

Home Bookin'

A White Paper on the Emergence of the Home-Based Agency Channel



- Growth in home-based travel agents is consistent with our thesis suggesting complex travel suppliers are selling into an increasingly efficient traditional distribution platform. We forecast both volume and productivity per agent in the home-based channel, already estimated at 15,000 strong, can expand at a 10-15% CAGR over the next five years.
- Home-based growth drivers include the need to reduce fixed costs, proliferation of sophisticated Web-based direct-access selling and productivity tools, validation provided by entry of major franchise groups and increasing supplier support.
- Greatest beneficiaries are high relative commission complex travel suppliers, particularly cruise lines as 84% of home-based agents surveyed cited cruise as primary product emphasis. Carnival (CCL/\$57/\$65/O/MW) and Royal Caribbean (RCL/\$53/\$65/O/MW) benefit from incremental demand creation and lower exposure to VBI payments.
- GDS implications are consistent with our strategic convergence thesis including volume migration to lower-cost/higher functionality channels and our forecast 3-5% channel shift for the GDS including Sabre (TSG/\$21/\$22/N/MW) and Cendant's (CD/\$23/\$28/O/MW) Galileo.

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Executive Summary

The home-based channel is expanding from both headcount and productivity gains

Home-based agent growth is offsetting degradation in ARC agency locations

Technology and supplier support are key enablers of home-based growth

We are witnessing strong growth across different home-based models

- The home-based agency channel is emerging as a force in travel distribution.* Growth in the home-based agency channel is entirely consistent with our long-held thesis that the traditional travel agency channel is becoming increasingly efficient. Faced with a zero base-pay environment in air and competition from automated channels, surviving traditional travel agencies have splintered into two camps – an increasingly consolidated number of major agency groups that focus on complex managed corporate travel and a number of relatively smaller agencies that have retrenched by focusing on complex travel categories that typically require higher service levels. The latter group includes home-based travel agents, which include experienced agents and newcomers to the business stimulated by reduced cost and training barriers. Based on rough industry association data, we estimate there are between 15,000 and 20,000 qualified home-based agents in the U.S., a number we expect to expand at a 10-15% pace through the end of the decade. Based on our survey work and recent precedent trends, we estimate home-based agency channel productivity could also compound at a 10% pace owing to proliferation of increasingly efficient inventory access, selling and productivity tools. Home-based agent growth stands in stark contrast to continued degradation in Airlines Reporting Corp. (ARC) locations, which have declined from 29,940 in 2001 to 21,096 currently. In fact, we suspect the reinvention of ARC-bonded agencies into non-ARC, non-GDS home-based businesses is contributing to the consistent decline in ARC agency locations. This is supported by the fact that a large percentage of home-based agents we contacted already had brick-and-mortar travel agency experience.
- Growth drivers include retail agency cost pressures and the application of technology.* Growth in the home-based channel is being driven by a confluence of dynamics including the need to reduce fixed costs associated with a retail location, particularly given volatility associated with external travel industry shocks such as the September 11 terror attacks, and the proliferation of increasingly sophisticated tools targeted at home-based agencies. These tools, which greatly simplify the marketing, selling and booking of complex travel are either provided by a franchiser/host agency or are made available direct from the supplier through targeted agent-only Websites. Our research indicates complex travel management tools now include sophisticated inventory access, automated passenger name record (PNR) and support functionality, which are typically better than those offered by the legacy global distribution systems (GDS) including Sabre and Galileo. We also note that the channel has benefited from enhanced validity provided by increased involvement of major agency franchise groups including American Express (AXP/\$55/\$54/U/MW) and Carlson Wagonlit.
- Three models have emerged in the home-based travel agency channel.* The home-based agency channel can be broken into three models: franchised, hosted and direct. The franchise model is a turnkey operation with the headquarters providing extensive support; there is a material sign-up fee and typically commissions are split between the umbrella organization and the home-based franchisee in the form of a royalty. Cruise Planners, which was recently signed by American Express to join its representative network, is an example of a franchise model. The hosted model is similar, although the cost of entry is much smaller and support from the host agency is significantly more limited. Commissions are split between host and member (usually

the host gets anywhere between 20%-40%). Examples of this model are Cruises, Inc. and Cruise One both part of National Leisure Group (NLG) and 98% home based. There are thousands of agents that fall under the independent category, which are often members of a traditional consortium (i.e. Vacation.com, Virtuoso, etc.) and typically book directly with travel suppliers.

We view the cruise operators as the biggest beneficiaries of this trend

Suppliers are providing increased support for the home-based channel, which typically delivers higher yields

Supplier support for the consortia waning with certain high-profile exceptions

- Experienced agents are taking their business home.* Nearly all of the home-based agents we contacted had prior experience selling travel in a brick-and-mortar travel agency environment. These experienced travel salespeople are a dramatic departure from the legacy stereotype of the non-productive home-based agent produced by the card mills of the past. Most home-based agents brought a sizable book of business home with them and enjoyed the flexibility in a home-based environment to both better service their existing book of business and expand their customer lists.
- Complex travel providers stand to benefit most.* The high-touch push travel categories such as cruising and vacations stand to benefit most from the home-based trend versus the pull categories including air and auto rental. In particular, the cruise lines appear to be the biggest beneficiary of this growing channel. Not surprisingly owing to its complex nature and highest level of intermediary dependency, cruise was the overwhelming product of choice across the franchise, hosted and direct home-based agents we contacted (84% indicated cruise as the primary product emphasis). Reasons cited include (1) high relative commissions (12-15% on average) and material supplier support (strong and improving productivity/functionality tools (Royal Caribbean and Carnival Cruise Lines cited as most forward thinking), level pricing across channels, and crackdown on rebating cited as examples); (2) the product's high satisfaction levels, strong relative value and high propensity to deliver repeat business.
- Survey says suppliers are supportive of home-based growth.* An informal survey of suppliers including cruise, resort and tour operators indicates significant and growing support for the home-based agent channel. Recent interviews also clearly indicate complex travel providers have implemented technology that allow them to mine increasingly sophisticated performance measurement data by various channels. This has shifted the focus from revenue and growth to a far more important metric – net yield. Suppliers and distributors are focusing on more sophisticated metrics beyond just revenue and growth including cost of sale to the supplier, efficiency measures, incremental distribution capability, and overall yield or return (i.e., ability to deliver bookings during weaker periods, sell less-favorable inventory, generate higher yields than other channels or third-party competitors, and produce favorable group retention). Roughly three quarters of suppliers we contacted indicated the home-based agency channel delivers net yields that are better than the company's overall average.
- Survey says supplier support for legacy consortia model continues to wane.* Cooperatives, or consortia, are membership-based, marketing service organizations, for independent travel agencies including the home-based variety. Advantages of membership include programs to educate, train, reduce cost, etc., and the opportunity to generate higher commissions and overrides owing to the greater leverage and volume associated with a large consortium. Historically, suppliers have taken issue with having to pay volume-based incentives (VBIs) to a group of agencies under one

We foresee more direct relationships between complex suppliers and home-based agents

Home bookin' is giving the traditional channel a boost versus the supplier-direct and online agency channels

umbrella that often exhibit highly varied productivity levels. Many operators express concerns that (1) suppliers end up paying higher back-end comp to a group of disparate producers, (2) there are typically too many preferred suppliers, and (3) consortia cannot successfully shift share. In our view, pay-for-play will be the rule for consortia, and support from complex travel providers will migrate from the umbrella organization to the producing agencies including home-based players. There are some notable exceptions; however, with examples such as Virtuoso mentioned as representative of the potential positives of a well-managed consortium (500 members doing \$3 billion of travel volume).

- Home-based growth may impact our online penetration forecasts for complex travel.* The healthy growth in home-based travel agency bookings has the potential to influence our explicit online penetration and channel mix forecasts in the complex travel categories. While the traditional channel has played a critical role in generating primary demand to this point and will remain the primary channel, the industry's lifecycle, recent consolidation, and the existence of multiple nontraditional distribution drivers suggests that traditional agents will continue to lose share of this \$15-20 billion category over the next several years. Using cruise as an example, we estimate the current 90/10 channel mix between traditional agents and nontraditional sources will shift to roughly 75/25 within the next three years, with 12-15% of the intermediary-driven volume coming from online intermediaries including full-service online agencies. Explicit in our assumption is that supplier-direct will more than double from 10% to 25% by 2008. While we still expect supplier-direct and online agency penetration to grow rapidly, growth in the number and productivity of home-based travel agents (albeit enabled online) could offset expected degradation in the traditional channel and delay realization of our forecasts beyond 2008.
- GDS implications are consistent with our strategic convergence thesis.* The home-based agency trend is consistent with continued migration of travel volume to lower-cost/higher functionality channels (i.e. from telephonic to GDS to supplier-direct sites). Suppliers continue to encourage agents to utilize lower-cost proprietary channels (i.e. an agent-only Web site or a direct API) primarily by developing enhanced functionality and productivity tools. We also believe complex travel providers would at some point be willing to pay a portion (25-50%) of the \$12 average segment fee to offset loss of GDS inducements and encourage utilization of direct channels. Based on channel feedback GDS vacation/cruise functionality is relatively weak, and proprietary channels offer greater functionality and better productivity capability. Aforementioned reinvention of ARC-bonded agencies into non-ARC, non-GDS home-based businesses is also contributing to continued decline in ARC agency locations (ARC travel agency locations are off another 8% YTD and down 40% from their highs). Home-based agencies typically do not utilize a GDS, which is another contributing factor in the ongoing channel shift away from these legacy platforms (we estimate 3-5% annually).

Home-Based Agency Dynamics

According to the U.S. Department of Labor Statistics, roughly six million businesses now operate from home, and that number is growing by 1,500 a day. Among these businesses are home-based travel agencies that are springing up everywhere and represent one of the most compelling trends in the distribution of complex travel.

The proliferation of increasingly sophisticated tools targeted at home-based agencies has greatly simplified the marketing, selling, inventory access and booking of complex travel. These tools are either provided by a franchiser/host agency or are made available direct through targeted agent-only Websites. Other drivers cited by interviewed home-based agencies include (1) the need to reduce fixed costs associated with a retail location, particularly given volatility associated with external travel industry shocks such as the September 11 terror attacks; and (2) lack of air base pay and more attractive relative complex travel commissions; and (3) validity, credibility and branding provided by increased involvement of major agency groups and increased supplier support.

Based on rough industry association data, we estimate there are between 15,000 and 20,000 qualified home-based agents in the U.S., a number we expect to expand at a 10-15% pace through the end of the decade. Based on our survey work and recent precedent trends, we estimate home-based agency channel productivity could also compound at a 10-15% pace owing to proliferation of increasingly efficient inventory access and selling tools. In fact, several of the individual organizations we surveyed indicated they were experiencing 15-25% roster growth and double-digit productivity gains. Home-based agent growth stands in stark contrast to continued degradation in ARC locations, which have declined from 29,940 in 2001 to 21,096 currently. In fact, we suspect the reinvention of ARC-bonded agencies into non-ARC, non-GDS home-based businesses is contributing to the consistent decline in ARC agency locations.

Some industry association contacts suggest more than 25% of travel retailers work at home

The National Association of Commissioned Travel Agents (NACTA), is the travel industry's leading national trade association representing independent contractors, outside sales agents, cruise and tour oriented agents, group oriented travel professionals and traditional ARC appointed travel agencies that provide services and support to such professionals. NACTA is an affiliate of ASTA, the American Society of Travel Agents. According to the general manager of this industry association, member participants have increased by 15% over the last year to 3,000 members.

