



In the black

The price of oil has dropped sharply from record highs but cruise lines must tread carefully when planning fuel budgets, especially in a downturn. Orla O'Sullivan talks to Prestige Cruise Holdings' **Robin Lindsay**, VacationsToGo.com's **Alan Fox**, Captain **William Wright** and **Patrick Sinclair** of RCCL and **John Krousouloudis** about dealing with a very volatile market.

In the relatively brief period that passed between two of the interviews for this story, the price of a barrel of oil fell from \$91 to \$33. And, if that does not illustrate the recent volatility of oil prices, consider that in 2008 the World Bank predicted oil barrel prices could fall to \$75 in 2009, while Russian producer Gazprom later forecasted they would rise to \$250.

By then, oil prices were on their dizzy ascent to almost \$150 a barrel, having broken the psychologically significant \$100 barrier at the start of the year. Prices then peaked in July before falling steeply.

Amid the global recession, demand for oil has fallen to its lowest level since 1983. Oil costs less than it did three years ago

and, at the time of writing, is trending downwards. On 12 January, crude oil sits at \$38 a barrel on the New York Mercantile Exchange.

Forecasts, for what they have been worth, see oil recovering to \$60 a barrel this year. That, at least, is the average anticipated by analysts surveyed

late last year by Bloomberg News.

Meanwhile, unprecedented cuts announced by OPEC and Russia, the world's second-largest producer, have not been enough to outweigh news such as the US, the world's largest oil consumer, losing more jobs in 2008 than in any year since the Second World War. Even with a weak

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dollar, which normally makes oil more expensive (it is priced in dollars so it takes more dollars to buy a barrel), oil remains relatively cheap.

Stormy seas

With fuel so cheap, it could be presumed that these prices mean great news for cruise operators. In some ways it has been, industry executives suggest. 'I'd guess we've cut our fuel bill in half,' says Robin Lindsay, executive vice-president of vessel operations with Prestige Cruise Holdings. 'In 2008, we were paying upwards of \$600 a ton. Now, for most of 2009, we'll pay \$250 to \$300 a ton.'

On the other hand, it hasn't been an easy ride and Lindsay says that 2008 was volatile. 'Fuel probably went up 2.5 times more than was expected between January and August,' he says.

Then there's the fact that the worst economic downturn since the Great Depression has lessened demand for discretionary travel. Operators have noted that demand is down, an observation echoed by Prestige, occupying the luxury cruise niche, and Royal Caribbean International, one of the world's biggest cruise companies.

Alan Fox, chairman and chief executive of VacationsToGo.com, a major reseller of cruises, based in Houston, Texas, said in mid-December, 'We had some slow periods early in the financial meltdown but have had substantially more cruise bookings in the past 30 days than we had during the same period last year. Ships are still going out full, though [ticket] prices are lower.'

Most cruise lines in November and December responded to cheaper fuel bills by dropping the controversial fuel surcharges introduced in late 2007, with effect from 2010 or sooner.

Cruise companies have responded to volatile oil prices by hedging their



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purchases – essentially placing two-way bets so they are covered whether prices rise or fall – and to general market volatility by keeping a close eye on all financial counterparties in the supply chain.

Meanwhile, whatever the price of oil, cruise lines keep striving for energy efficiencies to contain what is a considerable cost element.

Fuel ate about 9% of Royal Caribbean Cruise Line's (RCCL) revenues in 2006 and 2007 (the last reported year), up from 7.5% in 2005.

Cruise operators say they have little clout when it comes to negotiating the oil premiums they pay, whatever their size in the cruising world. Lindsay contrasts Prestige's seven-ship operation and its inability to bulk-buy fuel with the industry's top two cruise operators. 'Companies such as Carnival and RCCL have big advantages,' he says, 'Our yearly consumption for either line [Regency and Oceania Cruises] is probably less than what Carnival consumes in a week.'

Speaking before he left RCCL as its senior vice-president of marine operations for Celebrity and Azamara Cruises, John Krousouloudis said that cruises are

a 'tiny portion' of the global shipping business, with some estimates at 2%. The best opportunity for a discount is a particular port being visited by several RCCL ships at once. 'RCCL has the advantage in that it knows its itineraries in advance,' he said.

Future promise

When it comes to buying oil in fear of rising prices, hoarding might seem tempting, were it practical. That is what others on the supply side are doing. Right now the oil industry is in a quirky state known as contango, which means prices are lower now than at any point in the future, and maybe a lot lower.

There are those who bought oil futures six months ago forced by contract to pay \$100 a barrel when current prices are less than \$40 a barrel.

