SABRE HOLDINGS CORP
Form 10-Q
November 14, 2001

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 September 30, 2001.

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.)
4255 Amon Carter Blvd. Fort Worth, Texas	**76155**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code	**(817) 963-6400**

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 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 133,481,876 as of October 31, 2001

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SABRE HOLDINGS CORPORATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2001	December 31, 2000
Assets		
Current assets		
Cash	$ 13,258	$ 7,778
Marketable securities	817,227	137,258
Accounts receivable, net	393,305	448,463
Prepaid expenses	58,501	83,580
Deferred income taxes	45,300	15,889
Total current assets	1,327,591	692,968
Property and equipment		
Buildings and leasehold improvements	266,131	340,473
Furniture, fixtures and equipment	48,886	49,627
Service contract equipment	-	517,886
Computer equipment	166,608	527,085
	481,625	1,435,071
Less accumulated depreciation and amortization	(195,989)	(879,030)
Total property and equipment	285,636	556,041
Deferred income taxes	7,655	-
Investments in joint ventures	158,728	159,317
Goodwill and intangible assets, net	730,282	891,497
Other assets, net	163,262	350,531
Total assets	$ 2,673,154	$ 2,650,354
Liabilities and stockholders equity		
Current liabilities		
Accounts payable	$ 178,048	$ 173,954
Accrued compensation and related benefits	77,809	91,196
Notes payable	-	710,000
Taxes payable	182,663	15,664
Other accrued liabilities	358,977	275,574
Total current liabilities	797,497	1,266,388
Deferred income taxes	-	47,703
Pensions and other postretirement benefits	89,516	109,889
Notes payable	410,976	149,000
Other liabilities	61,841	46,877
Minority interests	222,548	239,480

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; 134,006 and 131,632 shares issued at September 30, 2001 and December 31, 2000, respectively		1,338		1,321
Additional paid-in capital		793,953		660,987
Retained earnings		297,098		196,164
Accumulated other comprehensive income		5,212		111
Less treasury stock at cost: 10 and 1,625 shares, respectively		(6,825)		(67,566)
Total stockholders equity		1,090,776		791,017
Total liabilities and stockholders equity	$	2,673,154	$	2,650,354

See Notes to Consolidated Financial Statements

SABRE HOLDINGS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

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

	Three Months Ended September 30, 2001	Three Months Ended September 30, 2000	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2000
Revenues	$ 524,829	$ 495,596	$ 1,680,278	$ 1,476,115
Operating expenses				
Cost of revenues	341,217	328,426	1,059,065	973,518
Selling, general and administrative	110,731	84,630	328,739	242,840
Amortization of goodwill and intangible assets	70,775	21,759	207,060	47,841
Total operating expenses	522,723	434,815	1,594,864	1,264,199
Operating income	2,106	60,781	85,414	211,916
Other income (expense)				
Interest income	8,086	3,376	15,596	12,200
Interest expense	(5,869)	(7,276)	(34,470)	(15,813)
Other, net	47,618	747	39,765	772
Total other income (expense)	49,835	(3,153)	20,891	(2,841)
Minority interests	5,038	8,544	17,209	23,451
Income from continuing operations before income taxes	56,979	66,172	123,514	232,526
Provision for income taxes	39,689	26,185	100,760	95,649
Income from continuing operations	17,290	39,987	22,754	136,877
Income from discontinued operations, net	-	4,428	36,305	36,562
Gain on sale of discontinued operations, net	38,772	-	38,772	-
Income before cumulative effect of change in accounting method	56,062	44,415	97,831	173,439
Cumulative effect of change in accounting method, net of minority interests and income taxes	-	-	3,103	-
Net earnings	$ 56,062	$ 44,415	$ 100,934	$ 173,439
Earnings per common share basic				
Income from continuing operations	$ .13	$ .31	$ .17	$ 1.06
Income from discontinued operations	.29	.03	.57	.28

Cumulative effect of change in accounting method		-		-		.02		-
Net earnings	$	.42	$	.34	$	.76	$	1.34
Earnings per common share diluted								
Income from continuing operations	$	.13	$	.31	$	.17	$	1.06
Income from discontinued operations		.29		.03		.56		.22
Cumulative effect of change in accounting method		-		-		.02		-
Net earnings	$	.42	$	.34	$	.75	$	1.28

See Notes to Consolidated Financial Statements.

