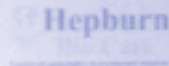
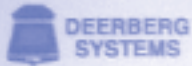


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A €34 billion partner in Europe's economic growth but many challenges remain

John Curran reports

It may be stretching it a little to suggest that the leaders of the European cruise industry arrived in Brussels for the ECC annual conference last month with joy in their heart and a skip in their step.

This is, after all, a forbiddingly difficult climate in which to work. After a decade of breakneck growth in which just about every available indicator, from fleet capacity to market penetration, revenues to profitability, grew with a regularity that seemed to make it inevitable, the crash when it came was all the more shuddering.

Since the fall of Lehman Brothers in late 2008 – the ignition point for a worldwide economic conflagration – the industry has had to become used to conditions that would have been unthinkable but a few months before.

Cruise executives had been able to plan with confidence far into the future as demand for cruise holidays surged steadily upwards. Now, all transparency gone, they became lost in a fog of indecision as cash-strapped and fear-ridden consumers put off their holiday choices until the very last moment.

Heavy discounting and special offers duly became a way of life. When the all-important mantra becomes "getting bodies on board at any cost", margins, and profitability, inevitably tumble in the rush. In those early months of 2009, a panic-stricken industry took that logic to its natural conclusion.

For Europe's cruise shipbuilders, the industry's grim mood also spelled trouble. Never a high-margin business at the best of times, shipbuilding was already in the midst of a slowdown in orders in late 2008. In the months succeeding the fall of Lehman Brothers, however, many would question despairingly when the next order would come.

And yet the industry leaders who convened in Brussels, almost two years on, were still in remarkably good heart given the battering the industry has taken. The ECC's latest economic analysis of the cruise business and its impact on the European economy, which was unveiled at the conference, provides some of the reasons for their good cheer.

Among the headline figures was the 12.1% increase, to more than 4.9m, in the number of European residents taking cruises last year compared with 2008, and the subsequent jump to 29% - compared with 22% five years ago – in Europe's share of the global cruise source market.

At the same time, more than 4.8m passengers took a ship from a European port, with 73% of that total being European nationals. Though this might have represented a more meagre increase, of just 3.2%, on 2008 levels, it also provides a measure of reassurance, coming as it did at the height of the most withering economic downturn since the 1930s.

Those latest figures also confirmed a developing trend, which sees Europe gradually taking over as the driving force



Lefebvre: ECC recognises that with commercial opportunities come responsibilities to behave in an environmentally sustainable manner and I underline that the cruise industry has always been at the forefront of responsible shipping."

behind the growth of cruise tourism worldwide as the North American market has slowed.

Indeed, though it still provides the core of the growing global cruising public. North America's share slipped from 68% to 61% over the decade to 2009. In terms of numbers, the 10.4m cruise passengers North America generated last year is almost identical to the 10.38m who cruised in 2006.

Europe, by contrast is bounding forward. At 4.9m, last year's total number of European cruise passengers represents a 163% increase on the 1.9m who cruised a decade ago and a roughly 44% jump on the 3.44m who sailed as recently as 2006. The UK and Germany are the leading source markets with 1.5m and 1m passengers respectively last year and Germany in particular coming on strong, but Italy, Spain and France are also on the rise.

As David Dingle, Carnival UK chief executive and a former president of the ECC, described it, this is "a remarkable story in a challenging year." And yet, the good news also concealed pockets of difficulty where the alarm bells have been ringing for some time.

The industry's total economic impact on Europe, for instance, goes from strength to strength. As current ECC president Manfredi Lefebvre of luxury cruise line Silversea noted with some pride at a pre-conference reception in Brussels' opulent town hall, the industry generated more than €34 billion of goods and services last year, 6% up on 2008, as well as almost 300,000 jobs.

He added that "2009 was an unprecedented year with all holiday sectors being affected by the economic downturn. Therefore, it is particularly rewarding that these latest figures show the resilience of the European cruise industry, which is outperforming other holiday sectors."

