Carnival (NYSE: CCL)

Fundamental Investments – Special Situations Group

Current price (9/29/23): $13.34 | Target Price: $16.93 | Implied Upside: 17.27%

September 2023

Table of Contents

Company Overview

The largest cruise operator in the world focused on expansion, diversification, and customer experience

Business Description & Strategy

Overview: Carnival Corporation & plc is a multinational cruise company known for operating a wide range of cruise lines and brands. As of 2022, they serviced 7.7 million passengers. It is the largest cruise line operator in the world with a fleet of 91 ships operating within over 150 countries annually.

Strategy: Carnival is focused on: **1) Global Expansion** to reach new emerging markets. **2) Having a Diverse Portfolio** of cruise brands to capture a broad range of customers. **3) Maximizing the Customer Experience** to ensure brand reputation through investments on ship designs, onboard amenities, dining options and entertainment. Carnival aims to increase its market share through the construction of new ships which caters to the larger market via its different brands. To achieve all these goals, Carnival is incurring more costs with the promise of long-term profitability.

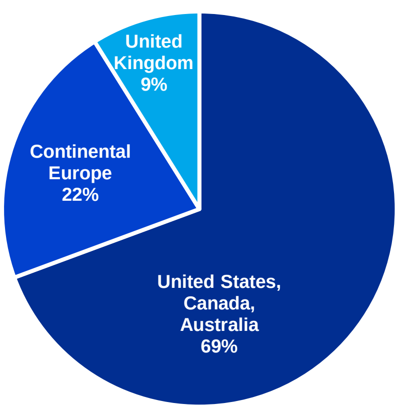
Valuation: DCF and comparable company analysis show Carnival is trading at a discounted valuation with significant operational and financial turnaround opportunities driving a target share price of $16.93.

Current Market Data (Sept 26)

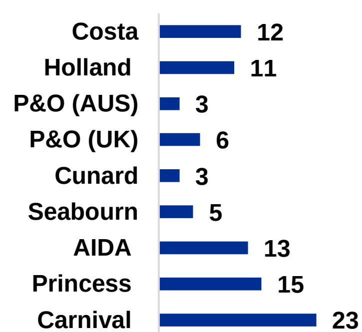
Mkt Cap (billion)	$17.2 B	**EV (billion)**	$47.40 B
Price	$ 13.76	**FY22 Rev**	$274,515
52 Week High	$19.55	**FY22 EBITDA Margin**	8.4%
52 Week Low	$6.11	**Q2 2023 Debt (M)**	$47,683
Div. Yield % (LTM)	0.0%	**EV/EBITDA (LTM)**	24.1x
Float %	12.06%	**P/E (LTM)**	7.1x

