



### To manage costs, the cruise industry can:

- shift deployment from the Caribbean
- focus development on European markets
- place greater focus on HR initiatives

The launch of Royal Caribbean's *Independence of the Seas* and Carnival's *P&O Ventura* in the UK earlier this year set the sights of the cruise industry firmly on Europe.

Figures from the Passenger Shipping Association project 1.55 million Britons will take a cruise holiday in 2008 – up from 1.35 million last year – and a vital part of the 12.8 million cruises predicted worldwide.

It is an optimistic forecast for an industry which is dealing with rocketing fuel prices and an uncertain economy while planning how to fill eight new ships delivered this year and more than 35 during the next four years.

Terry Dale, president of Cruise Lines International Association, which represents 24 cruise lines, says CEOs are confident the industry is, by its nature, reasonably recession-resilient.

'Consumers believe they have a right to a vacation even in a soft economy. They may be more diligent in resourcing it because they have fewer dollars but they also soon recognise that a cruise is the best value for money.'

'We are optimistic that 2008 will be a record breaking year for numbers of passengers. The tone is optimistic and ships are sailing full.'

He is excited about the future globalisation and diversification of the industry with 'innovative and exciting' itinerary planning and ships sailing to 'all corners of the world'.

Robin Farley, managing director of UBS Investment

## Market Outlook

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# Choppy waters

With rising costs affecting the tourism industry, Rebecca Burgess talks to Carnival's **Howard Frank**, Royal Caribbean's **John Tercek**, UBS Investment Research's **Robin Farley** and CLIA's **Terry Dale** about how cruise lines are weathering the storm.

Research, says she has seen prices holding up with bookings and predicts a yield growth between 2.4 and 4% in 2008.

However, she warns the cruise industry is subject to competitive pressures and the strength of the underlying economy. 'Profitability could be affected by fluctuations in wages, fuel prices and interest rates,' she adds. Farley also believes growth will come from redeploying ships to higher-demand itineraries and away from weaker markets, including a growth in European passenger sourcing.

Howard Frank, vice-chairman and CEO of Carnival Corporation, is optimistic about the effects of the economy. 'I think there is a little bit of concern in North America about the softening overall economy during 2008 but our bookings are holding up nicely.

'I think the reason for that is cruising is such great value – the only concerns we have right now are on the cost side. It has been a challenge to get revenues to cover fuel costs, it used to be small bit of budget but now it's the largest in terms of profitability.'

John Tercek, vice-president of commercial development for Royal Caribbean Cruises, agrees the credit crunch is hitting the industry less than anticipated. 'Our sales are fine and business is comparable to previous years. We have higher costs of fuel and all the brands have some type of fuel surcharge so going forward it is being added to the ticket price but it seems to be okay.'

However, to ensure they stay on top of the growth market and ahead of the recession, the leading lines are looking to Europe to shore up profits. 'Carnival, Royal Caribbean and Norwegian Cruise Line have increased their European deployments in 2008, while reducing their Caribbean trades 5% from 2007,' says Farley. 'We estimate the shift in deployments alone away from the lower-yielding Caribbean could provide net yield growth of roughly 0.5% to Carnival in 2008 and 1% to Royal Caribbean.'

This year she says European trade is up 16% on 2007 and 50% on 2006. 'Cruising is becoming more of a mainstream option for vacations in Europe as it already is in the UK. Europeans typically take more frequent and longer vacations than Americans and a good deal of Western Europe's population of more than 300 million people already live within driving distance of a major port.'



The Carnival Freedom arriving in Venice.

## 'Carnival, Royal Caribbean and Norwegian Cruise Line have increased their European deployments in 2008.' **Robin Farley**

Frank confirms Carnival is growing its business in Europe and the UK, seeing about 18% to 19% growth year on year. Carnival's expansion has been high profile, with the launch of Cunard's *Queen Victoria* and P&O's *Ventura* in Southampton, UK, and the arrival of the *Aida Bella* in April.

Germany-based Aida has strong presence and is expanding quickly with five new ships, according to Frank. 'The demand to fill up ships is attractive to us. Aida sails all round the world, in winter in Brazil and Argentina, and it has a strong recognition, it's a global brand. Europe is a less penetrated market and most of our 22 new ships in the next four years are there.'

