cycle. This win is an example of a competitive takeaway, and Pacific Airlines is one of the fastest growing airlines in Asia-Pacific with over 6 million passengers boarded in 2019. I am also pleased to announce a win with ASKY, a small African commuter airline that is the fastest growing in the region. We are in active conversations with other carriers around the world and feel good about our opportunities.

Turning to the Low Cost Carrier segment, our Radixx integration is well underway. We believe the LCC segment is recovering faster relative to other segments, and as a result, are seeing deal activity ramp up. We signed a renewal in the quarter with Skymark that includes an expansion into their domestic business.

We continue to see traction with Airline software sales and implementations. As we announced in May, Southwest extended its use of Intelligence Exchange, our leading analytics product, and adopted Proration Engine to perform real-time proration of tickets and deliver accurate, flight-level revenue data. In addition to Intelligence Exchange deployments, we also completed successful implementations to transform retailing and airline operations at Etihad and ASL France, and we implemented Digital Connect at LATAM in the quarter.

As I described, Hospitality CRS transaction trends are better than airline bookings. We have seen a steady recovery throughout the quarter, with transactions from down 90% to down 60% by quarter end. We are expanding our geographical footprint and seeing commercial growth in EMEA and APAC, including new agreements with Lotte Hotels & Resorts in South Korea and Resorttrust, Inc. in Japan. We also moved into the all-inclusive resort space with our recent implementation of Barcelo Hotel Group. Although our full-service PMS development was paused as Accor manages through COVID-19-related pressures, both parties remain committed to the partnership.

As mentioned, we are the leader in Hospitality IT and are encouraged by the conversations we've had with hoteliers. They are increasingly recognizing the advantages of our variable cost model over a fixed cost IT model.

Slide 11 – Technology update and strategic initiatives

As you are all aware, our technology transformation is a key component of our strategy. The progress we've made to date with the Cloud migration allowed us to dynamically scale down processing capacity and related expenses this quarter in response to reduced travel volumes.

We are taking advantage of the low volumes to accelerate certain aspects of our tech transformation. For example, session management and security modules, which as you may recall were rolled back to the mainframe last year, are now ahead of the revised schedule. The Distribution portion of the migrations is already complete, and the Airline component is substantially finished with completion expected in Q3. Offload migrations are also underway for Airport Check-in, Reservations, Pricing, Payments and Schedule Change.

We continue to make great progress on our Google partnership. We completed the technical integration of Sabre infrastructure with Google Cloud Platform in preparation to begin migrating applications in the second half of 2020. Additionally, we delivered the first phase of Google Flight Search Availability.

While we undergo a transformational journey with Google, we knew it would also be vital for us to partner with a third party to maintain the secure foundation of our existing systems while also modernizing our technology to meet customer demands. After a rigorous bidding process, in partnership with Google, I am pleased to announce an expanded multi-year agreement with DXC that reduced our cost structure and extends their support of our global reservation platform.

The tech transformation that I described is one of our five strategic initiatives. Our vision for the future hasn't changed. We still intend to transform our business and create new opportunities for personalized travel.

Our focus on NDC-enablement continues to progress. We achieved a significant milestone this week. We are officially in the NDC registry as a Level 4 Certified Aggregator. In addition, Sabre is the only Level 4 GDS aggregator in the registry to name the partners with whom we achieved the certification – Flight Centre and United. Another airline customer, Belavia, recently achieved Level 3 NDC-certification using Sabre Airline IT capabilities.

We are supportive of the NDC initiative and continue to believe in its long-term value creation. However, airlines are facing significant challenges right now, and we believe adopting NDC has changed in the priority list for some carriers. We will continue to execute against our roadmap and look forward to providing continued progress updates.

I want to once again reiterate the significant challenge COVID-19 presents to our industry. We have made hard decisions to better align our organization and cost structure with current demand. We continue to support our customers and remain active with commercial wins and renewals. We are continuing to invest in technology and are using this lower volume environment as an opportunity to accelerate our tech transformation and migration to Google Cloud.

As a mission-critical solutions provider to the global travel industry, we believe we have positioned the company well for growth post-COVID-19. Before I turn it over to Doug, I'd like to welcome our new Board members, Gail Mandel, who joined us in April, and Gregg Saretsky and John Scott, who joined in July. The Board continues to focus on refreshing its composition, and we believe their significant technology, hospitality and airline backgrounds will contribute significant value to the Board.

With that, I'll turn it over to Doug.

Slide 12 – Q2 results significantly impacted by COVID-19

Doug Barnett, CFO:

Thanks Sean, and good morning everyone.

We are in a time of unprecedented disruption to the travel industry. Revenue was down 92% in the quarter, totaling $83M versus $1B last year. Last quarter, we described how 15% of our revenue, or approximately $150M per quarter, is not tied to travel volumes. This remains the case, but we did not operate in a zero bookings environment in the quarter. Rather, net bookings were negative, and our financial results reflect this.

Travel Network bookings were down 105%, and bookings trends were in line with the updates we provided throughout the quarter. Gross bookings were down 95%, 91%, and 86% in April, May and June, respectively. We report bookings on a net basis, meaning net of cancellations. Net bookings were positive in June for the first time since early March and continued in positive territory in July. However, net bookings were negative in April and May, and for the second quarter as a whole as cancellations exceeded our expectations. Consequently, our TN revenue in the quarter was negative $33 million.

Let me update you on our current cancellations exposure. As of the end of Q2, we have recognized $27M of revenue from bookings that have not yet departed, and we increased our cancellation reserve to $60M as of the end of the quarter. Remember that about half of the impact of cancellations is offset by reductions in incentives.

