Getting There Is Half the Fun: How the *Dream, Oasis and Epic* Are Launching the Next Era of an Industry

By Ryan Wahlstrom

CRYSTAL BLUE WATERS GENTLY LAP AGAINST THE sandy shore in rhythmic timing to soft calypso music. A friendly ship waiter flashes a smile while delivering brightly colored drinks to passengers relaxing under beach umbrellas on a private Bahamas out island. The date? June 3, 1980, and you are sailing Norwegian Cruise Lines' newly rechristened SS Norway, the world's largest cruise ship, with 2,000 passengers. The "Ship Amongst Ships" is no longer with us, but still strongly in place is the spirit of responsibility among cruise industry leaders to build floating foundations for an industry's future and the enjoyment of millions of consumers worldwide.

In 1970, about half a million North Americans took seven-day cruises. By 1984, that figure had risen to 1.7 million with a 52,000-berth fleet. In 1984, cruise industry analysts were expressing concern about overcapacity. After all, three new ships were launching that year and three more were due for delivery the next. Too many new cruise ships, it was said, were contracted prior to the recession of 1981-1982. Nevertheless, by 1989, the number of cruisers had grown to three million.

1989 also ushered in a new holder of the world's largest title, Royal Caribbean's Sovereign of the Seas, at 2,852 passengers. Again, industry watchers expressed concerns:

> *"The veritable armada of giant ships due to follow in the wake of Sovereign of the Seas could produce overcapacity in the industry and a shake-out sometime in the next few years.... the cruise industry has embarked on a shipbuilding binge."*[1]
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> *"Of more concern to many analysts is that the optimism expressed by Mr. Arison and some competitors may open the industry to overcapacity."*[2]

Fast-forward approximately ten more years to 1996 and the Carnival Destiny became the largest passenger ship in the world. That record was short-lived, as in 1999 the first of five 3,840-passenger Voyager Class ships was launched. By 1999, well over seven million passengers worldwide took cruises.

Another decade later, we find an industry that will carry an estimated 18.4 million passengers in 2010 and generate $26.8 billion in revenue. On the heels of the 3,650-passenger Carnival Dream and Royal Caribbean's 5,400-passenger Oasis of the Seas, a total of 13 new ships (including the 4,200-guest Norwegian Epic) will be added to the fleet in 2010. In 2011 and 2012, another 13 cruise ships will be introduced.

"We Went Slower and Had Fun Along the Way"

That simple response by Ted Arison to rising fuel costs in the 1970s led to the installation of casinos, Vegas- and Broadway-style entertainment, pools, running tracks, spas and a litany of onboard amenities. Saving fuel by going slower started a trend that continues to transition the cruise ship from a means to arrive at a destination to a destination in and of itself.

The successful shipbuilding formula has met every historical challenge of overcapacity with:

- Continued economies of scale and improved onboard spending to compensate for flat ticket pricing (a seven-day summer Caribbean cruise aboard the SS Norway in 1980 could be had for as little as $630; amazingly, this compares to $631.95 for an inside cabin for seven days on the Carnival Dream with a May 1, 2010 departure date).
- Further market segmentation, discovering new cruisers and generating a "buzz" in the marketplace.

Economies of Scale Make It Affordable

Megaships like the *Dream, Oasis and Epic* can be more economical because they let cruise lines stretch fixed costs across a larger base of customers. In a recent *Globe and Mail* interview, Richard Fain, Chairman and Chief Executive Officer of Royal Caribbean Cruises Ltd., stated, "The *Oasis* will cost 40 percent less to operate per passenger than older ships." They also incorporate technological innovations that reduce costs by saving energy. The *Oasis*, with a high-tech electric propulsion system powered by diesel generators, uses nearly 30 percent less fuel per passenger. Additional savings come from installation of solar panels, compact fluorescents and LED lighting.

Interestingly, designers and engineers understood the height and width of a ship the size of the Oasis would require more energy to illuminate and air-condition. Their innovative solution was to "split the hull" with eight passenger decks rising on each side of an open-air courtyard. This allows natural light to filter in, and a tropical garden of 12,000 plants, trees and flowering greenery

[1] Stephen Koepp, Wendy Cole and Don Winbush. "All The Fun Is Getting There." *Time Magazine*, Jan 11, 1988.

[2] "Pacesetter for Cruise Industry." *New York Times*, July 25, 1987.

act as a natural coolant.

Megaships also create an excellent environment for increased onboard spending. According to Herbert Soanes, a cruise industry watcher for DVB Bank, "For all cruise lines, onboard spending has risen 25 percent over the past decade, while ticket prices have actually declined." Today, approximately 25 percent of cruise line revenues are generated from onboard spending. The decades-old adage of "going slower and having fun along the way" provides opportunity to mine for increased onboard revenues. On the *Oasis*, for example, these can include Botox treatments, teeth-whitening, and dozens of shops (including a tattoo parlor), boutiques, cafés, casinos, bars and restaurants.

The affordability and value of cruising compared to shoreside vacations have served the industry well, drawing in economy-minded families and couples. The added capacity of the megaships does, however, add to pricing pressure during economically challenging times. While this can reduce short-term margins, lower prices also act as a catalyst to consumers as pricing specials provide incentives to get onboard.