Primary Business Models

The home-based agency channel can be broken into three models: franchised, hosted and direct. We also make a distinction between professional organizations and legacy franchise organizations that provided travel agent credentials as a means for obtaining discount travel. We also make a distinction between professional organizations and legacy franchise organizations that provided travel agent credentials as a means for obtaining discount travel (commonly called card mills).

Nearly all of the home-based agents we contacted had prior experience selling travel in a brick-and-mortar travel agency environment. These experienced travel salespeople are a dramatic departure from the legacy stereotype of the non-productive home-based agent produced by the card mills of the past. Most home-based agents brought a sizable book of business home with them and enjoyed the flexibility in a home-based

environment to both better service their existing book of business and expand their customer lists.

Franchise Model

There are two good examples of the franchise model (CruiseOne, a subsidiary of National Leisure Group and CruisePlanners, which was recently signed as an affiliate by American Express). The latter is a non-ARC franchise group that does \$60 million of annual cruise sales through 400-plus members. About 40% are experienced cruise sellers with previous agency experience. The economic model is representative – CruisePlanners charges a \$495 fee to join plus 3% of gross commissionable sales. For inexperienced agents the 3% royalty is the same but the sign-up fee is \$8,995, which covers more extensive training and support services). The franchise model is a turnkey operation with the headquarters providing extensive support (selling, marketing, booking tools and back office). The commissions earned are split between owner and franchisee.

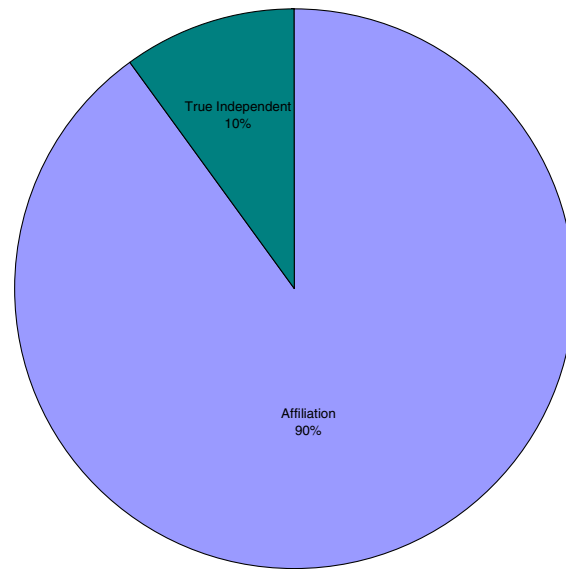
National Leisure Group is a major player in the home-based space

Hosted Model

The best example of the host model is Cruises Inc. (a subsidiary of National Leisure Group and formerly a Travel Services International company), a home-based host agency with 400 agents offering technology enabled personalized service. The cost of entry is much smaller (\$150-400) than under the franchise model, and thus the support from the host agency is typically much more limited. The commissions are split between host and member (usually the host takes between 20%-40%).

Independent Model

Although it is difficult to determine the size of the independent home-based agent space, there are literally thousands of agents that fall under this category. These agents are typically aligned with a consortium and they tend to book through the supplier-direct channel. As shown in Exhibit 1, the vast majority of the home-based agents we came in contact with are affiliated with an umbrella organization. While the reasons for this are intuitive, our view is that the percentage of true independents will rise over time as supplier tools become increasingly effective and existing businesses affiliated with a marketing services organization take their book of business and become truly independent.

Exhibit 1: Home-Based Agents – Affiliation with Franchise/Host/Consortium

Source: Company data, CSFB estimates

Owing largely to the deteriorating commissions in the air business, agents across the traditional and home-based channels have been pursuing more lucrative alternative business. Cruise is at the top of the list when it comes to relative commissions. As shown in Exhibit 2, cruise offers the highest relative commissions of any travel segment. Furthermore, the agent is implicitly being compensated on the meals and entertainment owing to the product's all-inclusive nature.

Exhibit 2: Relative Agency Commissions by Travel Category

Segment	Commission
Domestic Air	0% ⁽¹⁾
International Air	0% ⁽²⁾
Car Rental	8.0%
Lodging	8%-10%
Cruise/Packaged Vacations	10%-12%

(1) Exceptions: AirTran (5% uncapped, web booking only), Aloha (5% uncapped), Southwest (5% uncapped)

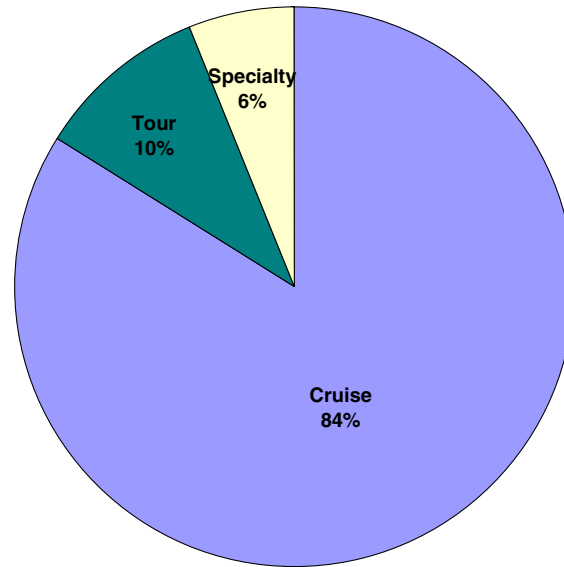
(2) Exceptions: Qantas (3% uncapped), Singapore Airlines (5% uncapped), Thai Airways (8% uncapped Asia only)

Source: ASTA, TIA, CSFB estimates

In large part owing to the attractive relative economics cited above, the vast majority of home-based agents (across the franchise, hosted and independent models) we contacted indicated cruises are the primary product emphasis. In fact, most participants specialized in cruise, with many specializing in one or two segments. For example, a major hosted group we contacted specializes in three and four-day cruises and another focuses solely on luxury cruises.

Most home-based agents do not just emphasize, but specialize in cruise

Exhibit 3: Home-Based Agents – Primary Product Emphasis



Source: Company data, CSFB estimates

As shown in Exhibit 4, the emphasis on cruise stemmed from several factors. Chief among them was the attractive relative commissions paid by cruise operators, but the product’s high satisfaction levels and strong relative value and solid non-compensation based support from cruise lines also scored high.

Exhibit 4: Home-Based Agents – Primary Motivation to Sell Cruise

(multiple answers accepted)

Attractive Relative Commissions	100%
High Customer Satisfaction Levels	90%
Strong Supplier Support	76%
Attractive Relative Price to Consumer	48%

Source: Company data, CSFB estimates

In addition, a cruise is a complex, high-touch product and the cruise industry is still relatively under penetrated making it a primary demand stimulation game. This provides the opportunity to educate and sell consumers, as evidenced by the fact that cruises exhibit the highest level of intermediary dependency among travel alternatives.

As shown in Exhibit 5, sources of important supplier support include access to productivity tools and (surprise, surprise) commissions and VBIs. In our conversations with channel participants, supplier Web-based productivity tools have been consistently improving in terms of functionality and ease of use. In particular, Royal Caribbean’s automated PNR functionality, Insight, was frequently cited as a bellwether tool. We believe supplier investment in Web-based direct agent access and selling tools will continue to increase and continue to drive improvements.

We expect continuous improvement in functionality tools provided by suppliers for home-based agents

Exhibit 5: Home-Based Agents – Key Sources of Supplier Support

(multiple answers accepted)

Access to Productivity Tools	100%
Commissions/Overrides	86%
Training	33%

Source: Company data, CSFB estimates

Representative Franchise/Host Groups

One of the recent drivers of increased relevancy of the home-based travel agency channel is the increased interest shown by major franchise/hosting entities including American Express and Carlson Wagonlit. The validation provided by the increased involvement of these franchise groups has acted as a catalyst and increased supplier attention on the trend as well.

Carlson Wagonlit

Carlson Wagonlit Travel Associates is one of the largest leisure and lightly-managed business travel agency networks in the world, and is the direct descendant of "Ask Mr. Foster," founded in 1888 in St. Augustine, Florida. All totaled, there are more than 1,700 travel agency locations that fall under the auspices of Carlson Leisure Group, including CLG's three U.S. travel agency franchise groups: Carlson Wagonlit Travel Associates, Cruise Holidays and Results Travel—along with the Carlson Wagonlit Travel retail agencies in the United States owned by Carlson Leisure Group.

Cruise Holidays, North America's largest cruise-travel franchise with 170 locations in the United States and Canada, was acquired by Carlson Travel Network Associates, Inc in June 2001. Carlson Travel Franchise Group also launched Seamaster Cruises, a cruise-only option made available to home-based agents. Carlson, like all of the franchise and host groups we contacted, is looking for entrepreneurs interested in driving volume growth and screens its franchisee applicants. For a franchise fee of \$9,500, members receive online direct marketing systems, a proprietary selling system and fundamental training. Carlson also added cruise Specialists All Aboard Travel and Singles Cruise.com as a way to develop new and exclusive products for Carlson's wholly owned and franchised agencies.

American Express

American Express Travel Services reps are independently owned and operated travel agencies, specially licensed by American Express Company to provide travel and travel related products and services to the general public. Last year, American Express' Consumer Travel Network signed its first cruise only home-based firm – CruisePlanners of Coral Springs, Florida. The new relationship is part of a strategy to expand Amex's tour and cruise sales and leverage the brand with the most successful agency groups. CruisePlanners is a non-ARC franchise group that does \$60 million of annual cruise sales through 400-plus members, of which 40% have previous agency experience.

Carlson's goal is to become the #1 cruise seller

NLG is the largest cruise distributor

National Leisure Group

Founded in 1986, National Leisure Group is a provider of online and offline leisure travel services. Since acquiring MyTravel Group's (MT.L/8GBP/NA/R/MW) U.S. cruise division (including brands such as CruisesOnly, 1-800-CRUISES, and Cruises.com) for \$110 million in November 2003, NLG has become the world's largest provider of cruise vacations (~10% North American market share). The acquisition gave NLG significantly more scale and complements the company's traditional wholesale business with a retail/consumer-direct presence. The company's customers plan and book their vacations (typically cruise) either online through dynamic packaging technologies or offline with its vacation specialists.

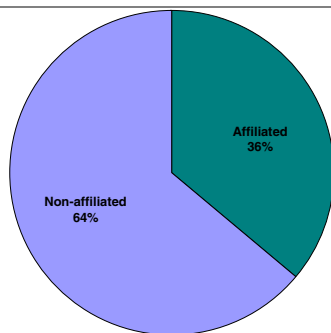
NLG sells through a multitude of different channels and brands—both owned and retail—including Vacation Outlet, CruisesOnly, 1-800-CRUISES, Cruises.com, Orbitz, Yahoo! (YHOO/\$35/\$45/O/OW), priceline.com (PCLN/\$24/\$28/O/MW), and BJ's (BJ/\$29/\$22/U/MW). NLG is headquartered in Woburn, Massachusetts and employs approximately 1,200 employees. NLG's primary direct websites include www.vacationoutlet.com and www.cruisesonly.com.

NLG has differentiated itself through its size and breadth of merchandise (cultivated through nearly twenty years of employing the merchant model), superior customer service center (whose staff has recently doubled in size), and diversified business model (both direct retail and wholesale via numerous online partners). In addition, the company has also invested significant resources towards developing its dynamic packaging technology.