Revenue Breakdown and Fleet Size

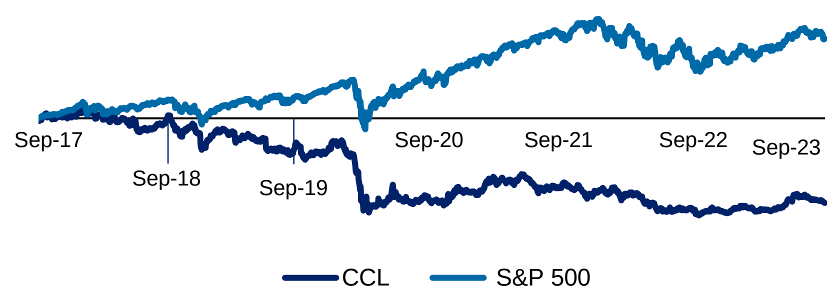
Revenue by Operating Geography



Number of Cruise Ships



Historic Share Price vs. Benchmark

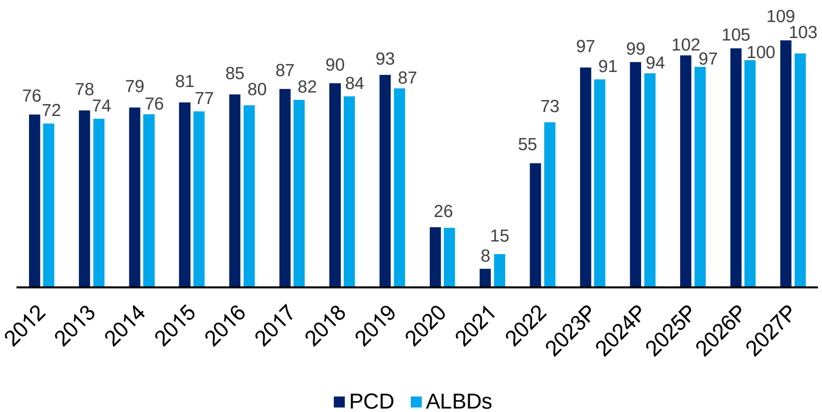


Investment Thesis

CCL presents a significant turnaround opportunity amid strong tailwinds, occupancy rates, and fundamentals

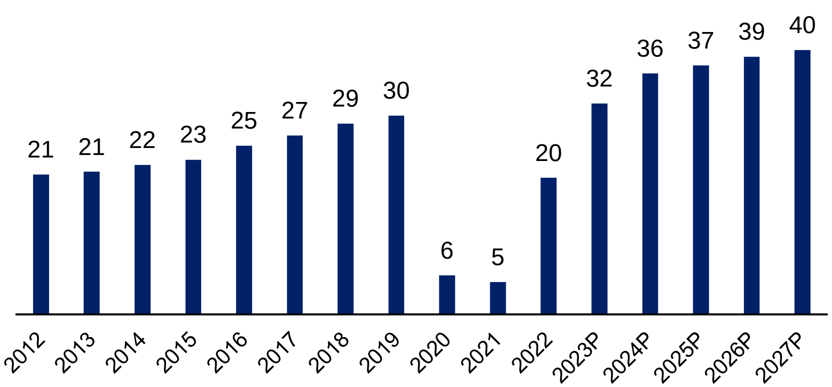
PCD versus ALBDs

Passenger Cruise Day versus Available Lower Berth Day (in thousands)



Global Cruise Passenger

Number of Global Ocean Cruise Passengers (in millions)



High Occupancy, PCD, ALBDs	Record Bookings	Resilient Financials
Occupancy rates recovered back to 75% in 2022, and currently in guidance to reach 106% for 2023 fiscal year. Overall ALBDs increased by 397% to keep up with demand, and currently projected to grow 3%-4% in future years. Q3 ALDBs capacity exceed expectations at 23.7m and carries a 109% occupancy rate.	Booking in Q2 of FY23 reached an all-time high despite price hikes and a decrease in promotional offerings. Customer deposits reached an all-time high in the third quarter at $6.3B, up 23% year over year. Booking volume is strong, with most 2024 voyages already sold out.	Adjusted net income hit $1.18B in Q3 and reduced $4B in debt giving $5.7B worth of liquidity. Redemption and refinancing initiatives now pushing maturities till 2027 to 2030. Estimated to reduce debt from $34B to $31B by the end of the year, giving potential for additional liquidity.

Strong Customer Demand	Industry Tailwinds	Market Dominance
Consumers are traveling again, demand for cruises, luxury cruise itineraries remain strong. Number of global cruise passengers recovered, and survey suggests an 325% CAGR from 2021 to 2022. Cruise versus land-based vacation discount gap is closing despite 15% price hike across industries.	Cruise booking across industry is up 5% and trending flat to 2019 baseline. August booking up 20% despite being slow month, with booking being up for most companies. Growth and performance in the European market are up industry wide compared to 2019.	Top 3 operator in market share across all segments/regions (NA, EU, AUS). Carnival holds the highest EBITDA/ALBDs ratio within the industry and highest ALBDs against its competitors. Carnival holds the highest revenue growth/recovery rate at 104% compared to industry average of 87%.