Moreover, the addition of the new megaships allows industry executives to spin off older ships to other overseas brands, generating additional revenues and further penetration of less-mature overseas markets. Globalization will be an industry watchword in the next decade. DVB's Soanes notes, "The annual passenger growth rate in North America over the ten-year period from 2001 to 2011 is expected to be slower than that of Europe and the rest of the world."

Market Segmentation

The more pressure on filling capacity, the more innovative cruise marketing executives get. Megaships address head-on one of the traditional excuses given by non-cruisers – being enclosed on a ship might be "boring." Active young cruisers and their families will be attracted to the idea of "floating cities" as some people find the experience new and exciting, but also safe and familiar.

Mall of America is the most visited shopping destination in the world – attracting more than 40 million visitors annually. The mix of indoor theme park, underwater adventures, hotels and shopping mall is a successful combination of entertainment and consumerism. TerraMar Travel Inc. agent Jani Doctor says, "Megaships are geared to a particular subset of cruisers as they offer many choices of venues all hours of the day and night. This group will tend to be younger and more interested in 'a variety of experiences' rather than the idea of being 'at sea.'"

Because it is truly about market segmentation, the onboard experience versus the destination argument of cruise traditionalists is not relevant – but actually makes the case. "Each line

has developed a ship portfolio," says cruise industry consultant Rod McLeod of McLeod Applebaum & Partners. "It is analogous to golf clubs in a bag. Each bag consists of a driver, putter, irons and wedge, any of which can be taken out and used based on a particular need."

Cruisers who want exotic, quaint or remote ports of call seek out luxury lines such as Seabourn or Regent. Cruisers who want to relax and get away from the day-to-day pressures of being around too many people seek out more moderate-sized ships. A group on a family reunion wants an active day of onboard activities for each generation of family members. In the cruise business, there's something for everyone.

Enough Market "Buzz" to Float All Boats

The market talks to each other. The more people who have cruised, the more who will tell others, and the more who will want to cruise too. "The new ships are a shot of Red Bull," says Rod McLeod, "It gets cruising back to front and center so people can think 'maybe that would be fun.'" This helps chip away at the edges of the "hard core" resistors, those 55 percent of the core U.S. market who have never cruised.

The new megaships bring attention to cruising, creating interest and bookings of first-time cruisers on all ships. As large as the *Dream, Oasis and Epic* are, they still represent a very small segment of total industry capacity but hold a much larger share of "voice."

"The entertainment approaches the best of Vegas," says Bob Utne, owner of EWA Travel, about the *Oasis*. Indeed, the *Epic* will feature performances by the Blue Man Group. The Las Vegas analogy also serves as an interesting comparison to cruise industry shipbuilding. All the cruise ships in the world filled to capacity

all year long still amount to less than half the total number of visitors to Las Vegas – that single city in the desert.[3]

Las Vegas saw the openings of the Mirage in 1989 and Excalibur in 1990, followed by the Luxor and Treasure Island in 1993. The new hotels and casinos did not cannibalize each other's business. Rather, each added to the creation of an even bigger overall destination. Each generated more buzz, which in turn spawned more new people traveling to Las Vegas. The number of rooms in Las Vegas has increased at a compound annual growth rate (CAGR) of four percent since 1990, while annual visitor volume has increased by 3.3 percent.

If cruise passenger growth were to slow to a CAGR of four percent from 2011-2020, over 26 million passengers would be carried in 2020. To achieve that would require an additional 177,000 passenger berths (assuming today's 7.1 day average cruise duration). That is three times the number of berths currently on order and would still fall 10 million passengers short of Las Vegas' 2009 visitor numbers.

[3] Las Vegas statistics courtesy of Bob Potts, Assistant Director, Center for Business and Economic Research, University of Nevada, Las Vegas. Cruise statistics from www.CruiseMarketWatch.com and the CLIA.

Challenges

No doubt recent conditions have been challenging. Analysis of ticket pricing shows discounting has continued into early 2010. But positive signs are emerging. The Oasis continues to garner premium-pricing power and will likely continue to do so. Silversea President Amerigo Perraso was recently quoted in *Travel Weekly* as saying, "There are now three new luxury ships on sale and, if we can sell as we are, it shows there's a big market and a

lot of confidence." He said Silversea achieved more than 70 percent of its 2010 revenue plan by the end of 2009 and reported it could take up an option on another ship. Showing additional support for the future, Carnival announced in December the order of an additional Dream Class ship, scheduled for delivery in 2012, following the 2011 delivery of the Carnival *Magic*.

Industry leaders have a responsibility to shareholders to navigate challenging economic environments and produce returns for investors, but they also serve as stewards for the industry's future. Cruise industry analysts in each of the past three decades have questioned the timing and quantity of new shipbuilds. While some 80 cruise lines have fallen by the wayside since 1970, the number of cruisers has continued to grow annually for three decades by nearly double digits. Exposure continues to increase in less-mature overseas markets, and new niches continue to be tapped in North America. The *Dream, Oasis and Epic* represent not only potential return on investment for shareholders and unique cruise experiences for cruisers but also wisely calculated assets for the next decade of an industry. And for those involved in the process, getting there will be half the fun. **Mar**Ex

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