SABRE HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2001
(Unaudited) (In thousands)

	Class A Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance at December 31, 2000	$ 1,321	$ 660,987	$ 196,164	$ 111	$ (67,566)	$ 791,017
Issuance of Class A common stock pursuant to stock option, restricted stock incentive and stock purchase plans	17	26,736	-	-	67,151	93,904
Tax benefit from exercise of employee stock options	-	17,472	-	-	-	17,472
Purchase of treasury stock	-	-	-	-	(6,410)	(6,410)
Reclassification of US Airways options	-	100,447	-	-	-	100,447
Change in fair value of contingent warrants to be issued to customer	-	(13,669)	-	-	-	(13,669)
Comprehensive income:						
Net earnings	-	-	100,934	-	-	100,934
Unrealized gain on foreign currency forward contracts, net of deferred income taxes	-	-	-	2,021	-	2,021
Unrealized gain on investments, net of deferred income taxes	-	-	-	3,048	-	3,048
Unrealized foreign currency translation gain	-	-	-	32	-	32
Total comprehensive income						106,035
Other	-	1,980	-	-	-	1,980
Balance at September 30, 2001	$ 1,338	$ 793,953	$ 297,098	$ 5,212	$ (6,825)	$ 1,090,776

See Notes to Consolidated Financial Statements.

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

	Nine Months Ended September 30, 2001	2000
Operating Activities		
Net earnings	$ 100,934	$ 173,439
Adjustments to reconcile net earnings to cash provided by operating activities		
Depreciation and amortization	351,176	214,629
Deferred income taxes	(84,769)	3,655
Tax benefit from exercise of stock options	17,472	1,547
Minority interests	(17,209)	(23,451)
Gain on sale of discontinued operations, net	(38,772)	-
Gain on sale of Equant shares	(47,303)	-
Cumulative effect of change in accounting method, net	(3,103)	-
Other	9,916	8,683
Changes in operating assets and liabilities		
Accounts receivable	93,491	(195,614)
Prepaid expenses	(9,537)	(69,230)
Other assets	(49,401)	(40,050)
Accrued compensation and related benefits	(14,167)	2,754
Accounts payable and other accrued liabilities	238,622	139,440
Receivable from related parties	-	29,093
Pensions and other postretirement benefits	(20,373)	(14,805)
Payment to US Airways	-	(81,469)
Other liabilities	(4,175)	(26,822)
Cash provided by operating activities	522,802	121,799
Investing Activities		
Additions to property and equipment	(133,231)	(144,193)
Acquisitions, net of cash acquired	(45,956)	(33,003)
Proceeds from sale of discontinued operations	660,763	-
Proceeds from sale of investments	47,303	-
Sale of securities acquired upon exercise of warrants	36,604	-
Purchases of marketable securities	(2,703,107)	(9,432,247)
Sales of marketable securities	2,028,523	9,857,073
Other investing activities, net	(34,106)	(12,452)
Cash provided by (used for) investing activities	(143,207)	235,178
Financing Activities		
Proceeds from issuance of common stock pursuant to employee stock plans	93,904	6,133
Purchases of treasury stock	(6,410)	(34,472)
Dividends paid	-	(675,000)
Payment of notes payable	(859,000)	349,000
Proceeds from issuance of notes payable	397,391	-

Cash used for financing activities		(374,115)		(354,339)
Increase in cash		5,480		2,638
Cash at beginning of the period		7,778		6,628
Cash at end of the period	$	13,258	$	9,266

See Notes to Consolidated Financial Statements.

