

INSIDE VIEW:

BETTING ON CELEBRITY

**A conversation with Richard Fain,
Chairman and CEO of Royal Caribbean Cruises Ltd.**

by

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Richard Fain has been Chairman and CEO of Royal Caribbean Cruises Ltd. ("RCCL") since 1988. Under his leadership, the company has grown from a single cruise line with five ships cruising primarily in the Caribbean to become the parent company of five cruise lines with a half interest in another. The world's second largest cruise company, RCCL now encompasses 38 ships with a passenger capacity of more than 84,000 and derives some 46 percent of its ticket revenue from its international operations. It is a multi-faceted growth story but in this article, Mr. Fain speaks about one aspect of that story - - the ongoing transformation of Celebrity Cruises by the introduction of five new and innovative ships collectively referred to as the "Solstice class".

The Corporate Players

RCCL's two largest and best known cruise lines are Royal Caribbean International ("RCI") and Celebrity Cruises. While the two lines have a

common ownership, they provide quite different cruising experiences. "With the Royal Caribbean brand, we say the objective is to deliver the 'wow.' We like it when people come onboard and say: 'Wow, look at this' or 'Wow, I don't believe that.' On Celebrity, we are hoping people say 'ahhh.'"

Royal Caribbean, the company's original cruise line, is geared toward adventure and physical activity in a family-oriented setting. Its ships are typically large, high quality and spectacular in their décor and their features. This is the line that introduced rock climbing walls, ice skating rinks, and surfing simulators to cruise ships.

Celebrity Cruises was founded in 1990 as an offshoot of the Greek shipping company Chandris Lines. With two new ships and a refurbished Chandris liner, it established itself as a small provider which offered a service-oriented cruise experience in the premium end of the market. During the consolidation of the cruise industry that took place around the turn of the millennium, Fain was able to successfully negotiate

Celebrity's merger into the Royal Caribbean family.

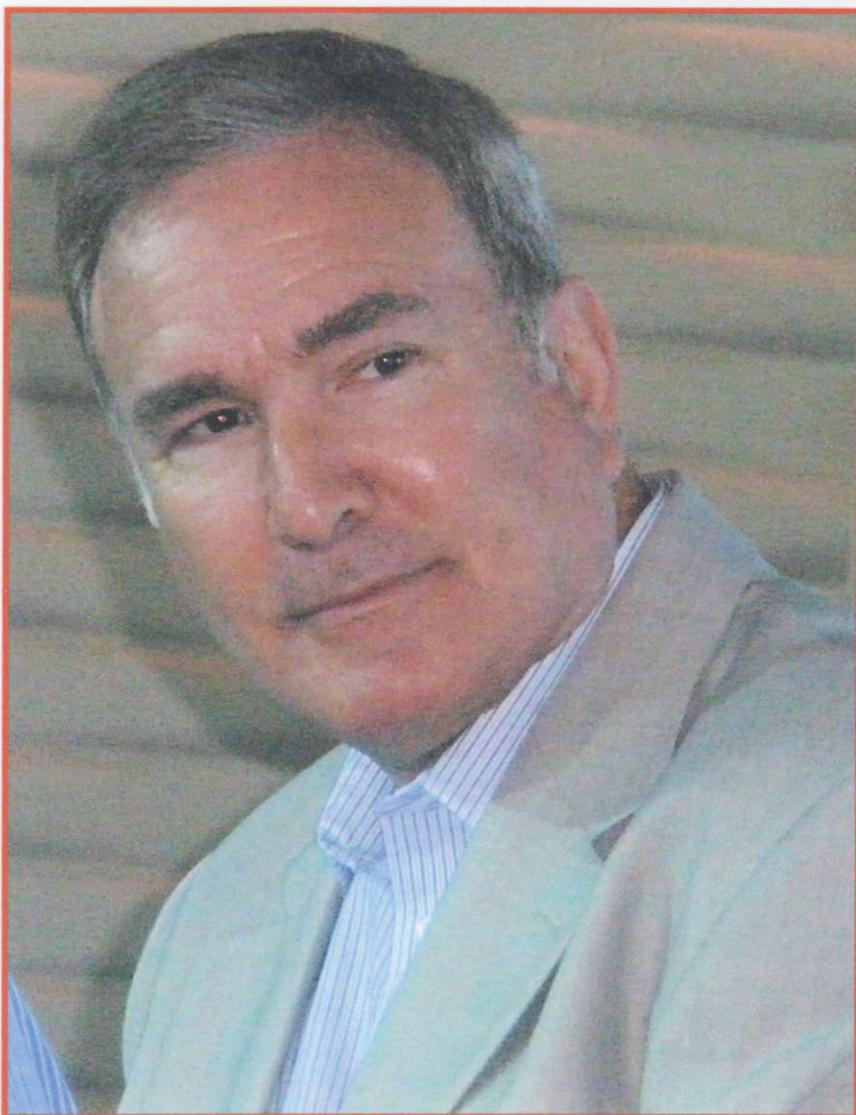
For much of the time since RCCL's acquisition of Celebrity in 1998, the Royal Caribbean brand tended to overshadow Celebrity. Royal had more ships and their spectacular size and features tended to attract the press. However, at the same time, Celebrity was quietly building a reputation of having high quality ships, tastefully decorated with museum-quality art collections and of providing an onboard experience strong in its dining, spa and enrichment programs. While other up-market lines tended to cater primarily to an older audience, Celebrity attracted baby-boomers who were already established and who valued a cultured but relaxed cruising experience. Over the last decade, the line has evolved from being a boutique operation to being a well-respected player in the premium market segment.