EBITDA, operating income and net income were all negative in Q2, reflecting the impact of COVID-19. The year-over-year decline in revenue was partially offset by a decline in incentives expense, headcount expenses due to cost savings initiatives, and technology expenses due to the lower transaction volume environment.

In addition, Free Cash Flow was negative in the quarter.

Our normal-course financial results slides are in the appendix of our earnings presentation.

Slide 13 – Variable cost base helped offset COVID-19 impact

Last quarter, we talked to you about how our variable costs account for 2/3 of our total cost base, or they represented about $2 billion in 2019. The three categories of variable costs are Travel Network incentives, volume-related technology hosting costs, and headcount-related costs.

In the second quarter, we saw the benefit of our highly variable cost base across all three categories. Incentives were $366 million lower than the prior year quarter.

Volume-related technology hosting costs totaled about $250 million in 2019. In the second quarter, given the dramatically lower volume environment, our technology hosting costs scaled down nicely. Because we were able to dynamically scale down processing capacity, we have reduced cloud costs by approximately $2 million per month. On the mainframe, our costs this quarter were down 35% year-over-year. Our total tech costs, which also includes fixed hosting and R&D costs, were down $53 million, or 26%, in the quarter.

On headcount, we recognized significant savings in the quarter due to our cost savings actions. We made the difficult decision to reduce our workforce by approximately 15%. In the quarter, we recognized a restructuring charge of $48 million related to this. We believe our total headcount-related costs will be down 20% to 25% versus where they were at the beginning of Sean's leadership three and a half years ago. For the quarter, our non-development labor costs were down $44M, or 37%.

The other third of our cost base, or $1 billion in 2019, we define as fixed in the near-term. We are working hard to reduce this fixed cost base. A couple of areas I'd like to highlight include examining our real estate footprint around the world as we look to adopt a more flexible, "work from anywhere" policy. Additionally, as Sean discussed earlier, we have extended our contract with DXC, which will help reduce the fixed portion of our technology hosting costs. We expect our new agreement to provide approximately $80 million in cumulative savings over the next three years, compared to our pre-COVID-19 expectations. This represents significant cost savings that largely offset the mainframe cost overruns we discussed on our February call.

To be clear, we no longer expect to spend the incremental $150 million of technology spend we expected coming into the year. We now expect our total tech spend to be significantly lower than the original guidance provided in February of $1.2 billion. This change is a combination of reduced volumes through the volume-related component of our hosting costs, DXC cost savings and reduced R&D headcount.

As we look to the future, our technology footprint and headcount have been aligned to what we expect will be a smaller travel industry post-COVID-19. We continue to expect total cost savings of $275 million in 2020.

On an annual run-rate basis, we expect approximately $200 million in savings versus 2019. This includes headcount-related savings from our smaller employee base and savings from our new DXC contract. Additionally, there could be incremental technology hosting cost savings if a lower booking volume environment persists. We can take further actions to reduce our cost structure, but we hope it won't be necessary.

Slide 14 – $1.3 billion cash balance

Let me remind you of the quick and effective actions we took to strengthen our liquidity position during this crisis. We identified and implemented $275M in expected 2020 cost savings, renegotiated our DXC contract, suspended dividends and share repurchases, drew down on our revolver, and raised $1.1 billion from the issuance of senior secured and exchangeable notes. Additionally, the Bureau of Transportation Statistics published the official data for April passenger enplanements, which confirms that a Material Travel Event Disruption occurred. Therefore, our leverage ratio covenant under our Amended and Restated Credit Agreement has been suspended for at least the second and third quarter of 2020. Current carrier capacity forecasts lead to our expectations that this suspension will remain for the balance of the year. Finally, we have no significant expected near-term uses of cash.

In a zero bookings environment, we continue expect approximately $150 million of revenue and $240 million of cash burn per quarter. In the second quarter, Free Cash Flow was negative $446 million and was impacted by:

- Approximately $240 million of cash burn in a zero bookings environment,
- $67 million lower revenue than zero bookings expectations because bookings were actually negative for the quarter,
- Three previously disclosed cash usage items:
    - $30 million in refunds owed to airlines for Q1 cancellations,
    - $52 million in incentive payments delayed from Q1 and
    - $21 million of Farelogix termination fees,
- And finally:
    - $13 million in severance payments, which we previously thought would be a Q3 item, and
    - $23 million in other working capital items.

We ended the quarter with $1.3 billion in cash. With our current cost structure and bookings mix, we expect we can achieve break-even Free Cash Flow at approximately 70% of 2019 volumes.

Before I turn it back to Sean, please note our business realignment that Sean reviewed earlier is expected to result in a reclassification of our financial statements in the third quarter. We intend to continue providing you with Distribution, IT Solutions and Hospitality IT level revenue detail and will continue reporting our key volume metrics.

Sean, back to you.

Slide 15 – Thank you

Thanks Doug. COVID-19 presented an unprecedented challenge in the second quarter that was reflected in our results. However, we remain focused on the opportunities during and after the industry's recovery. We continue to make advancements in our technology transformation and identify incremental savings, as well as commercial wins in Distribution and Airline IT. We are the leader in Hospitality IT and remain particularly excited about commercial growth as hotel bookings lead the travel industry's recovery.

Finally, I want to once again thank my Sabre teammates around the world for their dedication to serving our customers, shareholders and each other during this difficult time. Together, we will get through this. We will make travel happen again.