SABRE HOLDINGS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General Information

Sabre Holdings Corporation is a holding company. Its sole direct subsidiary is Sabre Inc., which is the successor to certain businesses that were previously operated as subsidiaries or divisions of American Airlines, Inc. (American) or AMR Corporation (AMR). AMR spun-off Sabre on March 15, 2000 and no longer has any ownership interest in the Company. Unless otherwise indicated, references herein to the Company include Sabre Holdings Corporation and its consolidated subsidiaries.

The Company generates most of its revenue from continuing operations by providing travel marketing and distribution services to travel agencies and travel suppliers using the Sabre® global distribution system, ("the Sabre system"), to consumers using the Travelocity.com Web site and to businesses using GetThere products. The Company also generates revenues from the development and marketing of airline software solutions, and from products and services offered by emerging businesses.

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 nine month periods ended September 30, 2001 are not necessarily indicative of results that may be expected for any other interim period or for the year ended December 31, 2001. The Company s quarterly financial data should be read in conjunction with the consolidated financial statements of the Company for the year ended December 31, 2000 (including the notes thereto), set forth in Sabre Holdings Corporation s Current Report on Form 8-K filed with the Securities and Exchange Commission on July 16, 2001.

Reclassifications Certain reclassifications have been made to the 2000 financial statements to conform to the 2001 presentation.

Recent Accounting Pronouncements In June 2001, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets*, (FAS 142) effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized, but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the nonamortization provisions of FAS 142 is expected to increase net income by approximately $218 million, or $1.60 per diluted share, in 2002, as a result of the cessation of amortization of existing goodwill and certain intangibles. Amortization of goodwill and other intangible assets recorded in connection with business combinations totaled approximately $71 million and $207 million during the three and nine month periods ended September 30, 2001, respectively, and approximately $22 million and $48 million during the three and nine month periods ended September 30, 2000, respectively.

Prior to the adoption of FAS 142, the Company's policy is to evaluate goodwill for impairment on an undiscounted projected future cash flows basis. The Company will perform the first of the required impairment tests of goodwill and indefinite lived intangible assets pursuant to FAS 142 as of January 1, 2002. The Company has not yet determined what the effect of these tests will be on the earnings and financial position of the Company (see Note 4).

The FASB has also recently issued FAS No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets* ("FAS 144"), which will be adopted by the Company January 1, 2002. The FASB's new rules on asset impairment supersede FAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* ("FAS 121").

FAS 144 retains the requirements of FAS 121 to (a) recognize an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset, but removes goodwill from its scope. This aspect of FAS 144 will primarily effect the Company s accounting for intangible assests subject to amortization, property and equipment, and certain other long-lived assets.

FAS 144 significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Under the provisions of FAS 144, assets to be disposed of will be stated at the lower of their fair values or carrying amounts and depreciation no longer recognized.

FAS 144 also supersedes the provisions of Accounting Principles Board ("APB") Opinion No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* ("APB 30") with regard to reporting the effects of a disposal of a segment of a business, and requires expected future operating losses from discontinued operations to be displayed in discontinued operations in the period(s) in which the losses are incurred (rather than as of the measurement date as presently required). In addition, more dispositions will qualify for discontinued operations treatment in the income statement.

The Company has not yet evaluated what the effect of adoption of FAS 144 will be on its financial conditions and results of operations.

3. Discontinued Operations

On July 2, 2001 the Company completed a transaction with Electronic Data Systems Corporation ("EDS") which provided for (i) the sale of the Company s infrastructure outsourcing business and information technology (IT) infrastructure assets and associated real estate to EDS (the "Asset Purchase Agreement"), (ii) a 10-year contract with EDS to manage the Company s IT systems (the "IT Outsourcing Agreement"), and (iii) agreements between the Company and EDS to jointly market IT services and software solutions to the travel and transportation industries (the "Marketing Agreements").