Not everyone is enjoying the party, however. As Lefebvre conceded, direct expenditure by the industry might still be 70% higher than it was four years ago, but it actually slipped last year, by a little over 1% to €14.05 billion, dragged down by the

results from an increasingly depressed European shipbuilding industry.

As the figures have it, the €4.6 billion spent in 2009 on the construction of new ships and the maintenance and refurbishment of the existing fleet represented a hefty 12.8% drop on the previous year.

Over the next five years, through 2014, 31 cruise ships are scheduled to be delivered with capacity for almost 71,000 passengers. Twelve of those vessels, equipped with 26,600 berths, are due for service in Europe. The flow of new orders, however, has all but dried up and Europe's yards are faced with ever-decreasing workloads as newbuilding orders are completed and sail away.

Europe's cruise shipbuilders are only too aware of the damage a continuing order drought can wreak on their industry, not least through a gradual loss of crucial expertise as their armies of skilled subcontractors go under or go elsewhere for work.

As Jacques Hardelay, general manager of STX France told the conference: "Nothing will be as it was before." Noting that orders were running at a pace of 12 ships per year until 2007, he added that just one ship – a Solstice-class vessel for Celebrity that went to Meyer Werft – was ordered in 2008 and 2009.

Since then, there had been a brief flurry of orders – Fincantieri had bagged two ships for Princess Cruises and one for Carnival Cruise Lines, STX one for MSC Cruises and another, very similar, vessel for GNMTC, and Meyer Werft one for Aida Cruises. For the shipbuilders, the new orders came as a relief, though none was under any illusion that they were enough. Indeed, Hardelay believes that the shipbuilding industry will have to adapt to just six or seven cruise ship orders per year for the foreseeable future.

He said STX was battling hard to cope with the downturn. It was diversifying into engineering work, into other work with linked industries, into refurbishment and lifecycle services work. It was reducing capacity and monitoring its overheads. But as he also conceded: "We need to invest, especially in process improvements, but that is difficult."



Vago: If the regulations impact too much on profitability, if they reduce our competitiveness, then we will be forced to move our ships somewhere else."



Dingle: A remarkable story in a challenging year"



Hardelay: This is a very challenging time for the building industry. We are struggling to adapt to the current situation. And either we do or we die."

On the positive side, he said new regulations might well mean new prototypes, with an emphasis on more efficient design. Price pressure on the cruise lines might also translate into longer series production. At the same time, however, he conceded that "this is a very challenging time for the building industry. We are struggling to adapt to the current situation. And either we do or we die. We have to maintain our present level of orders."

Corrado Antonini, president of STX's great rival Fincantieri, concurred with Hardelay's diagnosis, adding that capacity cuts were inevitable as orders slowed long-term. The Italian state-owned yard has been struggling to keep its eight domestic facilities open, picking up orders where it can, distributing the available work around its yards, and introducing temporary layoffs where need be. But the pressure is mounting.

Since the conference, the company has announced an operating profit for the first six months of this year but, just as in 2009, the as-yet-undisclosed cost of those layoffs and the lower price at which it is now being forced to sell its ships will surely translate into another hefty net loss at year's end.

At the same time, Fincantieri has been forced to deny any intention of closing yards after an internal analysis of the market and the company's possible options, leaked to the press. In a worst-case scenario, according to that analysis, the company would be forced to close the Castellammare di Stabia yard just south of Naples and the Sesti Ponente facility in Genoa.

In Brussels, Antonini said: "We are trying to slim down, while keeping the core of our yards open. We can't lose that core competency because when demand returns we will need it." He added that, while current prospects were gloomy, the two Princess orders secured earlier this year offered some hope for the future. As prototypes, he said, they could provide the basis for a new string of orders for Carnival group lines.

