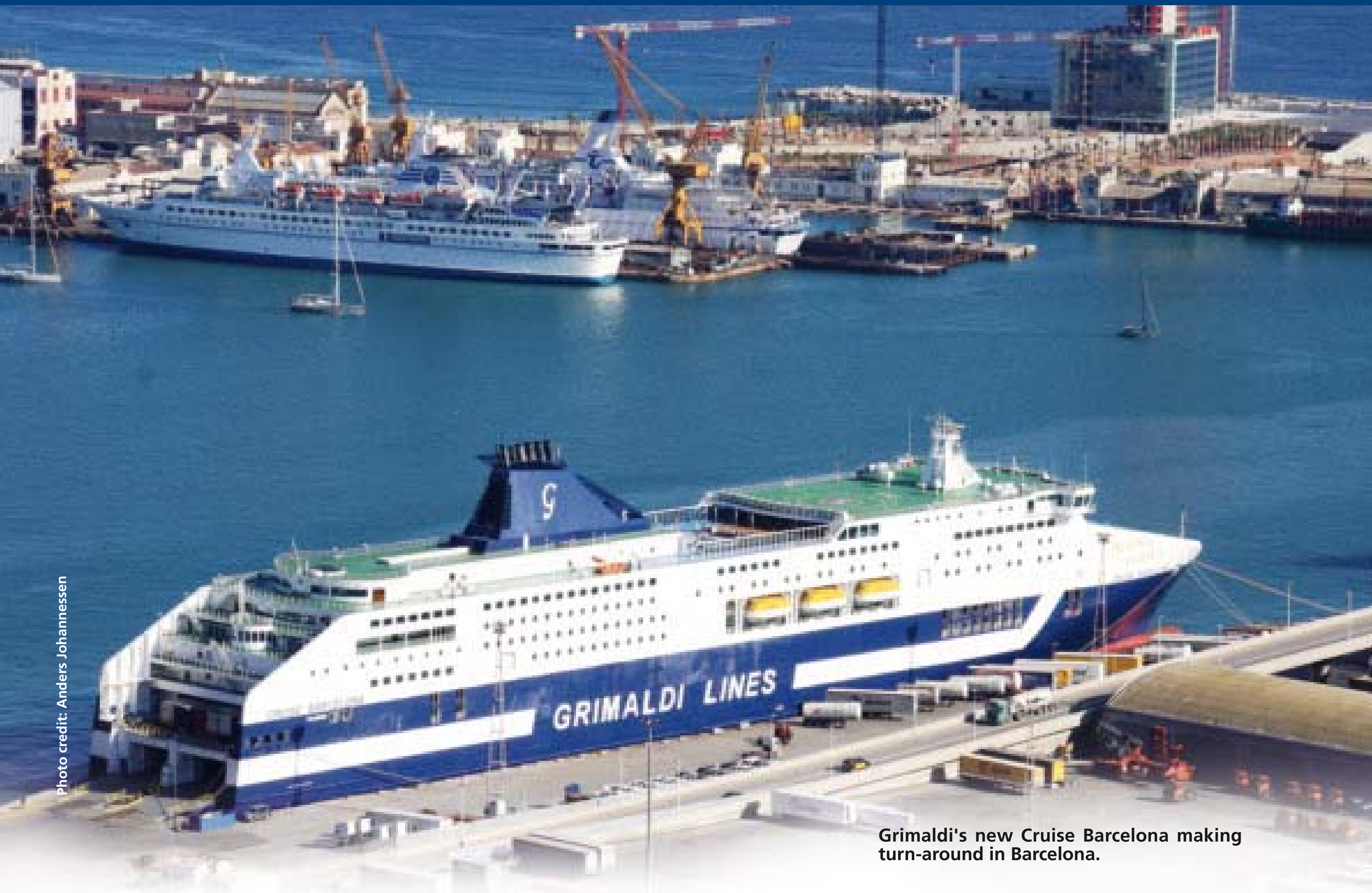
FOCUS ON FERRIES



Grimaldi's new Cruise Barcelona making turn-around in Barcelona.