The disposition of the infrastructure outsourcing business represents the disposal of a business segment under APB 30. The accompanying consolidated financial statements have been reclassified to present the results of discontinued operations separately for all periods presented. Summarized financial information for the discontinued operations is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2001	**2000**	**2001**	**2000**
Revenues	$ -	$ 171,740	$ 370,007	$ 497,912
Income before provision for income taxes	$ -	$ 7,206	$ 59,060	$ 59,239
Provision for income taxes	-	2,778	22,755	22,677
Income from discontinued operations	$ -	$ 4,428	$ 36,305	$ 36,562

Under the Asset Purchase Agreement, the Company sold its infrastructure outsourcing contracts, web hosting contracts and IT infrastructure assets to EDS for approximately $661 million in cash. The Company used the entire $661 million of the cash proceeds from the sale plus $49 million of additional cash to completely pay off $710 million of borrowings. In addition, the Company may receive aggregate additional payments from EDS for these assets ranging from $6 million to $25 million on April 15, 2003 and 2004, depending on the amount of revenues received by EDS under certain other airline outsourcing contracts. Such amounts will be recognized as a gain when and if earned. The Company recorded a gain of approximately $39 million, net of related income taxes of approximately $25 million, resulting from the disposition of these assets during the three months ended September 30, 2001.

The assets transferred included: outsourcing contracts with American, US Airways, Gulf Air, and Dollar/Thrifty Rent-A-Car; data centers; and network, desktop and mid range computer systems. Those assets were used for the Company s outsourcing business and for transaction processing in its travel marketing and distribution segment, including the operation of the Sabre system. Approximately 4,000 of the Company s employees, located mostly in the United States, transitioned to employment with EDS upon the closing of the transaction.

The Company retained its core travel marketing and distribution business, including the line of business related to contracts with travel suppliers and travel agency subscribers for participation in the Sabre system; the Company's investment in the Travelocity.com^{SM} consumer on-line business, GetThere^{TM} corporate on-line booking business, and online travel sites for Web site development and booking engine services. The Company plans to continue to focus its business on remaining the global leader in all channels of travel distribution.

The Company also retained contracts and assets that are related to airline solutions and emerging businesses, which includes providing internal reservation systems for airline customers; software applications development, maintenance and licensing; the Company's intellectual property assets, including its software applications portfolios; and the eMergo^{TM} suite of airline solutions offered by the Company as an online application service provider.

Under the IT Outsourcing Agreement, EDS will provide, manage and operate the Company's IT infrastructure, including data center management, applications hosting, selected applications development, data assurance, and network management services. The term of the outsourcing agreement is 10 years. Fees paid to EDS under the Outsourcing Agreement will be primarily based on the usage of services. The Outsourcing Agreement is expected to generate future cost savings for the Company.

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Under the Marketing Agreements, the Company and EDS will jointly market IT services and software solutions to the travel and transportation industries. As part of the marketing relationship, EDS will contribute $20 million toward enhancing and promoting the Company's portfolio of airline software solutions. Such amounts will be recognized as a reduction of the Company s costs of such enhancements and promotions. EDS also agreed to move its travel bookings to the Company's Sabre system and to implement the Company's GetThere corporate booking platform in its organization.

4. Significant Events

Sabre Pacific

In March 2001, the Company purchased the Sabre Pacific travel distribution business for approximately $46 million from TIAS, a travel distribution alliance among three airlines in Australia and New Zealand. The acquisition has been accounted for as a purchase. Assets acquired and liabilities assumed have been recorded at their fair values and the excess of cost over the estimated fair value of the net tangible assets has been recorded as goodwill. The purchase will give travel suppliers, travel agents and travelers in the South Pacific region greater access to the Company s global resources and technology, potentially boosting the Company s bookings share in that region. The following table summarizes the allocation of the purchase price and amounts allocated to goodwill and intangible assets (in thousands):

Fair value of assets purchased	$	9,738
Fair value of liabilities assumed		(7,944)
Goodwill and intangible assets		44,394
Total purchase price	$	46,188