If Europe's cruise shipbuilders are having to adapt bravely to a new world, its cruise lines will also have to be careful how they

tread as the economic crisis continues. John Richardson, maritime policy advisor at consultancy Finsbury International Policy & Regulatory Advisers, noted that difficulties for the yards mean difficulties for the lines.

The yards, he said, "will still need to be there, still productive, when demand resumes." There will also be other challenges. "Looking forward," he said, "we are facing years of austerity, which will affect customers in terms of what they have to spend, and psychologically.

"We can also expect a new wave of environmental legislation" that could push up the price of newbuildings by 10% or more and force the costly refitting of older vessels, as well as forcing increases in bunker costs and, more particularly the cost of low-sulphur fuels.

He, too, believed the world had changed, and changed utterly. "There will be no resumption of business as usual," he said, "and investment decisions are going to be more difficult than they have been for a very long time."

On the investment front, there was some encouragement for the industry from the banker in the room. Vincent Pascal, head of the ship finance team at BNP Paribas, had much that was good to say about the industry's operating model and its prospects for growth.

Bankers view the shipping industry generally as volatile, capital-intensive, lacking transparency and requiring specialist knowledge that many in their industry did not have. At the same time, he said, shipping is also seen as an essential long-term business in which the client-bank relationship is paramount.

Defining the cruise niche as "seaborne tourism", he said it had characteristics that would make it attractive to lenders. He cited in particular its resilience in the midst of the crisis, its good value for money, its huge growth potential. Culturally, he said, Europeans are still wedded to the summer or family holiday. Financially, he said, "the model works. Cutting prices to fill ships is working."

And yet this remains a challenging time for any industry seeking financing on



Pascal: Financing big ships today is not impossible, but it is tremendously difficult."

reasonable terms. Though two years after the collapse of Lehman Brothers "there are clear signs that the worst is behind us", there is still uncertainty in the air. Consumer hesitancy about spending, combined with continuing high levels of debt in developed countries, pose a threat to consumption, particularly on discretionary items such as holidays.

The defensiveness of the banks also poses a problem, even when a cruise industry borrower had the essential prerequisites of a good story, a strong balance sheet, a sizeable equity participation and support from an export credit agency. With banks refocussing on their core competencies and domestic markets and credit committees focussing more heavily on default risks, not all good risks will necessarily secure the financing they require. Pascal concluded that "financing big cruise ships today is not impossible, but it is tremendously difficult."

On the health front, Christos Hadjichristodoulou of the University of Thessaly in Greece and leader of the EU's Shipsan Trainet project, noted that the industry had made forceful efforts to improve levels of on-board hygiene. It had put in place quality management systems and outbreak plans and was using surveillance both before embarkation and during the voyage to manage health risks, among a number of effective control measures.

At the same time, he added that "there is always space for improvement, both for port health authorities and the industry." Shipsan Trainet, the successor to the 2006-2008 Shipsan programme, is designed to push that improvement along, informed by an awareness that the characteristics of cruising - the high number of passengers in a confined space, for instance, or the high average age of those passengers - pose a particular health and hygiene challenge that has only grown as the industry has taken an increasing share of the holiday market.

At the same time, as this process began standards of awareness and care were uneven in ports and on ships across the industry. The 30-month long Shipsan Trainet project, which will run until May of

next year, focuses heavily on the training aspect of good health and hygiene.

It includes the development of manuals covering key areas of health and hygiene, including the prevention and control of gastroenteritis, legionellosis and influenza-like illnesses, and on setting up training courses for seafarers, trainers and health care professionals.

A pilot phase would focus on setting up a series of inspections based on the manual, using a web-based network for ship-to-port reporting of diseases, and for port-to-port communication. Eight European countries are set for inclusion in the pilot phase, which would also involve at least two cruise ship and two ferry companies.