Consortia/MSOs

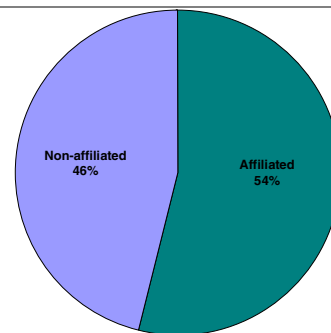
Cooperatives, or consortia, are membership-based, marketing service organizations (MSOs) for independent travel agencies. Advantages of membership include programs to educate, train, reduce cost, etc. and the opportunity to generate higher commissions/overrides due to the greater leverage and volume associated with a large consortium. On the corporate side, access to a global network is a key advantage. These organizations have become increasingly popular, as the competitive environment for the smaller retailer has intensified. In 1997, 28% of agencies were affiliated with a consortium or marketing association. On the leisure side, the percentage is even greater, with 54% affiliated with a leisure travel consortium. Ten years ago just 36% of agencies were associated with a leisure travel consortium.

Exhibit 6: Traditional Agencies – Affiliation with a Consortium, 1998



Source: Company data, CSFB estimates

Exhibit 7: Traditional Agencies – Affiliation with a Consortium, 2003



Source: Company data, CSFB estimates

Historically, suppliers have taken issue with having to pay VBIs to a group of agencies under one umbrella that often exhibit highly varied productivity levels. Many operators express concerns that (1) suppliers end up paying higher back-end comp to a group of disparate producers, (2) there are typically too many preferred suppliers, and (3) consortia cannot successfully shift share. In our view, pay-for-play will be the rule for consortia, and support from complex travel providers will migrate from the umbrella organization to the producing agencies including home-based players. There are some notable exceptions; however, with examples such as Virtuoso mentioned as representative of the potential positives of a well-managed umbrella organization (500 members doing \$3 billion of travel volume).

We estimate Vacation.com counts roughly 1,500 home-based agents among its membership

Vacation.com

Amadeus (AMS.MC/€7.3/€6.5/N/MW) acquired Vacation.com in October, 2000 for a total consideration of \$85.0 million (\$57.3 million in cash and assumption of \$27.7 million in liabilities) in order to better serve its agency constituency. Vacation.com maintains its headquarters in Alexandria, Virginia and also keeps a Toronto office to serve its member agents in Canada. Vacation.com is a travel services marketing company comprising of a network of more than 7,000 travel agency locations across the U.S. and Canada. Its membership network is primarily focused on leisure travel distribution and accounts for approximately a third of all travel agencies in North America. With more than \$18 billion in annual associated sales, Vacation.com is one of North America's largest vacation selling networks. Vacation.com focuses on building preferred supplier relationships for the benefit of its member agencies. Similar to other large-scale consortia, Vacation.com provides its affiliates with access to web-based tools (AgentNet), proprietary supplier content (preferred vendors), and the appeal of aggregated buying power of the entire consortia network.

Virtuoso

Virtuoso is a network of travel agencies with expert vacation-planning travel agents that specialize in connecting travelers to the world's most up-scale vacation destinations. Virtuoso focuses on the ultra-luxury segment of the market. In contrast to other consortia, Virtuoso only has approximately 500 travel agencies as members. Instead of

Virtuoso is often cited as an organization that works in part owing to high-end specialization

quantity, Virtuoso differentiates itself primarily through the intensity of service. As an example, out of the 107 top travel agents featured recently by Conde Nast, 83 were associated with Virtuoso. Virtuoso's relationships with top hotels, resorts, spas, lodges, cruise lines and tour companies provide clients with rare experiences, from complimentary upgrades and amenities, to special recognition and privileged access.

Virtuoso's roots in the travel industry dates to the 1950s, when Allied Travel was formed to help its independent carriage-trade member travel agencies with foreign international and group arrangements. In 1986, Allied Travel merged with Percival Tours to form Allied Percival International (API), bringing together the very best luxury travel agents in the country. API has been able to give its travel agency members and their clients an advantage in the competitive and always changing travel marketplace. Renamed Virtuoso in 2000, the company has continually expanded its focus, particularly on the luxury market.

Jurni Network/Nexion

Sabre created the Jurni Network in October 2003 as an offline leisure travel agency consortium that leverages the assets of the parent's portfolio of offline and online travel distribution assets. Concurrent with the creation of Jurni, Sabre also acquired Nexion and added its 750 independent agents as the charter members of Jurni. Jurni agents have access to a wide range of leisure travel products sourced from multiple Sabre subsidiaries including Travelocity, Site59, Nexion and Sabre Exclusives merchant hotels, in addition to negotiated products from preferred suppliers. In April, 2004, Jurni released an integrated desktop application for agents that allow the merchandising of preferred supplier offerings at the point-of-sale.

Jurni and NEST specifically target the home-based category

The Jurni Network offers market intelligence, marketing programs, high-margin products, and integrated technology. Member affiliates have access to Sabre's database of customer behavior, which can help agents better coordinate customer segmentation. Jurni also manages large-scale marketing campaigns for directing incremental traffic to affiliates. Moreover, Jurni agencies gain access to unique content from Sabre's other subsidiaries (such as merchant lodging). Finally, Jurni also offers comprehensive suite of technology solutions including multiple connectivity options, seamless integration with GDSs, integrated access to preferred vendors and booking tools, sales tracking/analytics, and group sales management functionality.

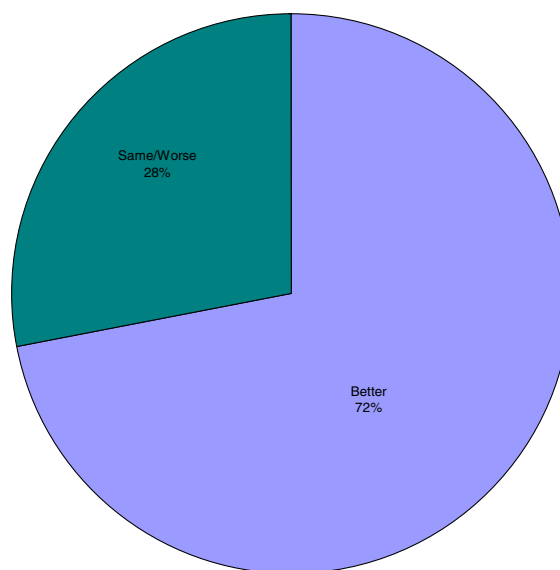
Network of Entrepreneurs Selling Travel

Launched in April 2004, the Network of Entrepreneurs Selling Travel (NEST) is a marketing organization geared exclusively towards home-based travel agencies. NEST is a sister operation of the Travelsavers consortium (2,350 domestic agency members), both of which reside under American Marketing Group umbrella. NEST's objective is to service the rapidly growing home-based agency constituency (with or without ARC accreditation) and enable them to connect directly with suppliers instead of through host agencies. NEST provides the full complement of typical consortia services including preferred supplier deals, a discount hotel program, air contracts, and 24-hour service center. In addition, NEST also offers technology solutions including a cruise and a tour booking engine.

Increased Complex Travel Supplier Support

Most complex travel providers have embraced the emergence of the home-based agency channel and are excited about its potential as an increasingly important distribution platform. An informal survey of suppliers including cruise, resort and tour operators indicates significant and growing support for the home-based agent channel. Recent interviews also clearly indicate complex travel providers have implemented technology that allow them to mine increasingly sophisticated performance measurement data by various channels. This has shifted the focus from revenue and growth to a far more important metric – net yield. Suppliers and distributors are focusing on more sophisticated metrics beyond just revenue and growth including cost of sale to the supplier, efficiency measures, incremental distribution capability, and overall yield or return (i.e., ability to deliver bookings during weaker periods, sell less-favorable inventory, generate higher yields than other channels or third-party competitors, and produce favorable group retention). Roughly three quarters of suppliers we contacted indicated the home-based agency channel delivers net yields that are better than the company's overall average.

Exhibit 8: Home-Based Agents – Relative Yield Performance for Complex Travel Providers



Source: Company data, CSFB estimates

Crackdown on Non-Advertised Discounting in Cruise Category

Carnival and Royal Caribbean recently revealed plans to penalize agents who advertise rebated rates and promotions not approved by the cruise lines. Carnival said it would cut compensation to retailers that advertise rates and promotions not approved by the line, effective January 1, as part of the second phase of its level pricing strategy. The pay cuts will be determined on a case-by-case basis. Repeat offenders will be placed on a do-not-book list. Carnival indicated the plan would ensure consistency in its advertised pricing including through the Internet channel and protect and enhance its brand and product reputation. Royal Caribbean and Celebrity indicated the lines would

cut co-op support and commissions to agents who advertise non-published or non-contracted rates as of August 16th 2004.

The consolidation in the retail travel agency business has created an increased number of high-volume cruise distributors, including many that are focused on complex leisure products such as cruises. These larger sales organizations have brought professional management, branding, and access to capital and cash flow to a distribution channel. These changes have allowed a partnership to develop between the major cruise suppliers and the major distributors. What is increasingly apparent, particularly this year, is that the partnership model still gives the cruise supplier little control over how its inventory is marketed and sold. Many distributors continue to treat the cruise product like a commodity, as the focus is to sell the price and discount, not the product's benefits and value. In addition, rebating remains prevalent, particularly among dot-coms and high-volume call center distributors. In addition, many agents are loyal to the consumer and will recommend action that is not in the best interests of suppliers (i.e., recommend that the potential cruise passenger wait for a better deal).

Reduced rebating should make home-based agents more competitive

Reduced rebating should allow the lower-volume agencies earning 10-11% average commission rates to compete more effectively with the higher-volume agencies earning 15-16% average commissions and getting larger owing to rebating. A more level playing field should put natural downward pressure on average commission rates over time, as share shift toward smaller agencies occurs. With respect to smaller agencies, we highlight the relative lack of booking concentration in the cruise category, and suggest the recent rebating crackdown highlights the growing importance of smaller and home-based agencies enabled by the Web. Initial channel feedback suggests smaller agencies have more than picked up the slack from the elimination of nonadvertised Royal Caribbean and Celebrity fares in the marketplace. In addition, more pricing consistency should reduce customer confusion and make the direct channel more competitive on price.

Exhibit 9: Home-Based Agents – Response to Initiatives to Reduce Cruise Rebating

"Initiatives to Reduce Rebating Are a Positive Development in Cruise Distribution"	
Agree	100%
Disagree	0%

Source: Company data, CSFB estimates

Structural Change Driving At-Home Growth

The distribution of travel, essentially unchanged for the past 30 years, is in the midst of tremendous structural change. In our view, the distribution of travel is inefficient, highly data intensive and based on legacy technology. As such, the industry can benefit from information and communication technology advances and is ripe for consolidation and re-engineering. Not surprisingly, traditional travel agents have been at the center of recent changes in the distribution channel. These changes include commission reductions, the increased threat of disintermediation and rapidly changing technologies, particularly growth in emerging channels such as the Internet.

Change in the travel agency business is being wrought by commission cuts on air and the rapid application of technology

Structural Change in the Traditional Channel

Domestic airlines have cut base commission rates three times in the past three years. Furthermore, domestic airlines are distributing fares and schedules directly over the Internet, giving the consumer easy access to information previously controlled by the travel agent. Commission cuts and encroachment by GDS-direct and supplier-direct channels will continue to squeeze traditional agents.

