

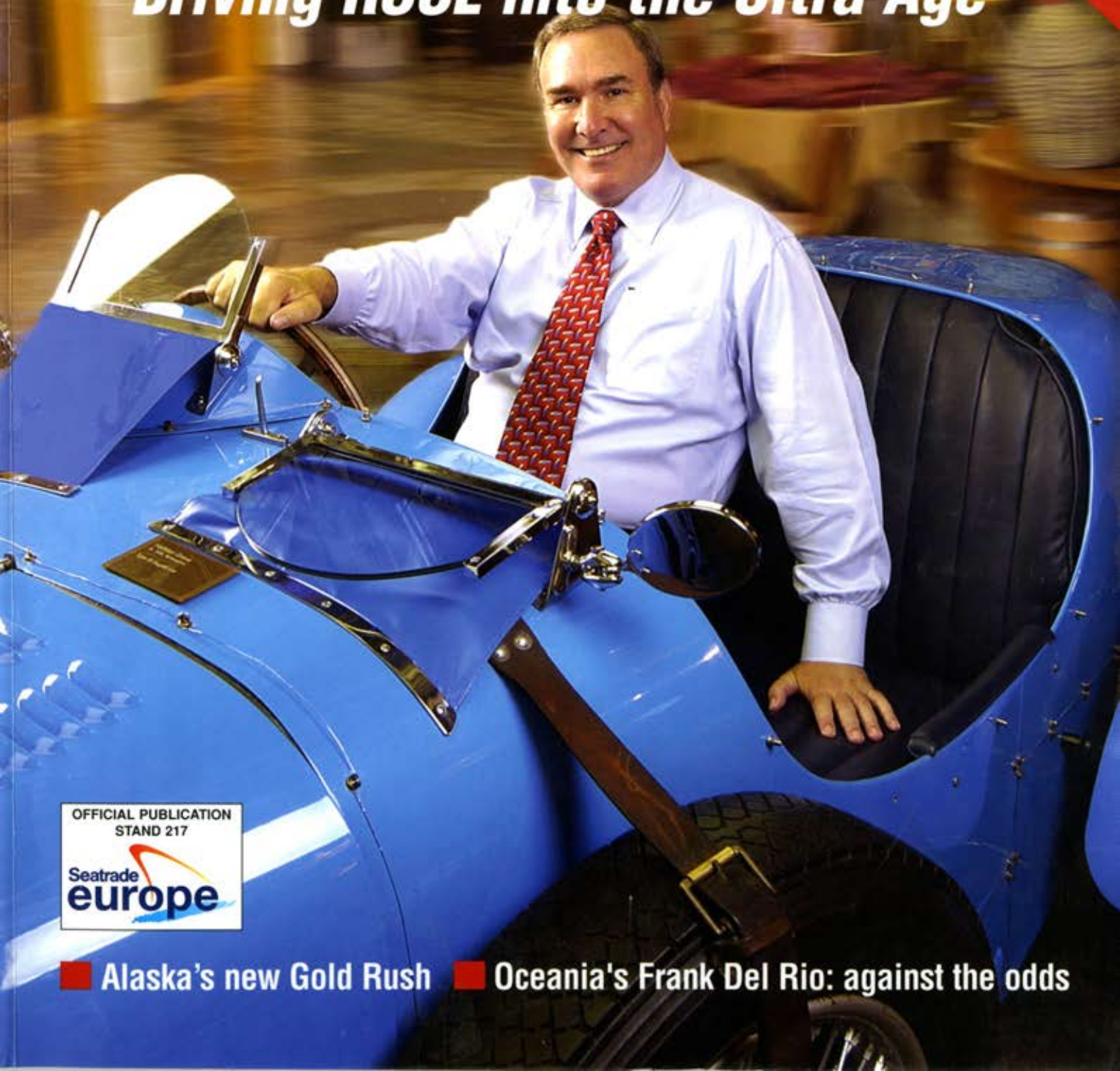
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CRUISE REVIEW

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Richard Fain

Driving RCCL into the Ultra Age



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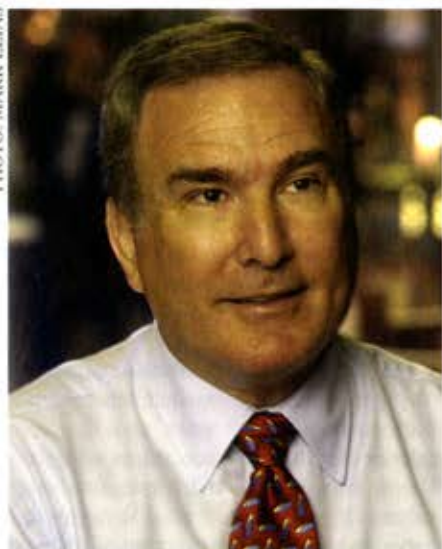
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Into the Ultra Age

Royal Caribbean lost out in the merger battle but instead of spinning its wheels, the company is refocusing on boosting returns and cutting costs while gearing up for Ultra Voyager and polishing the Celebrity brand. **Anne Kalosh** reports

PHOTO: MARK ELIAS



Richard Fain, Royal Caribbean's chairman and ceo

Building on a key strength 'the Voyager series' Royal Caribbean is driving future expansion with colossal ships. At 160,000gt, the Ultra Voyagers will dominate the seas, edging out previous titleholder Queen Mary 2 as the largest cruise vessel afloat.