Looking forward, Hadjichristodoulou said cooperation with the industry would be critical to improving cruise industry standards of health and hygiene. At the same time, decisions were needed on who would coordinate the effort in the future. A number of regulatory options were also on the table, ranging from a specific EU directive to a memorandum of understanding among member states to a new code of practice.

If ports are a key element in developing policy on health and hygiene, they are also a focal point of the European industry's development as cruising takes an increasing share of the holiday market. As a number of cruise line executives noted in Brussels, the quality of a homeport, no less than that a port of call, plays a vital part in shaping the cruise experience.

As in the health and hygiene area, quality and costs differ around the European portscape, and the two are not always strictly correlated. In a forensic tour of Europe's ports, John Tercek, vice president for commercial development at Royal Caribbean Cruises, noted that pressure - on itinerary planners and ports alike - was mounting in tandem with the growth of the world fleet.

The current world fleet numbers more than 250 ships, while 30 more are under construction for delivery through 2012. At the same time, ships leave the fleet only slowly, meaning that the new arrivals will



Hadjichristodoulou:
There is always space for improvement, both for port health authorities and the industry."



Scanning the ports of Europe and the myriad taxes, fees and service payments due Tercek painted a picture of dramatic variation and gaudy colour, in which local differences, and the power of local monopolies, remains strong."

account for a net increase of 2,500 calls a year over that period, this on top of an existing 50,000 calls per year. In 2010, 25% of global cruise capacity operated in the Mediterranean and 9% more in the Baltic, accounting for almost 40m bed/days.

Scanning the ports of Europe and the myriad taxes, fees and service payments due at each port for a 90,000 gt, 2,000-passenger Panamax cruise ship, Tercek painted a picture of dramatic variation and gaudy colour, in which local differences, and the power of local monopolies, remains strong. In the Baltic and North Sea ports, for instance, head taxes range from zero in Helsinki to €1.72 in Tallinn to €5.80 in Amsterdam.

And yet total fees per call ran to a hefty €52,760 in Helsinki and just €18,730 in Tallinn, the main difference the €41,110 paid for light dues, anchorage and navigation lines in the Finnish capital compared with the mere €3,540 charged for the same services in the Estonian capital just across the water.

At the same time, visiting cruise ships pay €6,110 per call for harbour dues and government fees in Helsinki and zero for such services in Tallinn. Amsterdam, meanwhile, may have levied a startlingly high head tax, but its total costs still came in well below Helsinki, at €30,370 per call.

Pilotage fees accounted for even more startling discrepancies. Tercek estimated the average daily pilot fee in Northern Europe's ports at €9,300, which adds up to almost €1m over a 100-day season. In Oslo, however, pilots haul in a princely €33,000 per call, translating into €3.3m per season.

In the Mediterranean, total fees per call range across a narrower band, and top-priced Venice, at €34,550 per call, is still well below the most expensive Northern European ports. Yet sizeable discrepancies remain, both in total fees per port and the individual components of that total.

In Venice, for instance, harbour dues and government fees come in at a paltry €450 per call, but tugboats cost a table-topping €11,770 per call, this in a

port where by common consent, he said, cruise ships have no need for tugboats.

Venice, of course, is a special case, and Tercek conceded that hefty payments are part of a necessary compact with one of the great cruise destinations and a city highly sensitive to external impacts on its fragile ecosystem. "You have to take into account the social reality," he said. On the towage issue: "If something happens and you don't have tugs, it's the end of cruising in Venice."

Tercek also conceded that, as at other major cruise ports around Europe, "there is a lot of investment going into infrastructure and superstructure that keeps Venice capable of accepting so many passengers," and that this cost must be paid for.

Roberto Ferrarini, marine operations director at Costa Crociere, argued that "it is not just a question of numbers. We are ready to pay. But at some ports you don't get the service you expect for the amount you pay. Lots of times you pay for no service at all, whether it is garbage disposal, sludge removal or fresh water." He closed with a warning: "Port costs are becoming more and more important in itinerary planning. If you can't get the response you want, you will go somewhere else."