Exhibit 10: Estimated Supplier Dependence on Travel Agents

Segment	Agent Share
Airlines	
Domestic	70%
International	75%
Lodging	
Domestic	25%
International	85%
Cruise	90-95%
Packaged Vacations	85-88%
Rail	35%
Rental Cars	50%
Bus	10%

Source: Industry data, CSFB estimates.

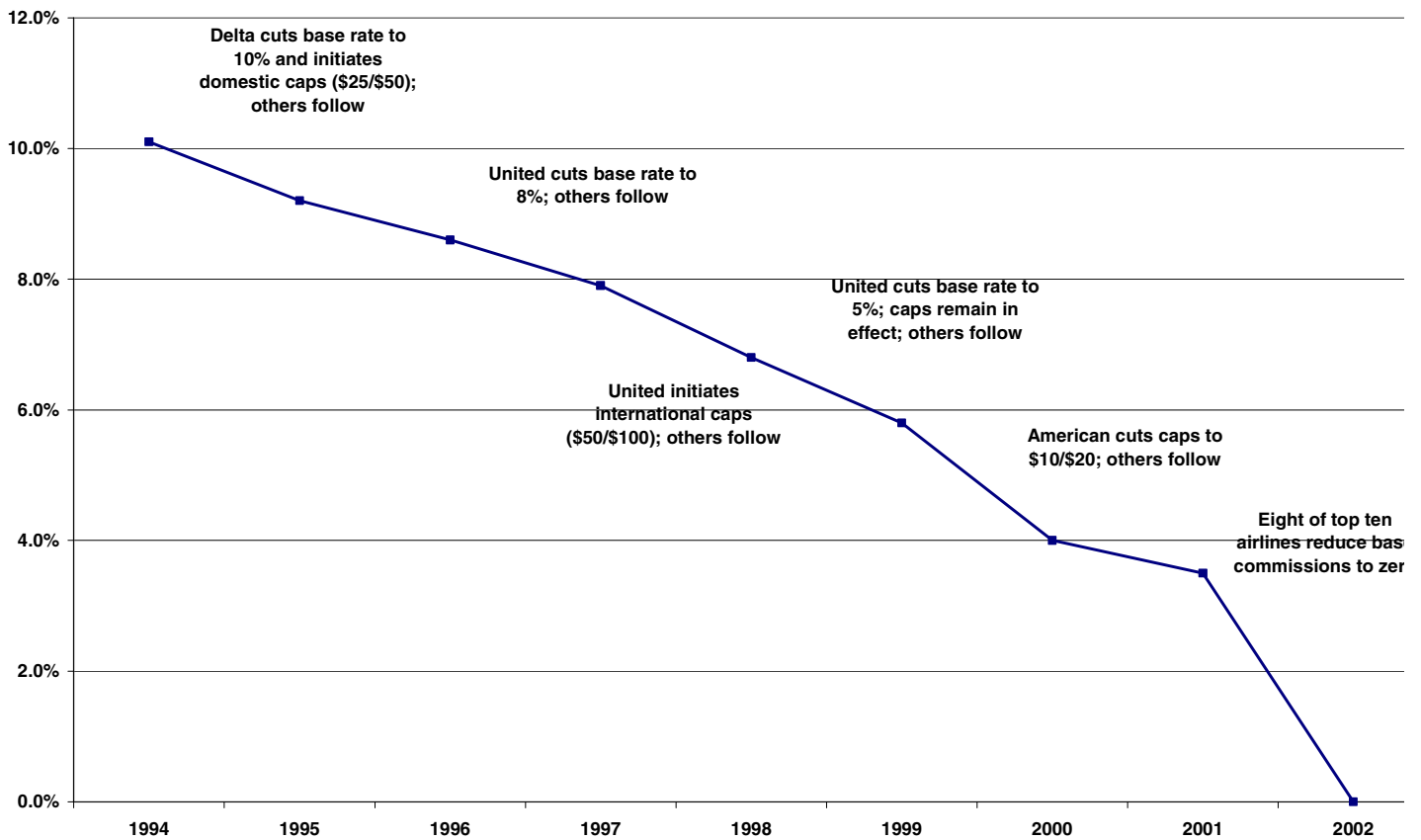
Elimination of Base Air Pay

The domestic air carriers began capping and cutting agent pay in the late 1990s, which has affected the structure of the traditional agency community more than any other factor. The airlines recognized that the migration of the airline seat toward a commodity pricing model had turned the travel agent distribution channel into a transaction-processing function with little ability to shift market share between carriers. Automation and self-ticketing further accelerated these moves by the airline industry. As a result, agencies have been forced to examine their business mix, transaction size, and sources of income.

Airline commission cuts resulted from the migration of the airline seat to a commodity-driven pricing model

The reduction in agent pay was started in mid-February 1995, when Delta announced it was capping domestic travel agent commissions at \$50 for domestic round-trip tickets and \$25 on one-way fares. Then in September 1997 United Airlines cut its domestic and international base commission rate from 10% to 8%, and most other large carriers followed. The last round of cuts occurred last October, when UAL led the major carriers in cutting base pay from 8% to 5%, with caps remaining in place. International base pay was also cut, with caps also remaining in effect. As an example of the impact of the cuts and caps, ARC data reveals that in December 1999, domestic air fares rose 3% while domestic agent commissions sank 29%. Exhibit 11 illustrates the downward slide in average domestic commissions on air volume over the last several years.

Exhibit 11: Decline in Domestic Airline Commission Rates, 1994-2002



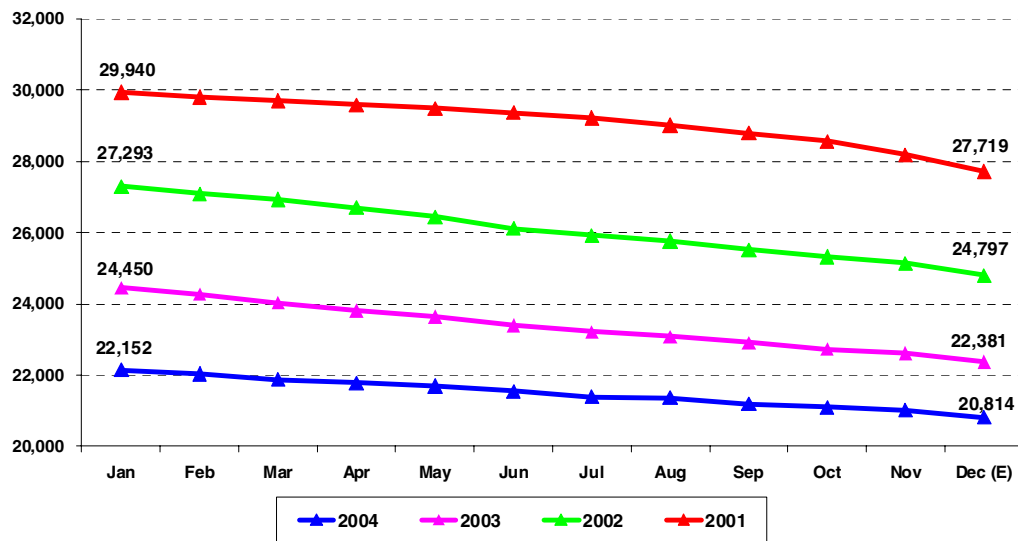
Source: ARC, CSFB estimates.

Shrinkage in the Traditional Channel

According to *Travel Weekly* and Airlines Reporting Corp., roughly 100 traditional full-service agency locations closed their doors during each month this year. According to ARC, at year-end 1999, there were 27,729 full-service agencies, down 3.7% versus the prior year. Agency locations now represent less than 2% of the nation's 1.5 million retail outlets despite the fact that travel represents more than 7% of total consumer spending. In fact, there are 2.5 times more furnishings outlets than travel agencies serving a market of similar size. In addition to closings, cost-reduction initiatives in the channel

have reduced agency employment and resulted in elimination of travel agent training programs.

Exhibit 12: Monthly Decline in ARC Travel Agency Locations, 2001-04 YTD



Source: ARC, CSFB estimates

As a result of these agents of change, travel agents have increasingly focused on selling complex products such as packaged vacations and cruises owing to pricing pressure on routine transactions such as domestic and international air. Consolidation is also allowing high-volume distributors to bring professional management and state-of-the-art tools to the vacation sales and marketing process. While these positive changes are already having an impact on the business, the major operators recognize the potential inherent in accelerating the process.

Exhibit 13: Trends in the Domestic Travel Agent Business

Segment	2002	2000	1998	1996
Total Dollar Volume Booked	\$129.7 bil.	\$139.5 bil.	\$126.0 bil.	\$110.6 bil.
Number of Agencies	27,597	33,352	34,749	35,500
% of Agencies < \$1 mil. of Volume	15%	18%	19%	30%
Avg. Revenue/Location	\$4.7 mil.	\$4.2 mil.	\$3.6 mil.	\$3.1 mil.
% Charging Service Fees	75%	68%	42%	19%
% of Leisure Business	60%	55%	51%	49%
% with Internet Access	90%	78%	56%	27%

Source: U.S. Travel Agency Surveys, Euromonitor, CSFB estimates

Avg. Revenue/Location	4.70	4.18	3.63	3.12
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Source: U.S. Travel Agency Surveys, 1995-2000.

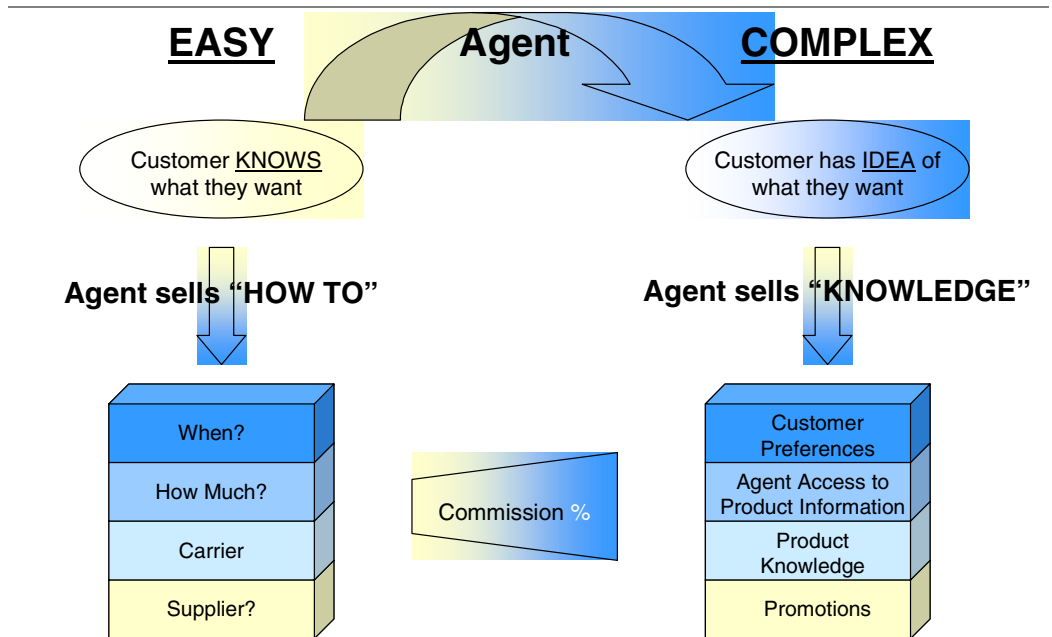
As a measure of the fragmentation in the industry, despite booking a total of \$126 billion in 1996, the average agency location only produced \$3.8 million. This figure has been steadily increasing, as the largest agencies get larger. As shown, the number of agencies doing less than \$1 million of volume has declined from 30% of all locations to less than 20% in just two years. Obviously, reduced airline commissions have triggered significant consolidation. The cuts have also prompted a shift in the business mix within the agency community. For the first time in nearly 20 years, *Travel Weekly* estimates leisure booking volume surpassed corporate travel by 51% to 49%.