Industry Landscape

Top 3 cruise line operators control 90% of global cruise line market share

Company	Subsidiaries & Target Demographics	# of Cruise Ships	2022 Passengers Carried	2022 Revenue	Price	Quality	On-Ship Amenities	Cruise Experience Options
CARNIVAL CORPORATION & PLC	• **Carnival** (Contemporary) • **Princess** (Affordable Adult) • **Holland America:** (Premium, Geared Toward Older Crowd) • **Seabourn:** (Ultra-luxury) • **Cunard:** (Luxury/ Older people) • **AIDA:** (Premium feel for German market) • **Costa:** (Contemporary ships for European market) • **P&O** (UK) • **P&O** (Australia)	91	7.7 Million	$12.2B	◔	◑	◕	●
RoyalCaribbean INTERNATIONAL	• **Royal Caribbean International** (Luxury) • **Celebrity Cruises** (Older people) • **Silversea Cruises** (Luxury)	64	5.5 Million	$8.84B	●	●	●	◕
NCL NORWEGIAN CRUISE LINE	• **Norwegian Cruise Line** (Relaxing) • **Oceania Cruises** (Location/ Culinary) • **Regent Seven Seas Cruises** (Luxury)	31	1.66 Million	$4.84B	◑	◕	◑	◔

Revenue Breakdown & Forecast

Revenue growth driven by increased ticket prices, more designations, tailored experiences, and shorter trips

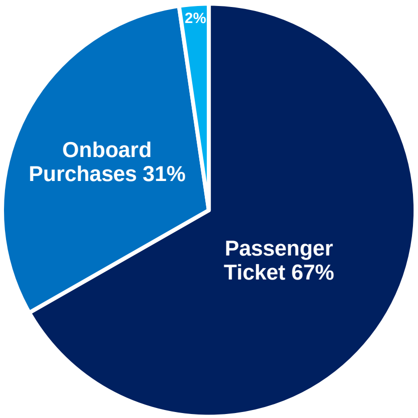
Greater Ticket Pricing Power and Reccuring Revenue

Revenue Recovery: 537% increase in 2022 and on track to reach $21.85b in revenue EOY, Q3 FY23 revenue hit all time high of $6.9b. Forecasts targets a revenue range of $25.01b by 2030, estimating average 2-3% growth per year.

Ticket pricing uptrend: Pricing for onboard services are up. Pre-cruise onboard revenue per PCD is also up 65% despite price increase, suggesting strong demand and predicable onboard revenue.

Strong Recurring Revenue: 55% of the revenue generated are from recurring guests, 50% are visible (booked trips), and 20-30% are predicated to be recurring. Increase in revenue are also due to effort channels like travel agents, and drivers like newer ships. Higher transaction value, package offerings, and itineraries are also attracting more recurring guests.

Revenue by Segment



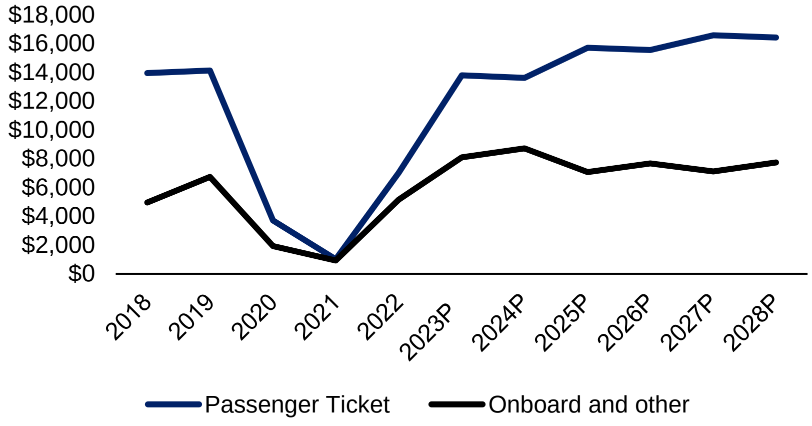
Increasing Streams

More attractive destinations: New Bookings are trending very well with substantial growth within the Caribbean market. While destinations in South America/Mexico remains the standard, European destinations like Italy, Greece, and even Iceland are now becoming increasingly popular.

Specialty offerings: New pricing and package offerings for Wi-Fi, beverages, and specialty dining are now also creating new streams in potential sales. Luxury small ship trips to Europe are expanding at record pace with strong bookings.