Tom Wolber, chief operating officer at Disney Cruise Line, said he expects the American cruise passenger to return to Europe in significant numbers. But he, too, stressed the importance of careful itinerary planning, with congestion a function of the location of homeports, and the role of the port in helping cruise companies contain their costs. "Putting a shore power plant on a ship costs a significant amount of money," he said, "and then you arrive at a port to find that the plug-in is too far away."

As subjects of discussion go, regulation remains the hardy perennial at ECC conferences and it was no different in Brussels, with deliberations on reform of the Package Travel Directive getting a thorough airing.

Jens Thommesen, legal officer at the European Commission's DG-Justice,



Ferrarini: "It is not just a question of numbers. We are ready to pay. But at some ports you don't get the service you expect for the amount you pay. Lots of times you pay for no service at all, whether it is garbage disposal, sludge removal or fresh water."

said the main objectives of the ongoing regulatory process on this issue were to eliminate regulatory fragmentation and obstacles to cross-border trade, to reduce administrative costs for businesses, and to ensure a level playing field, all of which would appear to chime with the cruise industry's view on reform. The devil, of course, is in the detail.

Maria Pittordis, head of marine, trade and energy at Hill Dickinson, said the current need to bond separately in different countries for fly/cruise and cruise only, an unwieldy, wasteful and expensive process, must be addressed as a matter of urgency.

Acknowledging that there was very little appetite among member states for a pan-European insurance scheme, she said the need was rather for mutual recognition. "It is difficult to see why a Passenger Shipping Association bond, for instance, cannot be accepted in other countries," she said. "We don't want a pan-European bond. It is all about mutual recognition."

By the same token, she argued that "there is a need for harmonised rules on insolvency protection. We have to have new rules on full protection for consumers, including repatriation of consumers if a company goes bust." Again, "there has to be mutual recognition. If bankruptcy protection is accepted in one member state, it should be accepted in all."

Of all the regulatory challenges facing the industry, the ongoing debate over the industry's relationship with the marine environment is perhaps the most delicate and its conclusions will almost certainly prove to be the most far-reaching. It was also an issue that provoked a good deal of nervous hand-wringing in Brussels. This was hardly surprising given the technical and financial challenge posed by the proposed amendments to Annex VI of the Marpol convention, particularly on the permitted sulphur content in fuel.

MSC chief executive Pierfrancesco Vago was the first to take up the cudgel on behalf of an industry that feels itself under serious threat from a wave of regulation that is coming at it hard and fast.

He called on Europe's regulators "to work with us while they are developing new laws and regulations" in such areas as sulphur dioxide emissions and VAT rates. He cited the example of Alaska, where head-tax increases and tougher wastewater discharge rules had prompted an exodus of cruise business from the US state. "If the regulations impact too much on profitability, if they reduce our competitiveness, then we will be forced to move our ships somewhere else," he warned.

Other speakers made a similar point, if somewhat less bluntly. Richardson noted that the European cruise industry "is looking at raising the penetration of cruise from 1.2% of the market to 3%. This is huge. The industry is the goose that lays the golden eggs and it can be killed by policy decisions."

Jamie Sweeting, vice president for environmental stewardship at Royal Caribbean Cruises, defended the industry's environmental record and asked for understanding as it adapts to the new environmental demands on its ships and operations. While conceding that the industry had perhaps rested too long on its laurels and that "there is progress we can all make", he added the cruise industry was "at the cutting edge" in terms of promoting environmental sustainability.

"It wouldn't be that difficult to regulate the cruise industry out of business," he argued. "We just ask that the regulators base their decisions on sound science and good economics, that they look at the whole picture and not let the perfect be the enemy of the good."

Robert Ashdown, director of technical, environment and operations for the ECC, made a similar plea, adding that "we want to see global regulation introduced as soon as possible but it must be truly global and not regionally gold-plated" to the detriment of the European lines.