'We're not emphasising that it's the largest but the best and most exciting,' says Royal Caribbean chairman and ceo Richard Fain. 'The fact is: the larger ships offer greater choice and greater variety. And the Voyager class ships are getting some of the highest per diems in the cruise industry.'

Stronger pricing is crucial to steering the company toward its top priorities: boosting return on invested capital and reducing debt. In 2002, Royal Caribbean's return on equity was 9% compared to Carnival Corp.'s 15.7%, and leverage (debt to capital) was 57.4% for RCCL and 29.9% for Carnival, according to

Ryan Beck & Co. P&O Princess also outperformed Royal Caribbean in both areas.

Now, after its top rivals merged, RCCL faces an even bigger powerhouse competitor. Losing P&O Princess to Carnival was a bitter disappointment. Royal Caribbean management believed it had crafted a bulletproof deal but ultimately, Carnival's deeper pockets won over the P&O Princess shareholders.

Royal Caribbean is now a distant No. 2

TOP THREE CRUISE GROUPS (October 2003)

| GROUP | SHIPS | LOWER BERTHS |
|----------------------|-------|--------------|
| Carnival Corp | 70 | 110,634 |
| RCCL/Celebrity | 28 | 58,206 |
| - of which RCI | 19 | 43,986* |
| - of which Celebrity | 9 | 14,220 |
| Star Cruises/NCL | 22** | >26,000 |

* Includes Island Escape RCI/First Choice jv

** Includes SS United States and Independence

SOURCE: SEATRIDE

Voyager Class changed the face of cruising



'Get Out There' team: From left, Adam Goldstein, RCI's evp brand operations; Jack Williams, president RCI/Celebrity; and Dan Hanrahan, svp marketing and sales, RCI

[see table] yet, says analyst Tim Conder of A.G. Edwards & Sons, 'Just because you're No. 2 doesn't mean you can't make a good return. Better premiums on their existing product and building future product more competitively will help them get their returns up.'

'They may be second, but they're still awfully big,' adds Dick Knodt, president and ceo of Vacation.com, the world's largest cruise consortium. 'Overall, they're a great cruise line. They've got the right people at the helm and if they keep their focus, they'll do very well.'

Booking surveys by brokerages like AGE and Ryan Beck indicate the Voyager vessels are leading pricing recovery industry-wide. 'The Voyager-class ships clearly changed the face of cruising,' Fain says. 'The Ultra Voyager will extend that success and, with lower per berth capital and operating

Ultra Voyager will have 500 more passengers



costs, provides even better economies of scale.' Royal Caribbean contracted Ultra Voyager at a little over \$200,000 per berth or approximately \$720m all-in.

'It's not a dramatically new ship,' Fain says. Ultra Voyager adds a forward fire zone and cabins for 500 additional passengers, kicking up the lower berth capacity to 3,600.

There's a two-year stretch between the spring delivery of a fourth and final Radiance-class ship, Jewel of the Seas, from Meyer Werft until the first Ultra Voyager arrives from Kvaerner Masa-Yards in May 2006. A second Ultra Voyager, if contracted, would come in 2007.

That amounts to 3% capacity growth in both '06 and '07, a dramatic change after berths ballooned 77% in the last four years, or more than 15% annually. Royal Caribbean is now of sufficient size to carry almost 3m passengers a year.

'We had gone through this period of rapid build-up to create the kind of critical mass we thought the brands needed. We've done that and now you'll see a more steady type of growth,' Fain says.

While RCCL let two Radiance options lapse, additional capacity could come from lengthening ships in RCI's Vision series and/or Celebrity's Century class.

Voyager's financial success holds extra meaning for a company whose point of differentiation has always been the quality

and innovation of its hardware. Royal Caribbean burst into the year-round Caribbean market with the purpose-built Song of Norway in 1970, made a technological leap with Song of America in 1982 and sparked the megaships-with-towering-atria boom in 1988 with Sovereign of the Seas.

The tradeoff has been paying more for newbuilds than competitors. 'Their cost per berth has been higher than Carnival's. That's an area for improvement,' says Cleopatra Murphy of Ryan Beck & Co. 'They've taken pride in putting leading-edge ships on the water. Unfortunately, in a difficult pricing environment, the investments made in more expensive, innovative hardware did not bring in returns comparable to those of the competition.'

However, Murphy notes that 'When good times resume, you would expect the pricing on these leading-edge ships to recover faster than that for other market offerings.'

Fain agrees. 'The challenge with both our brands is that we have tried to be at the upper tier of our competitive set and in a weak market, people trade down,' he says. 'As the market improves, we think we'll improve disproportionately.'

Of the industry's post-Panamax fleet, the Voyagers sport features that others don't, such as ice skating rinks and the large interior Royal Promenade spaces with their shops, bars, dining and views for inside cabins. 'If you want to have a Voyager-class experience, you have to get on a Voyager-class ship,' says RCI/Celebrity president Jack Williams. 'If you want a big-ship experience, you can go on a Voyager, a Destiny or a Grand-class ship.'