In fact, the future looks so much better than the present to those selling oil that a record amount is being kept in storage by producers, refiners and investors, notes MarketWatch.com, a Wall Street Journal affiliate. It is also worth suppliers paying perhaps \$2 a barrel to keep huge floating tankers offshore in order to lock in a \$10-a-barrel premium for future delivery.

Futures purchase contracts do not fix the actual price ahead of time, but they tie the future price to a local index – typically prices published by Platts – at the time the fuel is received.

Asked if Prestige found itself locked into arrangements that forced it to buy oil at prices far higher than prevailed by the time of delivery, Lindsay says no. 'It happened to some cruise lines we know but it didn't happen to us,' he says.

Lindsay says Prestige began hedging in October, starting at \$69 a barrel. 'Everything we buy in 2009 will be under \$60 a barrel. I would say we've hedged upwards of 65% already. Now that the fuel prices have dropped, everyone's hedging.'

RCCL has been systematically increasing its use of both forward purchasing and hedging since mid-2006.

The cruise company is committed to buying ahead and buys about three-quarters of its fuel up to 18 months in advance. It credits hedging with saving \$68.6 million on what it would otherwise have paid for fuel in 2007.

However, there has been one change to how the company purchases fuel lately. It scrutinises all the links in the supply chain, both from a value and risk perspective. 'We work with suppliers who have the commodity and traders who work with suppliers,' RCCL vice-president Patrick Sinclair explains. 'We've much more counterparties when we hedge. A large

majority of our counterparties are banks. Some banks offer trading services and some local suppliers are owned by banks. We want to make sure that they're stable, especially in the current environment.'

As for less dramatic company practices, Sinclair says the company has started to look at other counterparties to make sure the suppliers it works with are providing the best possible value.'

'There's only so much we can do,' he says. 'We haven't really changed anything significantly; our fuel programme is driven by the open market.'

When asked about consolidating suppliers to bulk buy, RCCL's senior-vice president of marine operations, Captain William Wright has stated, 'We have no special focus to consolidate suppliers and we're not convinced it would make that much difference.'

Sinclair seconds that with RCCL's bottom line. 'What we can control we're going after full speed: operational efficiency, we have about 200 initiatives there, and managing the [price] peaks and troughs with hedging.'

A graph included in an RCCL investor conference reviewing third-quarter earnings charts an immediate sharp drop in bookings just around the time of the Lehman bankruptcy. That collapse was for many a definite indication that this economic crisis is on a much greater scale than others we have known.

Prestige's Lindsay, speaking at the end of 2008, said, 'Bookings across the industry are a little softer. But we expect them to come back in January. This has been an exceptional time by any standards,' adding that despite the vicissitudes of 2008, 'we're having the best year we've ever had.' Prestige, a privately held firm, doesn't disclose its profits.

Prestige may be the largest of the small, luxury cruise operators, but it is not, Lindsay agrees, in a high-volume, low-margin business, where cost containment becomes more important. 'Fuel is not the be all and end all of profitability,' he says. Prestige's most important consideration is what passengers pay.

'Our goal is high per diems, not heavily discounted.'

So far, it is on course. However, 2008 may yet bring in its wake a drop in demand not yet felt. As Lindsay notes, 'Luxury cruises are booked eight to ten months out.' *wc*



Fuel for thought

Captain William Wright notes that a lot of people make the erroneous assumption that it is the propulsion of the vessel that consumes the majority of fuel, when half of it is used by passenger services. 'I think this awareness from our operating teams is changing,' he says. 'In the past, when fuel was around \$30, cost wasn't considered at all. If we could go from point A to point B with nice ports of call, we did it.'

Although oil is back around \$30 a barrel, it's hard to imagine a return to such innocent days. As Oscar Wilde's character Lady Bracknell remarked, 'Ignorance is like a ripe peach. One bite and it's gone.'

Power down
For John Krousouloudis, one of the most effective methods to improve fuel efficiency has been the use of an exceptionally durable silicone coating on the hull. This prohibits marine growth that would impede the ship from cutting cleanly through the water. 'About half of the ship's fuel is used for propulsion, the rest for electricity, the A/C, and cooking,' he says, 'which saves around 5%.'

A host of other measures are available, including the changing of thousands of lights from regular incandescent bulbs to light emitting diodes (LED); applying a window film to filter sunlight and so reduce

the need for air conditioning; reducing water in showers while swapping air for water so the pressure feels the same pressure; ensuring appliances not in use are promptly switched off, through a combination of policies and new technology.

Michael McNamara, associate vice-president of global fuel procurement at RCCL, adds that future and futuristic possibilities such as additives to make the oil last longer; smoke-stack scrubbers to make emissions cleaner, as an alternative to buying costly clean fuel; biofuels; and even a return to wind power. 'As yet, he says: 'Nobody can even manufacture sails for ships our size.'