Shorter travel options: Options for shorter sails spanning 3-5 days long are increasing, allowing guests to book at the last minute. In addition, survey shows most people enjoy traveling closer to home in shorter durations. Analysts project strong growth in this area over the next few months given current trends in booking.

Forecasted Revenue by Segment



Operational Cost Breakdown & Forecast

Forecasted steady forward operational expenses as economies of scale and operating leverage drive margins

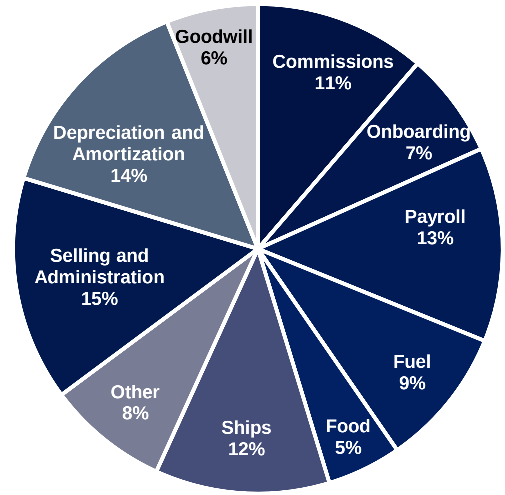
Breakdown of Operational Cost and its Implications

State of Operating Expenses: With an increase in net operating cash flows, there is a greatened outlook of the business being able to rebound from COVID. From 2021 to 2022 period, there was a 537% revenue growth with costs such as commission, onboarding, payroll, fuel, food, and other operating costs rising back to historical levels.

Economies of Scale: The purchase of larger and more efficient ships will result in greater economies of scale. We anticipate that the building of higher capacity ships that Carnival has such as the Celebration and Mardi Gras will allow for greater operating leverage, increasing margins.

Forecasted Cost Structure: Going forward, we anticipate that operational costs remain at their pre-pandemic % of revenue costs, with a slight decrease in real costs due to greater operating leverage and economies of scale counteracting inflation costs.

Average Operational Cost as % of Total Revenue



Forecasted Operating Expenses as % of Total Revenue

Operational Cost Breakdown and Forecast	2019	2020	2021	2022	2023P	2024P	2025P	2026P	2027P	2028P
Commissions & Payroll	4,969	3,994	3,908	4,840	5,768	5,191	5,240	5,290	5,342	5,394
% of revenue	*23.9%*	*71.4%*	*204.8%*	*39.8%*	*26.4%*	*23.3%*	*23.0%*	*22.8%*	*22.6%*	*22.4%*
Onboarding	2,101	433	247	1,485	2,136	1,731	1,766	1,801	1,837	1,874
% of revenue	*10.1%*	*7.7%*	*12.9%*	*12.2%*	*9.8%*	*7.8%*	*7.8%*	*7.8%*	*7.8%*	*7.8%*
Fuel	1,562	589	617	2,097	3,015	2,444	2,492	2,542	2,593	2,645
% of revenue	*7.5%*	*10.5%*	*32.4%*	*17.2%*	*13.8%*	*11.0%*	*11.0%*	*11.0%*	*11.0%*	*11.0%*
Food	1,083	296	170	839	1,206	978	997	1,017	1,037	1,058
% of revenue	*5.2%*	*5.3%*	*8.9%*	*6.9%*	*5.5%*	*4.4%*	*4.4%*	*4.4%*	*4.4%*	*4.4%*
Ship Costs, Impairment, & D&A	5,085	4,529	4,952	5,136	6,105	5,502	5,554	5,606	5,660	5,715
% of revenue	*24.4%*	*80.9%*	*259.6%*	*42.2%*	*27.9%*	*24.7%*	*24.4%*	*24.2%*	*23.9%*	*23.7%*
Other Operating	268	1,087	1,222	2,875	4,134	3,351	3,418	3,486	3,556	3,627
% of revenue	*1.3%*	*19.4%*	*64.0%*	*23.6%*	*18.9%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*	*15.0%*
Selling and Administrative Expense	2,480	1,344	1,711	2,445	3,515	2,849	2,906	2,964	3,023	3,084
% of revenue	*11.9%*	*24.0%*	*89.7%*	*20.1%*	*16.1%*	*12.8%*	*12.8%*	*12.8%*	*12.8%*	*12.8%*
Total Costs	**21,956**	**15,150**	**16,044**	**24,049**	**32,106**	**27,093**	**27,522**	**27,959**	**28,406**	**28,861**