Events of September 11, 2001

On September 11, 2001, the United States was the target of terrorist attacks of unprecedented scope involving the hijacking and destruction of multiple passenger aircraft operated by commercial air carriers. Air travel in the United States was suspended for several days after the attacks. As a consequence, the Company has experienced significant decreases in bookings volumes due to reduced travel in the United States and, to a lesser degree, internationally. The Company s results of operations for the three months ended September 30, 2001 were significantly negatively affected by this reduction in travel. Travel bookings decreased dramatically in the days immediately following the attack but steadily increased from a 65% decline as compared to the same period a year ago, to a 35% decline by the end of September.

We expect that the Company, the travel industry and the economy in general will continue to be adversely affected by the terrorist attacks on New York and Washington, and by any subsequent terrorist-related activity, particularly if any such activity involves commercial air transportation. It is not possible to predict either the severity or duration of such decreases in the medium- or long-term. A prolonged substantial decrease in travel bookings volumes could have an adverse impact on our financial performance, operations, liquidity, or capital resources and could impair the Company's ability to recover the carrying value of certain of its assets, including capitalized software, other intangible assets and goodwill (see Note 2).

To assist its customers dealing with the severe financial impact of the attacks on September 11, the Company implemented several initiatives to help the industry move forward toward eventual recovery. The Company provided credits to its airline customers for booking fees related to reservations canceled by subscribers on the day of departure for flights between September 11 and September 14 as a result of the FAA grounding U.S. flights. The Company also has waived through the end of the year the premium charged to airlines for connection to the highest connectivity level in the Sabre system. For travel agents, measures included waiving the shortfall levels through the end of the year, and creating Travel Bulletin Central, a travel advisory portal offering travelers the latest travel and security information. The Company estimates that the costs for the three months ended September 30, 2001 for these customer initiatives were approximately $2 million, and estimates fourth quarter 2001 expenses for these customer initiatives to be in the $8 million to $13 million range.

US Airways options

On December 31, 2000, the opportunity of US Airways to select an alternative vehicle in place of receiving approximately 3.4 million shares of the Company s common stock upon exercise of a second tranche of options expired. As a result, beginning January 1, 2001, those options held by US Airways began to be carried as an equity instrument instead of a liability instrument. The fair market value of the options on January 1, 2001 of approximately $100 million was reclassified from liabilities to Additional Paid-in Capital. The carrying value of the deferred asset associated with the options on July 2, 2001 of approximately $124 million has been included in the computation of the gain on the sale of discontinued operations (see Note 3).

Sale of Equant Shares

Prior to June 30, 2001, American held for the economic benefit of the Company 2.3 million depository certificates representing beneficial ownership of common stock of Equant N.V. (Equant), a telecommunications company affiliated with Societe Internationale de Telecommunications Aeronautiques (SITA). The depository certificates were issued by the SITA Foundation, which holds the underlying Equant shares. On June 29, 2001, the SITA Foundation completed a transaction whereby all of the SITA Foundation s Equant shares were exchanged for shares of France Telecom. On July 3, 2001, the SITA Foundation sold in entirety the Company s France Telecom shares. The Company recorded a gain on the sale of approximately $47 million which is included in other, net in the accompanying Consolidated Statements of Income for the three and nine months ended September 30, 2001.

Issuance of Notes

On August 7, 2001, Sabre Holdings Corporation issued $400 million in unsecured notes with a fixed interest rate of 7.35% due August 1, 2011, ("Notes") in an underwritten public offering, receiving net cash proceeds of approximately $397 million. The Company used $79 million of the proceeds to repay on August 8, 2001 the borrowings under the senior unsecured, revolving credit agreement entered into on February 4, 2000 by Sabre Inc., (the "Credit Facility"). Along with the repayment on July 20, 2001 of $70 million of borrowings under the Credit Facility using existing cash, the Company has repaid all outstanding borrowings under the Credit Facility. The remaining proceeds from the sale of the Notes were added to working capital.