'RCI has done an excellent job of positioning their Voyager-class ships as a huge family-market product. I haven't noticed as much Princess doing that,' asserts Vacation.com's Knodt.

Yet as Princess aggressively ramps up its year-round Caribbean presence with big new vessels, it's going on the attack with Love Boat execs touting their new tonnage as 'the only truly royal experience in the Caribbean.'

Fain says comparison campaigns are 'more than counterproductive' because instead of promoting cruising to consumers, they introduce negatives. Princess has done it before, he recalls, when it contrasted its Alaska offerings with Holland America Line's several years ago. 'That didn't work before. It won't work now,' Fain warns.

But what about the operational limita-

tions of post-Panamax vessels?

The Voyagers are 'a more versatile class of ship than we envisaged,' according to Adam Goldstein, RCI's evp of brand operations. In 1998, when the company was planning deployment for the first of the class, Voyager was seen as a Miami vessel which possibly could operate from San Juan. San Juan sailings came in due course. Mariner of the Seas will operate from Port Canaveral and, next spring, Voyager of the Seas initiates New York cruises to Canada and the Caribbean. It's possible a Voyager ship could sail in Europe in 2005. 'We had more choices than we thought we had,' Goldstein sums up.

Besides hardware, Voyager is distinguished by bold marketing. Williams points to the 'Get Out There' advertising message developed with Dan Hanrahan, RCI's svp of marketing and sales, as 'the most successful campaign in the history of cruising' because it shakes off the image of a seagoing vacation as for the 'overfed, newly wed and nearly dead.' 'Get Out There' appeals to the younger, more active, 'explorer mindset' and has helped push the brand's average passenger age down to 42 while also drawing 1m first-time cruisers to RCI in 2002.

Celebrity challenge

Celebrity's own 'A True Departure' campaign made a splash last year with its 'Faces' advertising depicting ordinary people in a t-shirt bearing the lower-case word 'celebrity'. The T's became a hot Internet commodity. There's more spend on this year's effort, 'Treated Famously,' now in full swing with television and print ads.

'Celebrity can perform better but it takes time,' Williams says, predicting 2005-06 as the period of 'full traction'. The brand

presents a special challenge, because although it has more than doubled in size since RCCL acquired it five years ago, it remains smaller with less name recognition than premium-sector rivals like Holland America Line. Hence, the edgy advertising. 'If you can't be the market leader, you want to be the brand everyone talks about,' Williams says.

Beyond raising brand awareness, RCCL is striving to differentiate the Celebrity product. A management reorganisation that gave Goldstein additional high-level duties at RCI was aimed at freeing up Williams to focus more on Celebrity. Dietmar Wertanzl was lured away from Crystal Cruises to sign on as svp fleet operations and add 'a touch of luxury' to the brand. More recently, the company appointed a dedicated vp sales, Dondra Ritzenthaler.

'The brands are more distinct now,' Knott says. 'They're trying to create more differences between RCI and Celebrity and that's the right thing to do. The market got confused when they merged the two.'

Meanwhile, on a corporate basis, Royal Caribbean strives to improve efficiencies. In a competitive analysis of the past four years, Ryan Beck found that operating income per available passenger day for Royal Caribbean lagged 30% behind Carnival on average. While analyst Murphy says that capacity differences explain part of the gap, she sees the biggest opportunity for improvement in day-to-day operations.

Every day, in every department, there's an aggressive focus on cost savings, according to Fain. The company snapped up former Princess exec Jeff Danis as its vp supply chain management. And analysts believe that cost is the top priority of new cfo Luis Leon.

From the revenue side, sophisticated management technology continues to play a monumental role in getting the pricing right. 'Royal potentially has the edge in the industry when it comes to yield management,' AGE's Conder says. 'It's an important factor, one of the most critical areas.'

Revenue management helped Royal Caribbean quickly adapt to the shorter post-9/11 booking curve. Another adaptation to contemporary realities was beefing up the number of US homeports. The company added New York, Philadelphia, Baltimore, Jacksonville, San Diego and San Francisco and continues ratcheting up capacity in Canaveral, Tampa, Galveston and New Orleans. 'We've gotten to the point that half of the American population is within driving distance of our ships,' Fain says.

Deployment in Alaska and particularly Europe is steadily growing, too. From this year to next, RCCL will hike the number of ships in Europe from five to six, and capacity will rise again in 2005, perhaps with the addition of a Voyager.

With stateside bookings drying up during the Iraq war, Royal Caribbean sourced more business on 2003 European itineraries from the UK and the Continent. Williams says the proportion of Europeans to Americans surged to a 45:55 ratio. On a normal, fleetwide basis, the company carries 20% non-US passengers.

Losing P&O Princess means that European expansion will not proceed with specialized brands but rather on Royal Caribbean's existing products. An exception is the Island Cruises j/v with First Choice. It's performing well enough for Williams to foresee growth in time and he suggests it could be 'a good exit strategy for older ships.' □