Financial Cost Breakdown - Capital Structure and Credit Analysis

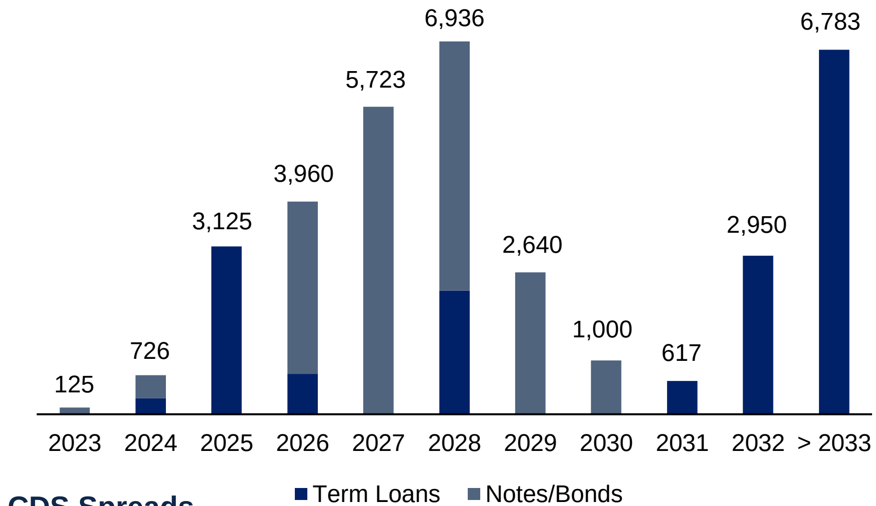
Anticipated recovery in credit quality before significant debt maturities ensure low default risk

Debt Structure Summary

Debt Type	Amount	/LTM EBITDA	/NTM EBITDA
Short Term Debt	1,789.0	1.22x	0.39x
Long Term Debt	33,710.0	22.99x	7.31x
Revolving Credit	0.0	0.00x	0.00x
Term Loans	16,824.0	11.48x	3.65x
Notes/Bonds*	17,760.3	12.11x	3.85x
Other	-874.3	-0.60x	-0.19x
Adjustments	-874.3	-	-
Long Term Debt, Less Current Portion	31,921.0	21.77x	6.92x
Total Debt	33,710.0	22.99x	7.31x

Long-Term Debt by Maturity Date

($ in millions)



Credit Analysis

	31-May-2023	28-Feb-2023
Total Debt	35,499	37,400
EBITDA	1,466	(156)
Interest Expense	1,967	1,785
CapEx	3,491	3,285
Total Debt/EBITDA	47.2x	-463.7x
Total Debt/(EBITDA-Capex)	-45.4x	-46.1x
EBITDA/Interest Expense	0.7x	-0.1x
Altman Z-Score	0.30	0.20

CDS Spreads

Duration	Latest (bps)	1 Day	1 Week	1 Month	3 Month	6 Month
1 Year	206.36	9.4	12.6	18.0	-17.2	-73.1
2 Year	299.30	10.0	13.5	12.9	-28.8	-71.5
3 Year	396.07	4.1	8.1	7.1	-16.5	-66.6
5 Year	519.64	3.0	5.5	5.6	-7.4	-58.1
7 Year	585.89	1.6	3.9	8.7	3.5	-51.6
10 Year	627.97	2.2	4.5	17.0	17.5	-44.6