"I think Celebrity has found its maturity, found its voice and found its ability to communicate its personality. I think that it is a more sophisticated, premium experience."

The Solstice Gamble

RCCL's faith in the Celebrity brand was underscored when it ordered for Celebrity five 122,000 gross ton ships to be delivered between 2008 and 2010. This move would transform Celebrity and move the line to a new level. Not only would it increase the number of ships in the Celebrity fleet but the ships would be nearly a third again larger in terms of gross tonnage than the biggest ships in Celebrity's existing fleet. They would have nearly half again as many passengers and they would have multiple dining venues, larger staterooms and a variety of new and innovative entertainment options even including a half acre of real grass lawn on each ship.

"Collectively, this class represents a two and a half billion pound [\$3.7 billion] investment - - the largest new building commitment for a single company in industry history. I have to tell you that it was a bit scary to be making such a large bet on one project but I can now call it a bet because it has now paid off. You might ask why did we undertake such a massive project. Frankly, it was because of our confidence in the strength of the industry and the power of the Celebrity brand. We knew that our guests already loved Celebrity and we



Richard Fain

also knew that there was a powerful demand for the kind of superlative design and engineering [these ships] represent."

Adding five large ships to the fleet would put Celebrity in the front ranks of the lines competing in the premium market in terms of overall passenger capacity. To illustrate, the Solstice class would give Celebrity a fleet of 11 ships but with an overall passenger capacity of 23,900 passengers which is slightly more than the overall passenger capacity of Holland America's 15-ship fleet. However, there were risks in this undertaking.

First, there was the question of whether ships this large would work in a premium cruising context. Looking back over history, one sees that one of the ways the Royal Caribbean brand has grown has been through the introduction of classes of ships that were much bigger than its existing ships. Sovereign of the Seas and her



Celebrity Eclipse

sisters were much bigger than Song of America, which had been considerably bigger than RCI's first ships. Voyager of the Seas was a quantum leap in size over the Sovereign class. Freedom of the Seas was larger than the Voyager class. Most recently, Oasis of the Seas is almost half again larger than the Freedom-class ships. These progressively larger ships gave RCI the benefit of economies of scale and also allowed the company to include new features on the ships that distinguished them from the competition and which attracted customers. While this strategy has proven itself in the mass market segment of the industry, it was a gamble whether it would work on ships that were supposed to be delivering a more luxurious experience.

Fain was confident that it would work. "Traditionally, you could basically categorize ships based on size and the smaller they were by and large, the more luxurious they were. [But] luxury is not just having a lot of space and being alone. Luxury is having a choice of where to go to eat, having a choice of dining rooms, having a choice of entertainment. I like being in a suite but I also want to be able to go to a casino that is more than three slot machines and a dealer. I like the fact that we have 10 places that I can go for dinner onboard. This is another form of luxury. So one of the interesting things is that five years ago [i.e. when the Solstice class ships were ordered], people would say you could never have a 2,800 passenger premium ship but now nobody questions that [the Solstice class ships are] premium ships."

Beyond the onboard experience, there was also

the question of whether large ships could do a premium itinerary. A widely subscribed to maxim was that the larger the ship, the more restricted it is in what ports it can visit and thus of less interest to sophisticated experienced cruisers. However, Fain realized that this maxim was based on an erroneous premise. "There are very few ports that could handle a ship half [the size of a Solstice class ship] but not handle [a Solstice class ship] because when you make the ship larger, the length does not go up anywhere near proportionately. Most of the increase is in width and height and almost no port cares about your width and height. Clearly, there are some ports that a very big ship cannot go into but it is relatively few."

The aforementioned risks were risks as to whether the Solstice class ships would be successful but there also could be a risk to Celebrity as a whole from this project even if the Solstice class ships were successful. The introduction of a series of new and innovative ships could have an adverse impact on Celebrity's existing fleet. The public might become conditioned to new ships and perceive anything that is not fresh from the shipyard to be old. Moreover, if the new ships had features that the existing ships do not have, it could become difficult to sell tickets for the existing ships.

"The bulk of our profitability continues to come not from the newer vessels but from the older ones and I think that will continue to be the case. The world today is very much focused on 'newer' [but] one of the things that I am quite impressed with and proud

of is the determination of our management people not to just look to the latest but to make sure that the experience is commensurate throughout the fleet. Unlike some other products, we are in a position to take some of the things we have learned from the new ships [and incorporate them into the existing fleet]. So, for example, when we saw the tremendous response to some of the features on Solstice [the first ship in the class], we undertook to 'Solsticize' our earlier ships. The Constellation [has gone] into drydock and [has received] some of the nice features from the Solstice class ships - the Tuscan Steakhouse, the Bistro on Five, Café Al Baccio etc - retrofitting her so we get the best of all worlds. We do the same sort of thing with the Royal Caribbean brand too." Similar retrofits have been scheduled for Celebrity's Summit, Infinity and Millennium. Celebrity Century went through a \$55 million refit prior to the introduction of Celebrity Solstice.