Similar to the migration in corporate, leisure agents are migrating to the most complex travel products

Increased Focus on Complex Leisure Travel

Exhibit 14 attempts to differentiate between a routine travel transaction and a complex leisure sale. In the former, the customer already knows what he or she wants, and the agent only responds to simple queries that facilitate the processing of the transaction. This is a process that can easily be replicated through automation and one that requires little personalization. A complex leisure transaction, however, is significantly more involved. The customer may have an idea of what she wants, but the agent plays a much larger role in the entire process, from identifying potential alternatives to selecting the appropriate supplier. The continuum from left to right is from commodity (air) to differentiated product (cruise), and the amount of commission rises relative to the amount of value added (expertise and service) provided by the intermediary. In our opinion, complex leisure would also include foreign, special interest, and luxury travel.

Exhibit 14: Routine Transaction versus Complex Leisure Sale



Source: CSFB research.

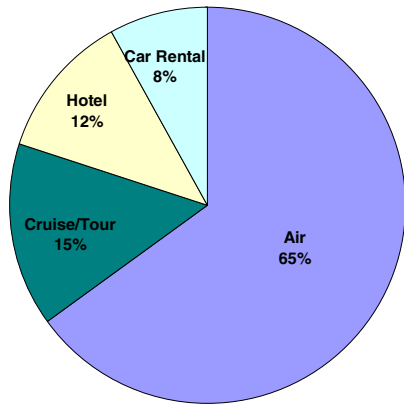
The growth curve is steepest at the right side of the complexity continuum

In a complex leisure transaction, the travel agent is a value-added intermediary that matches the clients' needs and resources with the best possible travel alternative. Research suggests the consumer sees important intangible benefits in using travel agents including providing unbiased/objective opinions to the traveler, ensuring a trouble-free trip, having someone to call if problems arise and helping the consumer get the best value for the money. Leisure travel is an unusual purchase in that a consumer pays up for the product some time before she takes delivery. Travel sales, therefore, rely heavily on the supply of information. The type of information the consumer seeks is also the stuff of imagination and dreams. This is difficult information to automate.

Most travelers know what to expect in an auto rental or a standard airline seat, hotels, nontraditional lodging, and cruises/vacations require a significantly greater amount of relevant content and typically salesmanship. As might be expected, the penetration of on-line distribution is higher in relatively simple products such as cars and air seats and far lower in more complex products such as lodging and vacation products.

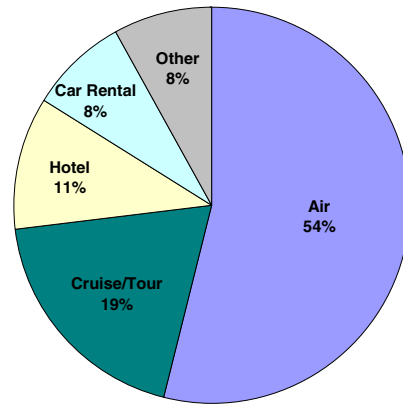
Prior to the commission caps in 1995, two-thirds of an agency's business comprised domestic air. That figure was down to 56% two years later. The migration of travel agency business away from air is illustrated in Exhibit 15 and Exhibit 16, which show the average travel agency's business mix pre-commission cap and post-commission cap. A separate survey conducted by Travelline Surveys indicated just 40% of the average agency's total volume comprises domestic air, down from 47% prior to implementation of the caps.

Exhibit 15: Average Travel Agency Business Mix, 1995



Source: Travel Weekly 1996 Travel Agency Survey.

Exhibit 16: Average Travel Agency Business Mix, 2003



Source: Travel Weekly 2004 Travel Agency Survey.

Less than 50% of leisure travelers even use a traditional travel agent

Travel agent surveys that we conduct regularly also suggest that air business continues to diminish in importance at most full-service agencies. In our most recent survey, three-quarters of the agency respondents indicated that domestic and international air ticketing had become secondary in focus to value-added products such as special interest travel, packaged vacations and cruises.

Responding to a Loss of Relevancy

While the percentage of travelers utilizing an agent appears to have remained relatively constant over the past few years, approximately one-third of agent users who also use the Internet to book reservations expect to use travel agents less in the next two years. We believe the potentially decreasing relevancy of traditional travel agents is due in part to the dramatic proliferation of travel-related information, particularly on the Internet. Moreover, the percentage of travel agent usage is higher among boomers and the mature (35%) than generation Xers (28%), a segment of the population that is more computer literate and familiar with the Internet as an information tool.

Exhibit 17: Incidence of Travel Agent Usage*among agent users who also use the Internet to book reservations***Expect to Use a Travel Agent within the Next Two Years:**

More than I do currently	8%
About the same as I do currently	62%
Less than I do currently	30%

Source: YP&B.

Although cruisers and noncruisers generally report high satisfaction levels with the agency community, consumer perceptions of travel agents appear to indicate a potential loss in their relevancy. According to *NFO Plog's* Cruise Market Profile Study, six out of ten vacationers believe they can get better rates when booking on their own as opposed to through a travel agent. In addition, 32% of cruisers and 42% of non-cruise vacationers believe they can get better information from the Internet than from their travel agent.

Exhibit 18: Perceptions of Travel Agents

Percent Strongly/Somewhat Agree:	Cruisers	Non-Cruise Vacationers
Can get better rates when I book on my own	54%	60%
Can get better information from Internet than TA	32%	42%
Are more interested in meeting sales goals than in meeting my vacation needs	31%	38%

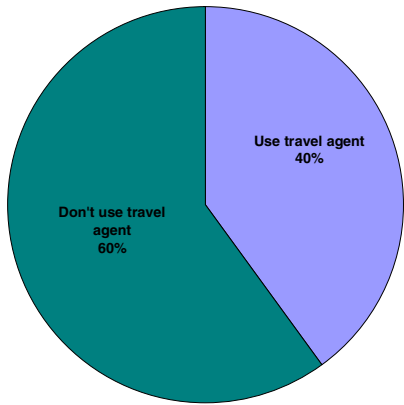
Source: NFO Plog.

Given the potential for increased defections, it is also important that agencies not only attempt to increase penetration of the consumer population but also fight to demonstrate relevancy to consumers who do utilize their services. The value providers of the future must possess expertise and specific competencies and understanding regarding the planning and purchasing of travel. The opportunity is there, and there is even increasing evidence that travel agents can take on an even more significant role in travel marketing owing to an underlying consumer trend to simplify and delegate certain nonessential tasks.

While data suggests the traditional agency does not reach a majority of consumers, growth in the home-based channel could change this disturbing fact. In addition, home-based growth could impact the change being wrought by the proliferation of information through sources such as the Internet, which appears to be diluting the relevancy of travel agents to the portion of those consumers that do utilize an intermediary. Although travel agents remain the single-largest source of travel information, according to the *Travel Weekly* Consumer Survey, only 40% of business travelers and 42% of leisure travelers actually utilize an agent at all. As further evidence, the *National Leisure Travel*

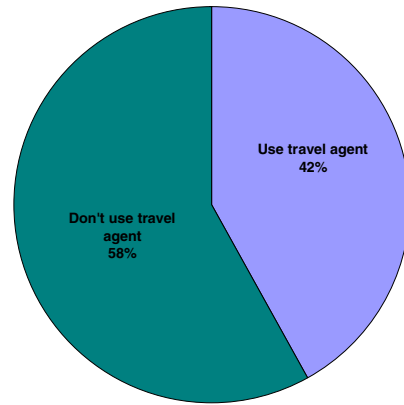
Monitor estimates that just a third of pleasure travelers utilized a travel agent within the last 12 months.

Exhibit 19: Use of Travel Agents—Business Travelers



Source: Travel Weekly, CSFB estimates.

Exhibit 20: Use of Travel Agents—Leisure Travelers



Source: Travel Weekly, CSFB estimates.

Changes in Travel Information Gathering

If only 30-40% of consumers use a travel agent, where do the others get their travel information and book their reservations? The answer is they get their information from a variety of sources including friends/relatives, 800 numbers, guidebooks, and increasingly, from the Internet. The importance of multiple channels to consumers makes it increasingly important for cruise operators to become more visible and more active in every channel that the leisure traveler is utilizing. The travel agent channel is a major information and booking source. This is even more so the case in complex leisure transactions. In fact, leisure travelers are also more likely (42%) to use an agent when booking a packaged vacation or cruise. Thus, the major cruise operators are dedicating significant resources to supporting this channel. The importance of cruise at the other access points needs to become more relevant. For example, proliferation of home-based agents enabled by technology could tap into the friend/relative column.

Even with the growth of online agencies, consensus thinking has come around to the belief that “convergence” is the model for online nontraditional complex leisure sales. Also known as bricks and clicks and/or multi-tier channels, this hybrid model for complex leisure has emerged largely because complex leisure is fairly high touch and needs to be sold. In our view, travel distribution has never been about technology. Particularly for complex leisure, the Internet and other advances will speed the re-personalization process, enabling more effective and efficient communications and returning technology to its proper place in the travel transaction—behind the scenes. We believe distribution of the cruise product is a complex, service-oriented process that requires knowledge and capability up and down the value chain.

Clearly, use of the Internet for information gathering and awareness is rapidly increasing in importance, which is having an impact on the selling process. Through the Internet, travel agencies and their clients now have access to vast amounts of new information. As browsers and search engines make surfing easier and more efficient, the resource

Consumer preference will drive channel mix

options will continue to grow. The new, richer array of choices will include not only more travel products, but also more aspects of the travel process. Consumers will pick and choose what they want to order as their travel experience, how they want the order filled—and by whom.

We note that the wide majority of the respondents in our most recent channel survey indicated that many of their customers spent at least some time researching various destinations and itineraries using on-line information tools. This capability stands in stark contrast to the consumer's access to information even a few years ago, when prior to these on-line tools, the only source of information on complex leisure product and availability was the agent. This democratization of information, coupled with consumers' general perception of Internet travel as something that can be booked with minimal effort and/or lead time, has already detracted from the general perception of product scarcity from the consumer's standpoint, and will continue to exert this influence as more robust booking tools become prevalent.

Growth in the Online Channel as a Change Agent

Through the consolidation and re-engineering occurring in the travel industry, new distribution channels are developing and the entire travel distribution business model has shifted. The biggest driver of that change is the Internet. Travelers are attracted to the Internet by its 24-hour access, convenience, the reliability of the content, and the ability to tailor information to individual needs and preferences. The Internet also provides a convenient and efficient medium for sales of travel product by affording customers direct access to up-to-the-minute travel information, including changing fares and routes, the ability to engage in competitive shopping, and the capacity to book tickets. Travel is the largest e-commerce category on the Web.

The evolution of automation and technology being applied in the travel industry is rapidly assuming the high labor-driven costs of providing interface to the inventory (and in the case of airlines, settlement) systems. Effectively, technology is decreasing or eliminating the need for inventory access and ticket delivery.