Uses of Cash & Liquidity Forecast

Large cash and revolver reserves ensure adequate Capex and debt service coverage

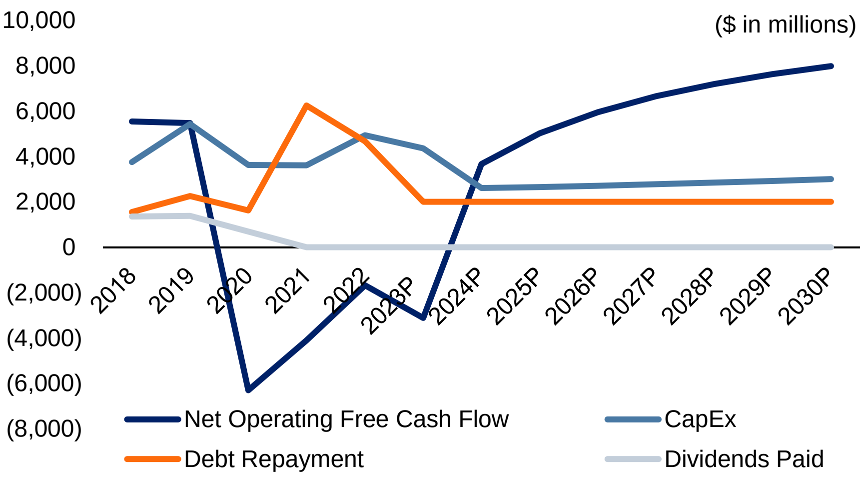
Uses of Cash & Solvency Expectations

Major Uses of Cash: 1) Capital Expenditures- The opening of new Carnival ships such as the Mardi Gras and resuming of the sailing of many of the older and established ships, caused large capex. **2) Debt repayment-** CCL has a significant debt burden which it is using cash to pay down. **3) Paying Dividends-** CCL used pay dividends but is now focused on paying off debt.

Capex and debt repayment are two of CCL's biggest uses of cash: We forecast that capex will increase at constant growth rate of 2.53% per year to account for cruise ship maintenance costs. Debt repayment will be stagnant at $2,000,000,000 per year as they raised $20B in debt during the pandemic and we assumed a straight line 10-year repayment of outstanding debts

Liquidity: Booking seasonality or decreases in profitability may result in CCL having to rely on drawing on its ample $4.4B in cash and $2B+ in revolvers to meet liquidity requirements

Major Uses of Cash Forecast



Liquidity

	Maturity	Facility Amount	Amount Outstanding	Amount Available
Cash & Cash Equivalent				4,486
Revolving Credit Facility		2,077	0	2,077
Senior Sec. Revolving Credit Facility	06 Aug '25	1,068	0	1,068
Senior Sec. Revolving Credit Facility - 104M GBP	06 Aug '25	129	0	129
Senior Sec. Revolving Credit Facility - 614.5M EUR	06 Aug '25	655	0	655
Senior Sec. Revolving Credit Facility	06 Aug '25	225	0	225
Total Liquidity including Cash				6,563

Valuation

CCL presents significant turnaround opportunity both on a relative and intrinsic basis

Discounted Cash Flow Analysis

Discounted Cash Flow Analysis	2023P	2024P	2025P	2026P	2027P	2028P	2029P	2030P
Unlevered Free Cash Flow	-7,474	1,065	2,375	3,245	3,875	4,345	4,705	4,987
Terminal Value @ 2% TGR								82,634
Present Value of Free Cash Flows	-7,329	985	2,031	2,565	2,832	2,936	2,939	50,613

Enterprise Value	**57,570**
- Net Debt	33,710
Equity Value	**23,860**
Shares Outstanding	1,409
Implied Share Price	**16.93**
Current Share Price (9/29/2023)	14.44
% Upside	**17.27%**

WACC	Expected Return	Amount	Weight
Debt	6.8%	33,710	63.4%
Equity	10.5%	19,490	36.6%
Total	**8.2%**	**53,200**	**100.0%**

Assumptions

Assumed steady 2% revenue growth following 2023's revenue recovery to pre-pandemic levels and consistent pre-pandemic cost structure with a reduction of capex to historical levels as CCL intends to reserve cash for debt servicing

