



Getting The House In Order

Royal Caribbean reported a remarkable financial turnaround in the second quarter--a profit of \$60.5 million coming off a loss in the first quarter of this year. How'd they do it?

To put the turnaround in perspective, rival Carnival Corp. reported a profit of \$252 million in the second quarter of this year, far greater than Royal's. But that's down from a profit of \$264 million in the second quarter of 2009 (versus a loss of \$35 million reported by RCL for second quarter of '09).

Unlike Carnival Corp., Royal is still not providing a dividend, but the company has come a long way from a year ago, when it was seen by several key financial analysts as saddled with dwindling cash reserves in the midst of an ambitious expansion. Now the focus is on balance sheets and liquidity, which is far less sexy than new ships with the latest bells and whistles, but it's apparently what Wall Street wants. "We continue to take steps to further our liquidity, and that's now exceeding \$1 billion," said CFO Brian Rice during a call with financial analysts. He added capital expenditures are dropping significantly over the next couple of years.

During the call, Royal execs cited already well-known factors for the turnaround, such as a growing overseas source market that's holding strong. The ongoing positive impact of *Oasis* was also cited.

But judging by several financial analysts' comments after the call, there's a third factor: cost cutting. "Strong cost controls yield increase in 2010 guidance," wrote Sharon Zackfia, of William Blair & Company, pointing to better-than-expected net cruise costs, which declined 2.8% in the quarter as ticket yields rose 7.1%.

Restraint With Ship Orders

In times past, we've heard earnings calls with Royal's Richard Fain proudly extolling the latest *Celebrity* ship to investors. He's the closest thing this industry has to P.T. Barnum--a true showman. But investors tend not to like hype now, so it made sense that of all the dozens of quarterly calls we've heard from Royal in the past decade, Fain was never more controlled than on this one. He emphasized in his opening sentence: "Today, my comments will be brief, because I think the numbers themselves deliver a nice story. Simply put, the year is progressing better than we expected it to."

Unlike several other earnings calls we've heard from Royal in recent years, not once was the word "Wow" mentioned. And the humor was limited to one quip, this time courtesy of RCI's Adam Goldstein, not Fain: "We were hoping Shrek could join us this morning, but he had another commitment. In any event, some might argue that there are enough ogres on this call already."

Fain was even somewhat quiet during the Q & A session, though when asked if Royal is changing in ship-

building philosophy back to one of growth, he quickly emphasized: "We'll give a clear 'no' to that....We're expecting to see more of our improvement in the future to margin improvement rather than just to top line growth or just through capacity growth. And so we expect new capacity increases to be less than the past."

Industrywide, orders aren't stopping entirely--just this past week MSC confirmed yet another newbuild--but Royal hasn't jumped in despite the strong response to *Oasis*. However, its ships already in the pipeline need to come through. *Allure of the Seas* arrives in fourth quarter, *Celebrity Silhouette* in the third quarter of next year, and the fifth Solstice-class vessel in the fourth quarter of 2012. Royal forecasts a 2% capacity increase for 2012.

Booking Trends

Restraint isn't the only thing tickling Wall Street. When Raymond James Equity Research upgraded Royal to a "strong buy," analyst Joseph Hovorka cited Royal's bullish tone during the earnings call with regards to booking trends: "Management commentary did not stress a weakened booking trend, as Carnival did on its conference call." However, Hovorka indicated that may well be due to changing trends in the past month. "Carnival is a May quarter end compared to Royal Caribbean's June quarter end. [Ed. note: in May, many retailers had reported weak business]. Furthermore, Carnival noted that bookings improved in the first part of June."

Hovorka, who also has CCL as a strong buy, concluded: "Combined with Royal Caribbean's strong new ship product, management's booking commentary was more robust relative to that of Carnival."

Indeed, Royal execs cited consistency in booking patterns, but CFO Rice indicated that bullishness in tone was partly due to coming off unusually easy comps: "If it weren't for last year, we would be miserable this year."

Factors Driving Down Costs

When asked what was the biggest component driving down the operating costs per cruise day by 2.8%, Royal execs were fairly vague in their reply: "It's pretty much across the board," said Rice.

Royal execs emphasized that they didn't rely on the economy to turn things around: "We've always assumed a lackluster economic environment for 2010, and we've never counted on big improvements driving our results this year," said Fain. "Rather, we've assumed that our new and efficient ships, along with good cost control, would drive substantial improvements in profitability, and that is clearly proving to be the case."