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 September 30, 2001	Three Months Ended September 30, 2000	Nine Months Ended September 30, 2001	Nine Months Ended September 30, 2000
Income tax provision at statutory federal income tax rate	$ 19,943	$ 23,160	$ 43,230	$ 81,384
State income taxes, net of federal benefit	2,560	1,574	4,014	7,756
Nondeductible goodwill amortization	21,457	3,818	59,350	10,669
Research and experimentation credit	(1,000)	(2,400)	(3,000)	(2,400)
Other, net	(3,271)	33	(2,834)	(1,760)
Total provision for income taxes	$ 39,689	$ 26,185	$ 100,760	$ 95,649

6. Derivatives

The Company adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133) effective January 1, 2001. FAS 133 requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of the change in fair value of a derivative designated as a hedge will be immediately recognized in earnings. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

At January 1, 2001, the Company was a party to certain derivative instruments, including foreign currency forwards related to anticipated foreign currency expenditures over the next twelve months, an interest rate/foreign currency swap contract entered into in connection with Euro denominated debt related to the acquisition of Gradient Solutions Limited during 2000 and warrants received from Hotel Reservations Network (HRN Warrants) by Travelocity.com in connection with an affiliation agreement entered into during 2000.

The Company has designated its foreign currency forwards as a cash flow hedge. As such, the effective portion of the gain or loss on the forwards is reported as a component of other comprehensive income and reclassified into earnings as a component of cost of revenues in the same period or periods during which the hedged transaction affects earnings. Effectiveness is measured by comparing the changes in the present value of the anticipated foreign currency denominated expenses, measured using forward rates, arising from the hedged forecasted expenses with the changes in the fair value of the forward contract using forward exchange rates. Any gain or loss on the forwards in excess of the cumulative change in the present value of the anticipated foreign currency denominated expenses, if any, is recognized in other income during the period of change. The cumulative effect of adoption of FAS 133 related to these foreign currency forwards was insignificant. Amounts reclassified from other comprehensive income to earnings during the three and nine months ended September 30, 2001 relating to the forwards were not significant. There was no hedging ineffectiveness recorded in earnings relating to the forwards during the nine months ended September 30, 2001.

The Company also recognized a cumulative gain in earnings upon adoption of FAS 133 of approximately $3 million, net of minority interest of approximately $2 million and deferred income taxes of approximately $2 million, relating to the HRN Warrants. During March 2001, the Company extended its affiliation agreement with HRN through July 31, 2005 and expanded the scope of the HRN relationship. In connection with the expanded and extended agreement, the Company received additional vested HRN Warrants with a fair value of approximately $30 million on the date of receipt. The Company will recognize this amount as revenue over the extended term of the agreement. During the three and nine months ended September 30, 2001 the Company recognized revenue relating to amortization of the fair value of the HRN warrants received at contract origination and modification totaling approximately $2.2 million and $5.2 million, respectively, compared to $0.2 million and $0.6 million, respectively for the three and nine months ended September 30, 2000. The Company may also vest in additional warrants in the future based upon the achievement of certain performance metrics. During the three and nine month periods ended September 30, 2001, the Company received additional HRN warrants, based on certain performance metrics, with a fair value of approximately $0.7 million and $2.5 million, respectively. Such amounts have been recognized as revenue in the periods the warrants were earned. The Company recorded a gain of approximately $0.1 million in other income during the three months ended September 30, 2001 and recorded a loss of approximately $3.3 million in other income during the nine months ended September 30, 2001, relating to changes in the fair value of the HRN Warrants, including a $0.4 million loss related to exercises of the warrants for HRN stock. The Company disposed of the HRN stock received upon exercise for cash proceeds totaling approximately $37 million. As of September 30, 2001 the Company holds approximately 50,967 unexercised HRN warrants.