He noted that the new 0.1% sulphur limit proposed for three "emissions control areas" - in the Baltic, the North Sea and the English Channel - is not backed by any economic impact studies whatsoever." Indeed, he argued



Pittordis: There has to be mutual recognition. If bankruptcy protection is accepted in one member state, it should be accepted in all.



Sweeting: It wouldn't be that difficult to regulate the cruise industry out of business."

that by making the cost of maritime transport more expensive, the ECA limit will have the effect of driving traffic, whether cargo or passenger, from sea to land, with a damaging effect on the environment.

Ashdown: You could achieve 90% of the human and health benefits at one tenth of the cost by going to 0.5%."

Commenting on the various ways of improving environmental standards without unduly penalising the industry, he argued that: "You could achieve 90% of the human and health benefits at one tenth of the cost by going to 0.5%" rather than 0.1% maximum sulphur content. A delay in implementing the rules – currently due to come into force in 2015 – might also give the industry time to adjust, and to develop technologies to meet the new standard.

Boardley: I wouldn't be at all surprised to see nuclear ships in ten-years' time."

Tom Boardley, marine director at Lloyd's Register, argued the case for liquefied natural gas (LNG) as the fuel of the future, remarking that "it solves the Nox and Sox problem and reduces CO2 emissions. I can see, shortly, the Baltic covered by LNG for shorter distances." He noted that there were ample refuelling possibilities and that LNG "will probably be cheaper than other fuels for some time." He also said that nuclear power was also an increasingly viable option: "I wouldn't be at all surprised to see nuclear ships in ten years' time."

For the moment, however, it was certainty that his shipowner clients were after most of all. "They are saying 'will you please just tell us what we have to do'. They face huge technical challenges just to make sure they meet existing compliance."

The European Commission's representative on the environmental panel was all for certainty, though her views were perhaps not as congenial as the industry might have liked. Elena Visnar-Malinovska, a

member of the cabinet at the EC's DG-Environment, agreed that the industry and the regulators "have common goals for the long-term," but she bluntly rejected claims that the cruise lines had not had sufficient time to consider the proposed changes and that it was being victimised by Brussels.

"The question is the short term and how to take it forward," she said. "The amendments to Annex VI were first tabled in 2006. You have already had four years to consider them. We have to draw a line. Let me be very clear. I would like to dispel any lingering doubts about whether we would consider a delay. For the EU, it would be very damaging. It would be an unprecedented political move and very difficult."

As the industry frets over its options – and lobbying for a delay in implementation is underway with member states at the International Maritime Organization – it did at least receive some good news from the policymakers in Brussels.

As the keynote speaker at the conference, European vice president Antonio Tajani, who is also commissioner for enterprise, industry and tourism, pledged to push through a range of measures that he said would contribute to cruise industry growth.

Describing tourism in Europe as a vital resource, "like oil for Arab countries",



Visnar-Malinovska: "Let me be very clear. I would like to dispel any lingering doubts about whether we would consider a delay."

he spoke of crafting incentives – such as cut-price travel cards for children or the elderly – to promote tourism within Europe and working to attract tourists from the rising economies of China, Russia and Brazil. He touted the benefits of a promised new quality standard for tourism providers in Europe and invited the ECC to participate in the development of a new plan for "sustainable coastal and marine tourism" across the continent.

For the cruise industry, which has long felt that its contribution to Europe's economy is under-appreciated, Tajani's acknowledgement of its role was doubtless welcome. The industry is weathering the downturn relatively well, yet as this year's conference made plain, the crisis is still with us and the industry has no room for complacency. Its recent decision to beef up the ECC, hiring additional staff and pouring in fresh resources, is a direct response to the operational, financial and regulatory challenges that still lie ahead of it. ■



Tajani invited the ECC to participate in the development of a new plan for "sustainable coastal and marine tourism."

Speakers and panellists at ECC 2010 Conference





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