As for commission indicators, Royal reported "commissions, transportation, and other" increased from \$232 million in the second quarter of '09 to \$271 million in the second quarter of 2010. For the first half of the year, that bottom line expense increased from \$468 million to \$540 million.



Twitterin' Andy

Visiting a cruise line's corporate headquarters recently, we observed an exec using Twitter to check relevant cruise postings. We looked over the exec's shoulder to see who he was following. He, of course, was following his own brand's tweets and a main competitor's plus all the leading consumer and trade publications. But some stood out. One was Cruise Holidays of Mission Viejo (cruisebuzz), and another was the tweets of an exec from a competing line: Andy Stuart of NCL (nclandy).

The exec observed that no *individual* on the supplier side tweets as prolifically as Stuart. In recent weeks, he's tweeted on topics ranging from *Epic* (excerpting positive reviews from publications such as the *Orlando Sentinel*) and the new pricing policy going into effect August 1 (see following story). So when our Florida correspondent Art Sbarsky sat down with Stuart this week in Miami, Twitter was among the topics, as Stuart says it's the social medium he uses the most.

He started tweeting at a conference a year ago, and now he's got about 1,350 followers, about half of which are travel agents, and he spends about thirty minutes a day following others' tweets and tweeting himself. He has no great desire to have a huge following, emphasizing the importance of making sure he is communicating with the right people; for example, Stuart turned down an Austrian wigmaker who asked to be in his network.

In expressing the value of Twitter, Stuart says: "It's important to be engaged in the conversation. You can either be talked about, or you can talk with other followers." When negative comments are made, especially when the info is factually incorrect, Stuart and others at NCL have the option to engage and respond/correct as appropriate.

While there is no way for Stuart to actually quantify the specific value of Twitter, he gives an illustrative example. During the inaugural two-night introduction out of Miami on *Epic*, there were two people on board who had a total of about 45,000 followers. They posted a variety of messages about their experience and attached links to 16 pages of information (so posts can effectively convey more than the allowed 140 characters of information). Then, one of their followers liked the information so much, he forwarded it on to his 1,000,000 followers. That's an enormous ripple effect for communication at virtually no cost.

Epic Ripple Effect

Another ripple effect at NCL is seen with *Epic* bookings, as Stuart tells *CW* that the rest of the fleet is positively impacted by the high publicity levels. "Advance bookings for next summer's season in Europe are doing extremely well for *Epic* and *Jade*," he reports. "About

50% of all bookings are coming within Europe."

As for the one issue with staterooms with water splashing out of the sink, Stuart tells *Cruise Week*, "We are testing a revised faucet, and assuming it improves the situation as expected, we'll have it implemented across the ship within three months."

Pricing Policies Prompt Change

The new pricing policies of CCL and NCL going into effect August 1 aimed at curtailing rebating are expected to change the way many agents transact business in selling those brands. Both lines are no longer permitting discounting in one-to-one communications.

Clearly, high volume call centers with reputations for discounts will be doing business differently. Already, Smartcruiser, a national online marketer, issued a press release this week announcing they've removed booking fees for all cruises booked at its site or with one of its cruise professionals. Meanwhile, agents who say they are rebating just to keep even with other rebaters theoretically will no longer need to do so; those who don't rebate now won't have to deal with customers wasting their time shopping. "This is a step forward," says Emerson Hankamer of Vacations To Go.

The Enforcers

When Royal Caribbean brands began prohibiting agents from rebating over the phone several years back, there were doubts Royal would be able to police rebaters by phone. We don't hear those doubts expressed anymore, and NCL's Andy Stuart sounds confident about his brand: "The easiest way to enforce is that we only accept payment for the gross fare in the amended policy, whereas previously we would accept payment for any amount between net and gross. This is the clearest way to ensure that no rebating takes place. Travel partners will also police for us. It is a small community, and rebating will stand out if and when it occurs."

What will become more important now is positioning of value-add onboard credits. There's some flexibility for agents.

Naysayers say the new policies will strengthen CCL's and NCL's ability to sell direct, but most agents discussing the topic with *Cruise Week* say they support the change, as it enables them to focus on marketing and sales, not repricing.

CCL VP of sales Joni Rein says that's the point. "Our research with agents was loud and clear that uneven pricing in the marketplace was not allowing agents to sell based on their expertise, relationships, and services they offer. We still have a value-add program, which is very strong and a good way to close the sale. The issue of having disparity throughout distribution is a very significant one, and this levels pricing."

Rein adds, "We don't know if it will increase pricing, but it will provide stabilization."