In connection with the issuance of the Notes (see Note 4), the Company entered into two interest rate swaps. Under the terms of the first swap, which has a notional amount of $100 million, the Company will receive semi-annual payments based on a fixed interest rate of 7.35% and will make semi-annual payments on a LIBOR plus 140.5 basis points. Under the terms of the second swap, which has a notional amount of $200 million, the Company will receive semi-annual payments based on a fixed interest rate of 7.35% and will make semi-annual payments on a LIBOR plus 157.4 basis points. The Company has designated the swaps as fair value hedges of $100 million and $200 million principal amount, respectively, of the notes.

Changes in the fair value of the swaps are expected to reflect changes in the fair value of the Notes due to changes in the swap rate, the designated benchmark interest rate. Because the critical terms of the Notes and the swaps match, the swaps will be considered a perfectly effective hedge against changes in the fair value of the Notes due to changes in the LIBOR rate. Changes in the fair value of the swaps are recognized as a component of other income in each reporting period. Additionally, the carrying value of the Notes is adjusted by a like amount, with the adjustment recognized as a component of other income. During the three months ended September 30, 2001, the Company recorded a hedging asset of approximately $14 million, which is included in other assets, net in the accompanying balance sheet, and a corresponding increase in the carrying value of the Notes.

The estimated fair values of the Company s derivatives as of September 30, 2001 are provided below (in thousands):

		Asset/(Liability)
Foreign currency forwards	$	935
HRN Warrants		714
Interest rate swaps		13,538
	$	15,187

Derivative assets and liabilities are classified as current or long-term other assets and other liabilities, respectively, in the accompanying balance sheet, depending on the date of settlement of the contract.

7. Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	**2000**	**2001**	**2000**
Denominator:				
Denominator for basic earnings per common share weighted-average shares	133,110	128,889	132,092	129,191
Dilutive effect of stock awards and options	1,966	169	2,519	398
Denominator for diluted earnings per common share adjusted weighted-average shares	135,076	129,058	134,611	129,589

Income from discontinued operations, net, used in the diluted earnings per share calculations for the three and nine month periods ended September 30, 2000, has been decreased by approximately $0.2 million and $7.4 million, respectively, to reflect the amortization expense that would have been recognized by the Company had options issued to US Airways qualified as equity instruments for accounting purposes during these periods.

8. Segment Reporting

The Company has four reportable segments: Travel Marketing and Distribution, Travelocity.com, GetThere, and Airline Solutions and Emerging Businesses. The Travel Marketing and Distribution segment distributes travel services to travel agencies (subscribers). Through the Company s global distribution system, subscribers can access information about and book reservations with airlines and other providers of travel and travel-related products and services. The Travelocity.com segment distributes travel services to individual consumers. Through the Travelocity.com Web site, individual consumers can compare prices, make travel reservations and obtain destination information online. GetThere distributes travel services on-line directly to businesses. GetThere operates one of the world s largest Internet marketplaces focused on business-to-business travel services and powers online travel sites for leading airlines. The Airline Solutions and Emerging Businesses segment primarily provides software development and consulting solutions and other products and services to airlines and other travel providers. The Company s reportable segments are strategic business units that offer different products and services and are managed separately because each business requires different market strategies.

The segment information for 2001 is presented on a basis that excludes certain special items that are summarized below. The 2000 data has been reclassified to conform with this presentation. This presentation is consistent with the manner in which the Company s management assesses the operating performance of its business segments.

Selected information for the Company s four reportable segments for the three and nine months ended September 30, 2001 and 2000 follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2001	2000	2001	2000
Revenues from external customers:				
Travel Marketing and Distribution	$ 389,304	$ 403,950	$ 1,299,172	$ 1,228,801
Travelocity.com	61,174	39,957	180,729	93,653
GetThere	11,312	1,274	33,150	3,572
Airline Solutions and Emerging Businesses	57,244	44,508	150,710	134,760
Total	$ 519,034	$ 489,689	$ 1,663,761	$ 1,460,786
Intersegment revenues:				
Travel Marketing and Distribution	$ 6,751	$ 4,549	$ 19,550	$ 11,318