Travel distribution and the
Web are a perfect fit

Exhibit 21: Evolution of Online Travel Distribution

The Beginning	Online booking <ul style="list-style-type: none"> • selling of simple products • basic travel research
Current Technology Shift	On-line booking with fulfillment infrastructure <ul style="list-style-type: none"> • offering more complex products (cruises, bundling, tours) • providing customer support/service and ability to fulfill a complex sale
Next Generation	Complex online booking with infrastructure and supplier partners <ul style="list-style-type: none"> • delivering the promise of dynamic packaging • simplifying the complex sale through content offering online and customer support off-line • re-engineering the process to drive channel costs down • tapping customer relationship marketing potential • integrating new media possibilities

Source: CSFB research.

Next-generation Internet solutions will begin to replace high-touch aspects of the traditional agency business

The Internet and other advances are speeding the re-personalization process, enabling more effective communications and returning technology to its proper place behind the scenes. However, the need for travel information is increasing with the explosion in distributed information and related expectations. The need for marketing packages that integrate travel information with destination (really, fulfilling consumer dreams) is concurrently increasing as information becomes more readily available and the ease of booking at lower prevailing costs further enables fulfilled consumer expectations.

Virtual Product/Virtual Marketplace

The travel product's virtual nature enhances scalability and capital efficiency of the on-line agency model

We believe travel distribution and the Web are a perfect fit. Travel distribution is information intensive and comprised of a massive number of perishable SKUs. The process, as illustrated earlier in this report, is also convoluted and complex. Moreover, traditional off-line distribution methods leave a lot to be desired. Travel works particularly well on the Internet owing to its virtual nature. As a virtual product, travel eliminates the need for warehousing inventory and shipping. This eliminates a major bottleneck that has stunted e-commerce penetration in other categories. In addition, the incremental costs associated with warehousing, distribution and fulfillment significantly reduce the ability to scale operations profitably.

For the travel industry in particular, the returns on Web marketing promise to be especially good. By combining the persuasive power of interactive promotions with easy-to-use reservation services, a well-designed Web site makes it possible for a travel agency to carry the point of purchase right into the homes and offices of its clients—thus improving the appeal of the agency's services while reducing its overall cost.

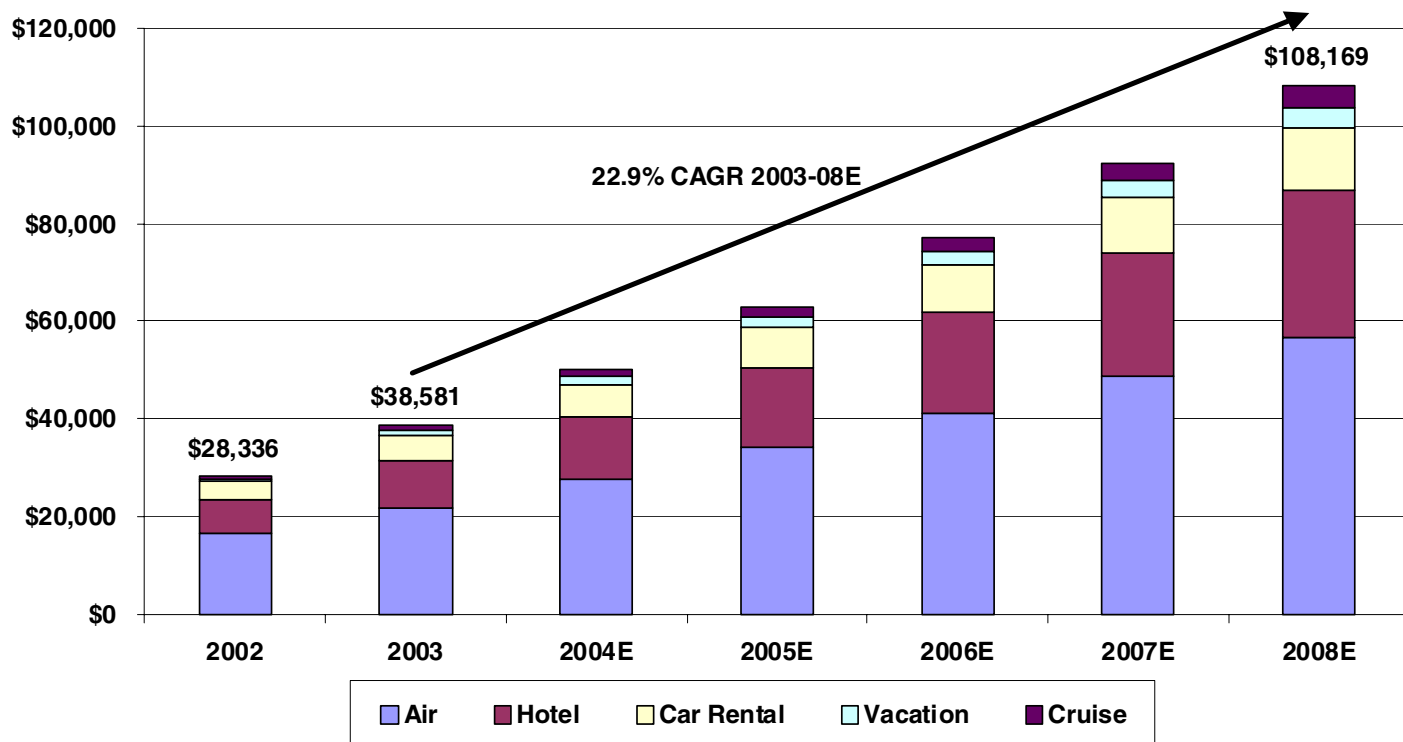
On-Line Penetration by Travel Category

Exhibit 22 and Exhibit 23 detail CSFB's on-line travel distribution estimates by major travel category. We expect strong growth across all four major domestic travel categories, with cruise/vacation leading the way with a 34.0% CAGR (albeit from a relatively small base) from 2003 to 2008. Of the four categories, we expect lodging and

cruise/vacation to grow faster than the overall category and capture share of market over the next several years. Air segment growth is forecast to lag the overall category, which will cause air segment share to decline as a percentage of total on-line travel distribution by 2008. We also expect auto rental to grow somewhat slower than the category at a 19.3% CAGR through 2008.

Exhibit 22: CSFB On-Line Travel Volume Forecasts by Travel Category, 2003–08E

US\$ in millions, unless otherwise stated



Source: Company data, CSFB estimates.

Exhibit 23: CSFB On-Line Travel Forecasts by Travel Category, 2003–08E

US\$ in millions, unless otherwise stated

	2001	2002	2003	2004E	2005E	2006E	2007E	2008E	CAGR 2003-08E
Air	\$12,713	\$16,617	\$21,602	\$27,435	\$34,019	\$41,163	\$48,778	\$56,583	21.2%
Hotel	4,513	6,743	9,777	12,905	16,519	20,648	25,294	30,353	25.4%
Car Rental	2,721	3,781	5,199	6,759	8,279	9,728	11,187	12,586	19.3%
Vacation	345	600	1,050	1,522	2,131	2,877	3,668	4,401	33.2%
Cruise	363	596	954	1,383	1,936	2,613	3,397	4,246	34.8%
Total	\$20,655	\$28,336	\$38,581	\$50,003	\$62,883	\$77,029	\$92,324	\$108,169	22.9%

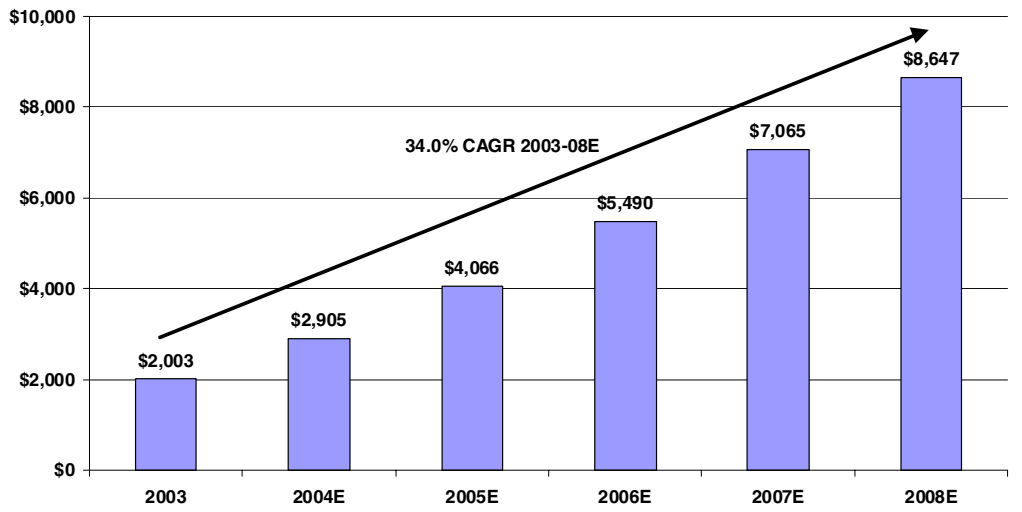
Source: Company data, CSFB estimates.

On-Line Cruise/Packaged Vacation Category Forecasts

Cruises and packaged vacations are by far the most complex product to distribute without an intermediary. We estimate that 85-90% of cruises and approximately 70% of vacation packages and tours are still booked through a traditional intermediary. While the cruise industry is highly concentrated, the broader packaged vacation segment is highly fragmented. We estimate on-line cruise and vacation package bookings will increase at a 34.0% CAGR through 2008, or from \$2.0 billion to \$8.6 billion. These estimates imply on-line cruise/package vacation booking penetration will increase from 6% in 2003 to 19% by 2008.

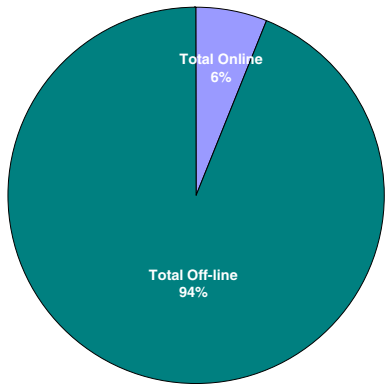
Exhibit 24: On-Line Cruise/Vacation Category Growth, 2003–08E

US\$ in millions, unless otherwise stated



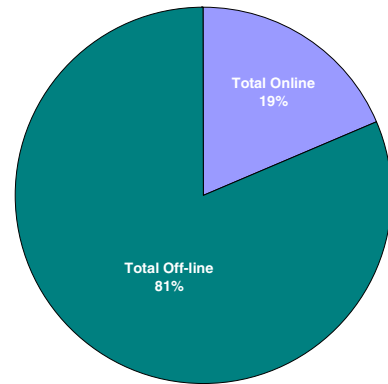
Source: PhocusWright (historicals); CSFB estimates.

Exhibit 25: On-Line Cruise/Vacation Penetration, 2003



Source: CSFB estimates.

Exhibit 26: On-Line Cruise/Vacation Penetration, 2008E



Source: CSFB estimates.

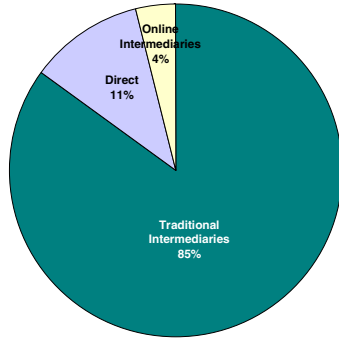
In addition to the favorable impact of increasingly better online tools, we believe dynamics including reduced barriers to trial and an ever-increasing number of experienced cruise passengers will drive online cruise penetration.