Frank notes that 3% of the US population have taken a cruise, in the UK it is just over 1% and in Europe just less, so there is room to grow. 'Cruising is becoming a more mainstream vacation against the package holiday – it's a viable alternative and attractive and affordable in price,' he says.

Europe is also proving pivotal for Royal Caribbean, with a significant proportion of the company's profits generated there, according to Tercek.

The 160,000-tonne *Independence* became the largest vessel based in Britain at its launch in April and the first RCCL new-build to spend its inaugural season

in Europe. 'It is much more expensive to run ships in Europe but you can also get a good basic ticket price which is what it is all about,' Tercek says. 'It was quite a big leap for us when we put the new *Independence* in Southampton for the British market – but it shows how important this market is.'

Royal Caribbean also plans to leave a ship in Barcelona this winter for the first time, selling to a mix of Americans and Spanish traveling to the Canary Islands. 'You don't get a great ticket price but if you operate the ship out of Puerto Rico you have two weeks downtime in each direction, you have to factor for the whole year,' Tercek says.

Royal Caribbean has also expanded its presence in Europe with the purchase of the largest cruise operator in Spain, Pullmantur, which it intends to upgrade as a quality three-star product.

Royal Caribbean is also launching a joint venture with travel agent Tui in 2009 in the German market, which will see it compete with Carnival's *Aida*.

Dale says CLIA is seeing tremendous growth in markets in the UK and Europe. 'It's a logical expansion into Europe as customers have wanderlust and want to explore. And with a weak dollar you are more insulated on board a ship against any fluctuations.'

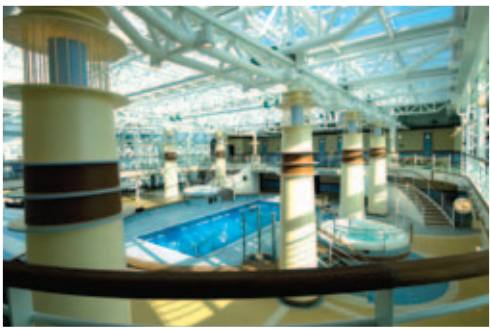
## Development plans

But it's the weak dollar that Farley says has stopped Carnival from ordering any large new ships for North America since 2005, while Howard Frank believes the strength of the euro is making costs higher. 'I think in terms of ordering more ships for the US it's making it difficult from 2012 and beyond,' he says.

Meanwhile, Royal Caribbean has unveiled its most expensive pre-order for its fifth Solstice-class ship at \$192 million. But Robin Farley calculates Royal Caribbean will need to earn \$135 per berth per day to get a return of 15% – roughly two and a half times the company average.

And while Royal Caribbean is building bigger, Carnival has a philosophy of modest change to its fleet profile, according to Frank. 'It works for us. One of the challenges of building an innovative ship is that the market tends to gravitate to the ship that affects the rest of the fleet.

'It really comes down to the service and how we train our people and how well they execute their job – that's more important than the iconic features. We are much more evolutionary than revolutionary.'



The *Ventura* launched earlier in the year.

Tercek says Royal Caribbean's strategy does include building huge new ships for the Caribbean market – such as Genesis – and moving older ships to other areas. 'Each company tries different ways to come up with strategies and each brand is trying new products,' he says.

'We've always had the very best ships in the Caribbean and chase our own tickets so we move older ships to other areas to 'seed' other markets with high-quality ships.' These other new markets include China, the upper echelon of Taiwan, and Singapore.

In addition to new ships and destinations, Royal Caribbean is investing heavily in upgrading ports worldwide, with \$700 million-worth of development

to accommodate its Genesis class.

Projects include building a port from scratch in Falmouth, Jamaica, which will open in 2009, and a \$35 million upgrade of the port of Roatan, Honduras, Central America.

For Frank, human resources is the focus for the immediate future and sourcing the right group of executives for the next generation of business. 'A lot of our businesses are legacy businesses which were created 20 to 30 years ago, and

many have had the same people for life.

'They are a very talented group of people but as the business matures and people get older, you have to make sure you have the talent for the succession of leadership of Carnival in each of its operating areas.'

For Dale at CLIA, the future is about working together to grow the cruise market globally. 'It's less about competition and more about how we attract first-timers to the industry as a whole.' *wc*

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Still smiling: European trade is up 16% on 2007.