In addition, while the introduction of the Solstice class required Celebrity to make an investment in its existing fleet, the publicity generated from the Solstice class ships has inured to the benefit of the existing fleet. "I think that adds a bit of a halo to the fleet. I think all of the publicity associated with Oasis of the Seas and the Solstice class have really helped the whole industry, not just us."

With three Solstice class ships now in service, Mr. Fain's gamble appears to be paying off despite the risks. The ships have won praise from travel writers, travel agents and most importantly, passengers. "I have been very gratified by the response that all the Solstice class ships have gotten."

One aspect of the Solstice class that has won them much praise is the attention to detail in their design. "The word that I have gotten most often from the guests that we have had is it is 'stunning'. I do think that people care about that. There are those who say it is not worth putting that much effort or money into the design, into the art etc. But I think it makes us feel good. It lifts our spirit and makes whatever we are doing that much more enjoyable."

"Each of these things requires somebody to think about it, care what the outcome is. They are not just putting lines on a piece of paper. I am in awe of their ability to do that. I think part of it is the passion. I really do think that one of the things that distinguishes us is the passion that everyone shares".

Still, it is not just the décor that makes these ships successful. Celebrity has been able to transfer its standard of service to its new large ships. "We have always said the most important aspect isn't even the ship, it is the men and women who operate the ship. We really noticed starting with the Solstice what a tangible

impact the crew's pride in the vessel makes. I remember when I went for the delivery of Solstice our crew members were proud of the ship that they were about to start working on and I promise you that they were at least an inch taller than they had been on any other ship. It is a virtual circle - - the ship is beautiful, the crew is skilled, the pride in both makes the ship work better."

"A lot of effort went into the crew areas, the back of the house areas. Part of what makes this [class of] ship run so smoothly is the back-of-house areas get the same attention as the front of the house areas do; not just for giving the crew a good place to live but also to make their job easier and more efficient. If you have a good flow for how you get food to the restaurant or how you get garbage out, that makes their job easier."

A British Solstice

The latest of the Solstice class ships is Celebrity Eclipse, which entered service in April 2010. Eclipse is similar to but not identical to her two earlier sisters Celebrity Solstice and Celebrity Equinox. "Whenever we take delivery of a ship, we go through a process where we go over the things we have learned. Our mantra is continuous improvement and there are always things you learn from anything that you do. Solstice came out and Equinox came out and we said they really did do a good job and so there were very few changes that we wanted to make here."

With cruising becoming increasingly popular outside of the United States, RCCL is deploying ships to Europe, Asia and South America so as to diversify its sources of passengers and to grow the business. To this end, Celebrity Eclipse is being based in Southampton, England during the summer months and is being marketed primarily in Britain and Ireland. "We have been witnessing tremendous growth in the U.K. and in Ireland and we wanted a ship that could help satisfy that growing demand."

When RCI entered the British market in earnest in 2005, it did so by first deploying one of its smaller ships to Southampton. When this was well-received, it replaced that ship with a larger ship and when that was successful, it deployed its then-newest and largest ships to England. Celebrity, however, is not taking such a gradual approach and is entering the market by deploying its newest top-of-the-line ship to England.

"We have not historically been as well known in this market and we felt that we had to do something fairly dramatic to move that needle. We wanted to be sure that it was not just the most sophisticated ship but we also wanted it to be the coolest ship. I think the intent was to be able to attract quite a broad market and to have

something everyone would enjoy and not just pride ourselves on the fact that we have lawn chairs for people to sit and read."

In deciding what type of ship to station in the U.K., Celebrity also took into account the weather conditions that the ship would encounter. "These ships [the Solstice class] have very good seakeeping. We go through the Bay of Biscay and these ships are as good as you can wish. Once you are at this kind of eight or nine meters draught you have a solid vessel. But there are things that we do to make them more amenable to cold weather. Here, the Solarium [a glass-enclosed adult pool and dining area] is probably one of the best examples."

Having determined that a Solstice class ship was the right type of ship for its entry into the British market, Celebrity sought to adapt Eclipse to that market

while still remaining true to the company's style. "Since this was going to be an ex-UK dedicated ship, the art, the color schemes, the fabrics, the textures, [were selected with an eye toward British tastes]. I think Celebrity in general has a European flavor and obviously we tried to play into that strength when we were deciding what kind of design choice we were making here. Incidentally, it is very subtle differences [intended to make guests say] 'I feel more at home here'. A comment that I have gotten from a lot of people here is that to the British palate, this is very acceptable."

So far, Eclipse has met with an excellent reception. "It is well in excess of expectations. It is well in excess of anything we have ever seen before. It is well in excess of anything based on past experience one could have expected."



At a ceremony in Southampton, England, Fain assists Emma Pontin, the ship's god-mother, to cut the ribbon officially naming Celebrity Eclipse.