- *Online agencies have bricks-and-clicks capability.* All of the major online intermediaries are increasing their off-line customer-service and booking capabilities in an effort to drive more complex travel. In fact, when it comes to complex travel in the near term, the major online agencies will resemble off-line agencies in many ways. The primary differences will be the online agencies' emphasis on the Internet distribution channel and the expansive distribution reach and leisure traveler relevancy they bring to the table.
- *Reduced barriers to trial reduce traditional agency dependency.* Efforts to reduce barriers to trial (both time and cost) including proliferation of short-cruise itineraries and drive-in homeports naturally reduce the "push" required to initiate trial. As such, these dynamics make non-traditional distribution (i.e. picking up the phone, booking online) much easier for the consumer. From a distribution standpoint, short cruises, by nature, tend to book closer in to sailing. As a result, these products are more of an impulse buy. Thus, they are more suited to nontraditional distribution methods, including direct booking through the Internet. These regional products also allow for targeted geographic marketing through direct channels, or through agencies located in the targeted region. As a result, we expect a significant degree of the nontraditional distribution penetration within the cruise industry will come in the short-cruise category.
- *An increasing number of consumers are becoming experienced cruisers.* Cruising is still a primary demand-stimulation game, thus each year roughly 50% of North American cruise passengers try the product for the first time and become experienced cruisers. With knowledge about the product, particularly given increased supplier concentration, consumers will become increasingly comfortable booking through an online intermediary or direct with the supplier.

Exhibit 27 and Exhibit 28 illustrate our own explicit estimate of distribution channel market share within the cruise industry last year and three years from now. As we have indicated throughout this report, travel intermediaries will remain the dominant channel. We include traditional leisure agencies, specialized distributors, corporate travel agencies, and traditional agency Web sites among the traditional channel. Explicit in our assumption is that supplier-direct will more than double from 10-12% currently to 25% by 2008. While we still expect supplier-direct and online agency penetration to grow rapidly, growth in the number and productivity of home-based travel agents (albeit enabled online) could offset expected degradation in the traditional channel and further delay realization of our forecasts beyond 2008.

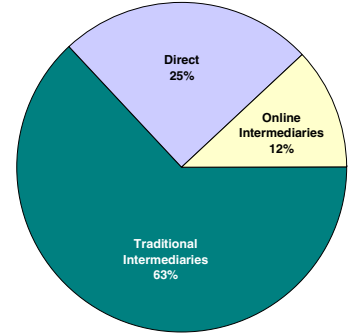
Growth in home-based agents could mute our forecast for increased supplier-direct penetration

Exhibit 27: CSFB North American Cruise Industry Channel Mix Forecast, 2003E



Source: Company data, CSFB estimates.

Exhibit 28: CSFB North American Cruise Industry Channel Mix Forecast, 2008E



Source: Company data, CSFB estimates.

GDS Implications

Growth in the home-based travel agency space is consistent with a couple of key travel distribution themes including supplier migration to lower-cost channels and GDS disintermediation in complex travel. The overall distribution of travel is in a state of flux, as structural change driven by the application of technology is breaking down traditional models. As a result of new applications, the strategies being employed by each link in the travel distribution value chain are beginning to converge. Suppliers, through direct APIs and their own Web sites are attempting to take greater control of the distribution process and get closer to the end customer, whether a consumer or corporation. In the case of home-based travel agents, suppliers seek to increasingly develop direct relationships with channel participants outside of a consortium or GDS relationship. This channel shift in complex travel mirrors the aggressive push the airlines have made to channel shift away from the GDSs, including Sabre, Cendant's Galileo, privately held Worldspan, and European market-leader Amadeus.

The travel value chain is collapsing with suppliers seeking to get closer to the end consumer

Our broader travel distribution thesis suggests the onset of full deregulation (the DOT's CRS Rules fully expired on July 31) and the collapsing of the value chain from technological innovation will further accelerate convergence in travel distribution. In particular, we believe the economic model for GDS distribution is unstable and will likely come under further pressure when transitory supplier and GDS arrangements including Sabre's DCA three-year option and Galileo's Preferred Fares Select programs begin to expire starting in 2006. In our view, the recent sunset of the CRS rules shifts market power away from the GDSs including Sabre and Galileo to the front-end TMCs and the back-end travel suppliers, particularly the network air carriers that drive a large percentage of GDS volume. Based on extensive conversations with industry participants and network airline management, which continue to operate under financial duress, the GDSs will likely be faced with another significant round of segment-fee discounting when the current agreements roll off in 2006 (material potential TMC share shifts from content loss are the alternative). In fact, industry sources suggest initial contact with DCA participants about program extension met with demands for significant further segment fee reductions. As such, early extension of these agreements appears unlikely at this time. This is consistent with our view that there is a significant disconnect between the perceived cost/value relationship of segment processing by GDSs and their supplier customers including cruise lines.

GDS are providing improved solutions and accessibility for smaller agencies

Agencies (including the home-based variety) are responding to change by aggressively pursuing their own customer relationship management (CRM) initiatives and developing (or asking access vendors/suppliers for) more sophisticated tools with which to service customers and demonstrate value add. GDS providers do typically offer a wide range of tools that are suitable for home-based agents and have unbundled many offerings to facilitate penetration of smaller agencies. In our view, supplier tools will continue to take share within the home-based channel. Many complex travel operators are stepping in and providing enhanced productivity and tools (Web-based inventory access tools) and full passenger name record (PNR) functionality (record management tools such as RCI/Celebrity's well-regarded Insight PNR management tool). Particularly in the cruise space where GDS functionality is generally regarded as poor, cruise lines have the opportunity to migrate agencies to better proprietary tools.

Disintermediation/Erosion of GDS Pricing Power

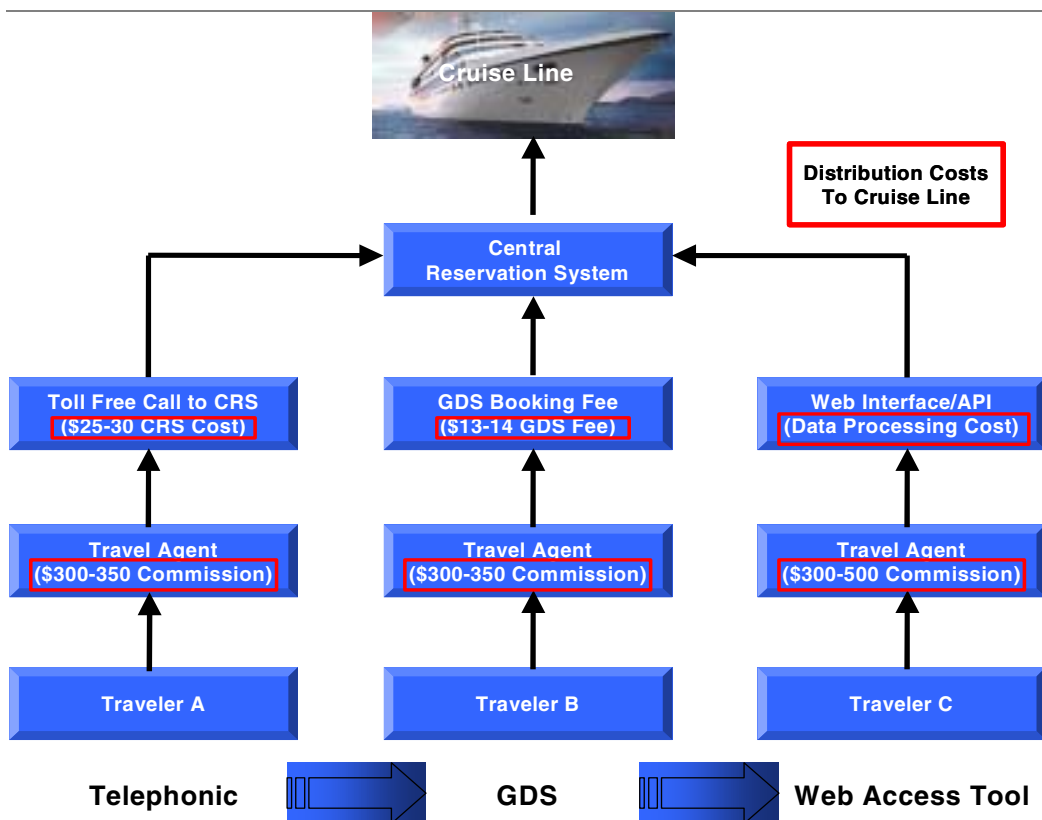
The application of technology such as the Internet has increased the ability of travel suppliers to distribute their travel products and services directly to customers. As a consequence of years of pricing increases, the GDSs have created the perception among suppliers, particularly the major air carriers, that segment fees have become disconnected from the GDSs' value added. This has become an even more intense issue now that the airlines, most of which are in financial distress, have gone to zero base pay. In a zero-commission environment, the GDS segment fee is often the single largest component of distribution cost. Owing to this perception gap, the major air carriers have been actively seeking to reduce the GDS volume concentration that supports this intermediary's pricing power.

Complex providers including cruise lines are migrating indirect bookings to lower-cost automated solutions

Exhibit CC illustrates the costs associated with the traditional indirect distribution model. As shown, there are three primary ways to access inventory and execute a booking through an intermediary. The traditional, and most expensive, means of distribution has the travel agent contact the cruise line's reservations center to inquire about inventory availability and pricing and to make the booking. We estimate the reservations center costs can amount to \$25-30 per booking on top of a 15% agent commission. Increasingly, cruise lines have attempted to migrate distribution away from the call center to a GDS, an Applications Programming Interface (API or direct connect) or a Web-based tool such as Royal Caribbean's CruiseMatch (Cruising Power) or Carnival's BookCCL.com. As shown, these automated systems carry significantly less cost than a telephonic booking. We estimate the GDS fees are roughly half of the call center cost and an API or Web-direct tool only carries data processing costs to develop and enhance the link or dedicated Web site.

Exhibit 29: Indirect Cruise Industry Distribution Models

assumes 2.2 passengers per booking @ \$1,000 per



Source: Company data, CSFB estimates.

To overcome GDS incentive fees, we envision cruise lines may provide agents incentive to migrate to a lower-cost API or proprietary Web application

Cruise lines have already experienced some success in shifting bookings from the left of the diagram to the right, although the process is gradual. The biggest hurdle to migrating an agency from the GDS inventory access channel to a proprietary supplier-direct Web tool appears to be the GDS incentive fee, or the portion of the cruise booking fee that is rebated back to the agent as an incentive to use the GDS. To overcome GDS incentive fees, we envision that cruise lines may provide agents incentive to migrate to a lower-cost API or proprietary Web application. Matching a \$3-4 incentive fee would still provide \$10-11 of cost savings per booking before DP cost.

Shrinking and Increasingly Demanding GDS End-User Market

Sabre and the other GDSs face a primary customer base in the United States that is both shrinking and becoming increasingly demanding. And home-based travel agency growth appears to be contributing to the former. Reinvention of Airlines Reporting Corp.-bonded agencies into non-ARC, non-GDS home-based businesses is also contributing to continued decline in ARC agency locations (ARC travel agency locations are off another 8% YTD and down 40% from their highs). Suppliers also continue to encourage agents to use lower-cost proprietary channels by developing enhanced functionality and productivity tools.