Comparable Companies Analysis

Financial Comps Company Name	Share Price	Mkt Cap (M)	EV (M)	Sales (M)	EBIT (M)	EBITDA (M)	EV/EBIT	EV/EBITDA
Carnival (US)	14	19,385	47,145	17,487	(1,014)	1,466	-	32.16x
Norwegian Cruise Line	15	6,797	18,900	7,162	(0)	834	-	22.67x
Royal Caribbean	91	25,850	43,817	12,005	1,339	2,763	32.73x	15.86x
Lindblad Expeditions	7	385	910	531	(6)	41	-	22.39x
Average	32	13,104	27,693	9,296	80	1,276	32.73x	23.27x
Median	15	13,091	31,359	9,584	(3)	1,150	32.73x	22.53x

Margin Comps Company Name	Gross Margin (%) Actual	NTM	EBITDA Margin (%) Actual	NTM	EBIT Margin (%) Actual	NTM	Pretax Margin (%) Actual	NTM	Net Margin (%) Actual	NTM
Carnival (US)	10.2%	60.3%	8.4%	23.0%	-5.8%	12.4%	-19.7%	4.6%	-19.8%	4.6%
Norwegian Cruise Line	20.0%	23.0%	11.6%	24.0%	0.0%	13.9%	-12.2%	6.3%	-11.9%	6.8%
Royal Caribbean	25.3%	27.0%	23.0%	32.3%	11.2%	21.4%	-0.4%	14.4%	-0.5%	14.5%
Lindblad Expeditions	32.7%	46.4%	7.7%	15.2%	-1.0%	6.2%	-9.7%	-1.6%	-12.2%	-2.3%
Average	22.0%	44.6%	12.7%	23.6%	1.1%	13.5%	-10.5%	5.9%	-11.1%	5.9%
Median	22.6%	46.4%	10.0%	23.5%	-0.5%	13.1%	-10.9%	5.5%	-12.0%	5.7%

Risks and Mitigations

World crisis events and over-extended capital pose the most significant risks to CCL

Internal

Risk 1 Long-term Debt Maturity
The maturity schedule can expose a company to interest rate risk. If interest rates rise significantly when a substantial portion of long-term debt matures, it may lead to higher interest expenses when refinancing or renewing debt.

Risk 2: Dependency on Higher Occupancy
Relying on high occupancy rates means that Carnival's revenue is heavily dependent on filling large numbers of cabins on each cruise. If there is a sudden downturn in demand, such as an economic downturn, health crises (like the COVID-19 pandemic), or negative publicity related to safety or environmental concerns, Carnival may struggle to maintain high occupancy levels. This can result in revenue volatility and financial instability.

Risk 3: Capital Expenditure Backlog
Carnival Corporation's capital expenditure backlog, which includes ship construction contracts with shipbuilders like Fincantieri and MARIOTTI in Italy and Meyer Werft in Germany can exceed the initially budgeted amount. Unforeseen expenses, design changes, or currency fluctuations can contribute to cost overruns, impacting Carnival's financials.

External

Risk 1: Accidents, War and Terrorism
Accidents at sea can lead to significant safety concerns, environmental damage, and reputational damage for cruise companies. Safety incidents involving passengers or crew members onboard may result in legal liabilities and compensation claims. During times of war, geopolitical tension, or acts of terrorism, concerns about safety and security may deter passengers from traveling. This leads to reduced demand and revenue for cruise companies.

Risk 2: Rising Fuel Costs
Due to the International Maritime Organization's (IMO) regulations on sulfur emissions (IMO 2020), Cruise ships shifted from cheap heavy fuel oils (HFOs) to marine gas oil (MGO) or very low sulfur fuel oil (VLSFO). As a result, Carnival had to invest in technologies like scrubbers or switch to cleaner fuels to comply with these regulations, thus weakening profitability.

Risk 3: Weakening Consumer Purchasing Power
The rise of fuel prices can increase gasoline prices and higher transportation costs, lowering the discretionary income of potential cruise passengers and weakening the consumer purchasing power, especially among the working-class and middle-class demographics. Reduced disposable income would decrease demand for leisure activities like vacations, and thus the total revenue of the company would decrease.