For the mega-agencies, this consolidation has generated increased channel power. This increased concentration could potentially create additional upward pressure on agency

incentive fees (a GDS segment-fee share for its agency customers). Moreover, in a zero-commission environment where the corporate agencies are relying on customer service fees, their need to demonstrate value added is significantly enhanced. Consequently, agencies are increasingly pressuring the GDSs, including Sabre, for more sophisticated productivity enhancement and management tools.

Summary and Conclusion

Home-based growth is a positive trend for the cruise lines

We are encouraged by the emergence of the home-based agency channel and its positive demand implications for complex travel providers, particularly the cruise lines. Structural change in the distribution of travel – namely the elimination of air commissions and the application of technology – sparked the trend, which has accelerated owing to both an increased need to reduce costs following external travel shocks over the last couple of years and increased supplier support for the channel.

As we suggested following the elimination of air base pay in 2002, surviving consumer-oriented travel agencies have migrated toward increasingly complex travel categories. Consistent with this migration, we suspect the benefits from emerging growth in home-based volume will accrue to the suppliers to the far right of the complexity continuum. In particular, cruise lines stand to benefit significantly as more than 80% of home-based agents contacted cited cruises as their primary product emphasis (many sold only cruises). Not surprisingly, cruise is a high-touch, push category still in the primary demand stimulation stage, thus providing relatively high 13-15% average commissions. Home-based agents also like the product's consumer value proposition, high satisfaction levels and productivity/selling support provided by the cruise lines. As a result, we view the cruise operators, Carnival and Royal Caribbean as the best ways to play the home-based agency trend.

Home-based growth is partially offsetting share capture by online and supplier-direct channels

While we still expect supplier-direct and online agency penetration to grow rapidly in complex travel, forecast continued growth in the number and productivity of home-based travel agents (albeit enabled online) could offset expected share loss in the traditional channel. We are sticking with our 19% online penetration forecast in cruise/vacation travel and our 75% traditional (online and off-line retail and home-based) and 25% supplier-direct forecast for the cruise category by 2008 (pushed out from prior by the home-based trend), but we recognize increased traction of the home-based agency trend could further delay realization of these penetration and channel mix forecasts.

We envision migration toward even closer direct relationships between complex travel providers and home-based agents

GDS implications are consistent with our strategic convergence thesis including volume migration to lower-cost/higher functionality channels and our forecast 3-5% channel shift away from the GDS including Sabre and Cendant's Galileo. All suppliers including those to the far right of the complexity continuum will continue to encourage agents to use lower-cost proprietary channels by developing enhanced functionality and productivity tools. While GDS such as Sabre and Galileo are migrating toward a value-added reseller model and attempting to increase their service offerings to smaller traditional and home-based agencies, we continue to see migration toward utilization of closer direct relationships between complex travel providers and home-based agents.

Companies Mentioned (Price as of 06 Jan 05)

Carnival Corp. (CCL, \$56.95, OUTPERFORM, TP \$65.00, MARKET WEIGHT)
 Royal Caribbean Cruises (RCL, \$52.85, OUTPERFORM, TP \$65.00, MARKET WEIGHT)
 Sabre Holdings Corp. (TSG, \$21.43, NEUTRAL, TP \$22.00, MARKET WEIGHT)
 American Express Co. (AXP, \$54.44, UNDERPERFORM, TP \$54.00, MARKET WEIGHT)
 Cendant (CD, \$22.54, OUTPERFORM, TP \$28.00, MARKET WEIGHT)
 Amadeus (AMS.MC, Eu7.32, NEUTRAL, TP Eu6.50, OVERWEIGHT)
 Priceline.com Inc. (PCLN, \$23.59, OUTPERFORM [V], TP \$28.00, MARKET WEIGHT)
 Yahoo Inc. (YHOO, \$36.13, OUTPERFORM, TP \$45.00, OVERWEIGHT)
 My Travel Group (MT.L, 8.00 p, RESTRICTED [V])

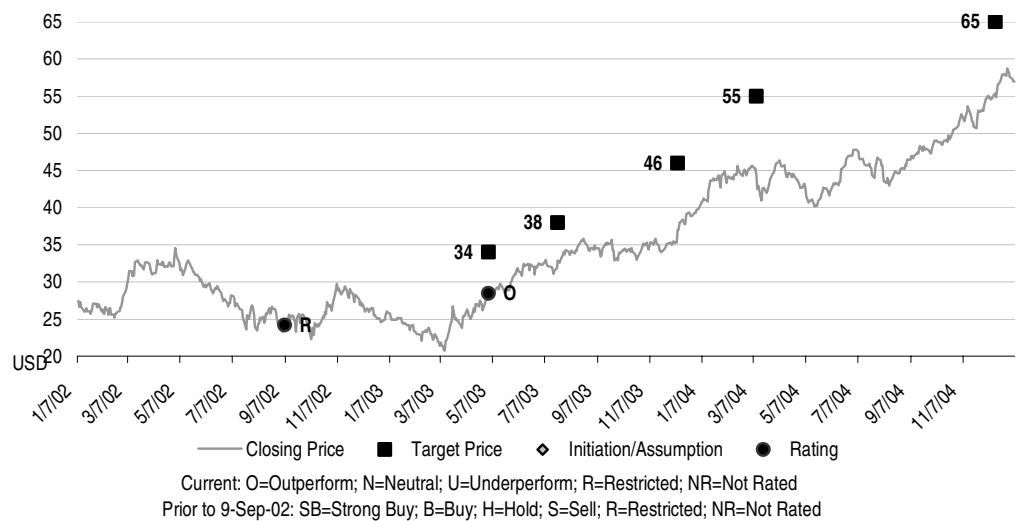
Disclosure Appendix

Important Global Disclosures

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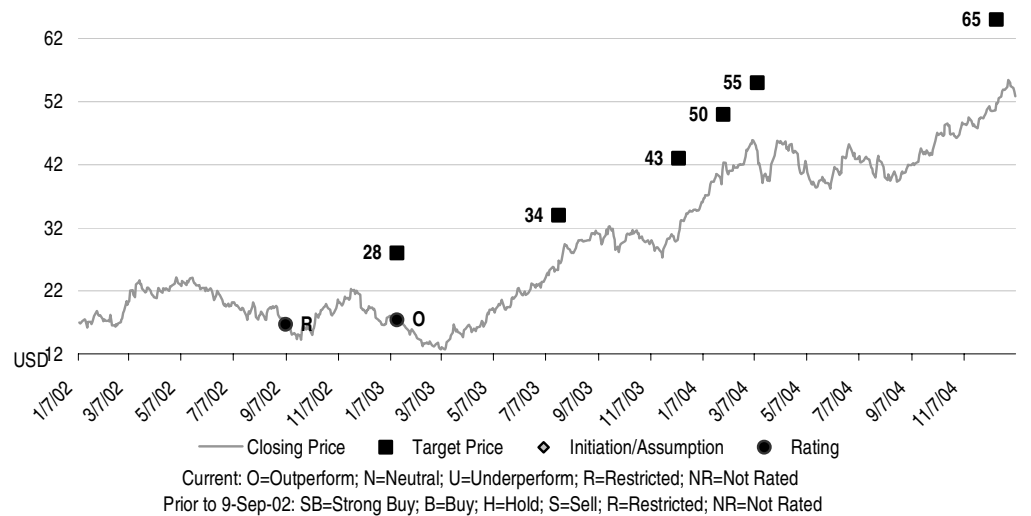
See the *Companies Mentioned* section for full company names.

3-Year Price, Target Price and Rating Change History Chart for CCL



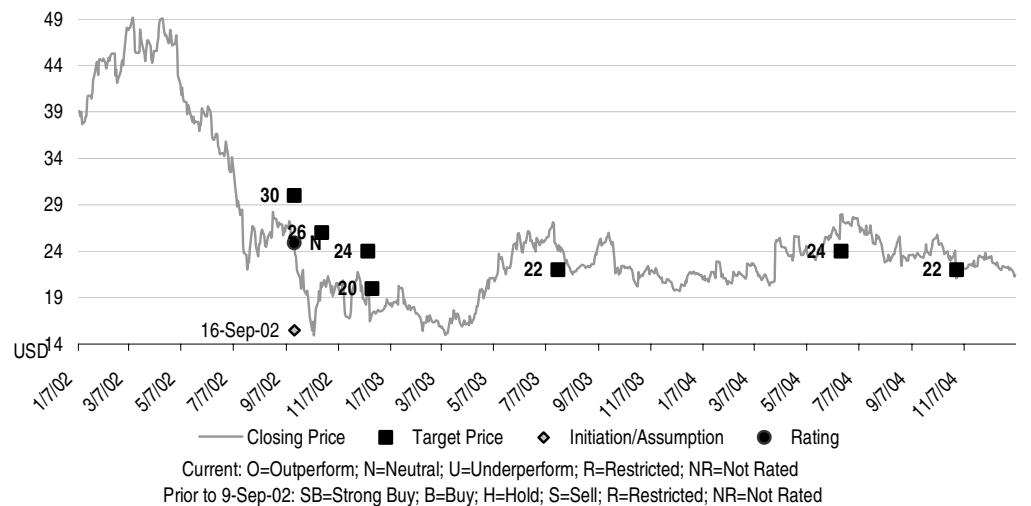
CCL Date	Closing Price (US\$)	Target Price (US\$)	Rating	Initiation/Assumption
9/6/02	24.2		RESTRICTED	
5/2/03	28.47	34	OUTPERFORM	
7/22/03	32.85	38		
12/9/03	37.06	46		
3/10/04	44.41	55		
12/14/04	55.4	65		

3-Year Price, Target Price and Rating Change History Chart for RCL



RCL Date	Closing Price (US\$)	Target Price (US\$)	Rating	Initiation/Assumption
9/6/02	16.68		RESTRICTED	
1/14/03	17.4	28	OUTPERFORM	
7/22/03	26.77	34		
12/9/03	31.11	43		
1/30/04	42.37	50		
3/10/04	44.16	55		
12/14/04	51.78	65		

3-Year Price, Target Price and Rating Change History Chart for TSG



TSG Date	Closing Price (US\$)	Target Price (US\$)	Rating	Initiation/Assumption
9/16/02	24.89	30	NEUTRAL	X
10/18/02	20.15	26		
12/11/02	19.3	24		
12/16/02	17.3	20		
7/21/03	24.06	22		
6/16/04	27.56	24		
10/29/04	21.1	22		

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Method: Several intrinsic valuation analyses including discounted cash flow (DCF), value-based analysis (VBA) and equity-based VBA analyses, and verified against historical trading multiple parameters.

Risks: Negative dynamics relative to our expectations regarding travel volume; regulatory change; shifting environmental standards.

Price Target: (12 months) for (RCL)

Method: Derived from the average of discounted cash flow (DCF), value-based analysis (VBA) and equity-based VBA analyses, and verified against historical trading multiple parameters.

Risks: Negative dynamics relative to our expectations regarding travel volume; regulatory change; shifting environmental standards.

Price Target: (12 months) for (TSG)

Method: Derived from the average of discounted cash flow (DCF), value-based analysis (VBA) and equity-based VBA analyses, and verified against historical trading multiple parameters.

Risks: Negative dynamics relative to our expectations regarding travel volume; travel industry impairment.

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