FERRY OPERATORS FACE CHANGING LANDSCAPE

Unlike the cruise sector, the European ferry industry is going through somewhat challenging times. In spite of this, the landscape is changing. In cruising, three large groups – Carnival Corporation & plc, Royal Caribbean Cruises Ltd. (RCCL) and MSC Cruises – operate worldwide and also derive their guests from all corners of the world. In the ferry business, most operators are regional and only one – Grimaldi Naples – is showing an ambition to gain a foothold all over the Continent. Although consolidation has not yet led to a number of pan-European operators, on a regional level the number of operators is on the decline, mainly due to the formation of bigger entities.

By Kari Reinikainen

The Mediterranean took over as the focal region of the ferry industry in the early 1990s, when investment in cruise ferries in the Baltic withered away and a heavy investment in fast ropax ferries by companies such as Grimaldi Naples, Superfast Ferries and Minoan Lines moved into high gear. The fast ropax ferry has retained its position as the most common type of vessel that ferry companies build in the Mediterranean, but while early on such vessels had a lane-meter capacity of about 2,000, the latest ships' capacity is twice as high.

Thus, significant signs of consolidation are in evidence in the Mediterranean, where the Italian Grimaldi group has launched an offer to buy Minoan Lines, the listed Greek ferry company. Grimaldi has offered €5.29 per share in Minoan, thus paying an 18.8% premium on the average weighted value of Minoan Lines shares in the last six months of trading. The offer valued Minoan Lines at €375.2 million. The Italian group said it had to launch the offer after raising its stake in the Greek company to 33.36% of shared capital and voting rights, above the limit of one third, which triggers a bid for the rest of the shares, the Reuters news agency reported. Grimaldi also attempted to take over Finnlines, the Helsinki-based roro shipping company, but the attempt stalled last year, and Grimaldi is now its largest shareholder. Additionally, Grimaldi Naples has agreed to team up with the Spanish ferry group Suardiaz to operate a joint service between Italy and Spain.

Another step of consolidation is taking place in Greece, where Attica Holdings, best known for its Superfast Ferries brand, offers shareholders an exchange of shares between Attica and Blue Star Ferries, in which it already is the biggest shareholder. The plan suggests that minority shareholders in Blue Star would exchange each of their shares for 0.69 new shares of Attica Holdings. Provided that shareholders of both companies agree to the proposal, Blue Star and Superfast Ferries would both become fully owned by Attica Holdings. On completion of the merger, Attica's share capital will be € 117,539,371, comprised of 141,613,700 common shares with a par value of € 0.83, of which Attica's current shareholders will hold 104,173,680 shares.

A crucial question for the profitability of ferry companies is to what extent they can grow their business? A study conducted in Greece showed that between 2001 and 2006, the volume of passengers, cars and lorries rose by only 2%, 5% and 1% respectively. XRTC, the consultants behind the report, said that ferry companies must restructure their business, phase out old vessels and consider mergers to face the challenges of the future, according to media reports.

"In my opinion, Grimaldi's and Attica group's recent moves change the landscape in the Greek ferry industry dramatically. For one, this seems to trigger the demise of the traditional, mainly family owned local ferry companies who – those who are still surviving – will inevitably have to focus on niche services only," commented **Dennis Vernardakis,** Chairman of Master Shipping, the Athens-based shipbroking company that specialises in passenger vessels. Given this, further consolidation among Greek ferry companies appears unlikely. Some weaker companies may even go bankrupt and in any case, the smaller players do not pose a threat to major operators. "Furthermore, the ones that could in theory be seen as acquisition candidates are, in general, rather too incompatible with the stock-exchange listed companies, both in terms of management structure and of the age and type of tonnage," he told CBR.

The credit crunch has brought the market for selling and purchasing of all types of ships to a virtual standstill, and Vernardakis expects that it will be more difficult for operators in the future to raise funds to invest in new tonnage not only for the Greek domestic ferry sector, but also for international trades like Greece-Italy. Everyone will feel the pain as the effects of the crunch move from the financial markets to the real economy, he pointed out.

Some lines expand, others cut back

One of the few ferry companies with good news in recent times is the Irish Continental Group that trades as Irish Ferries. It bucked a weak trend and reported a profit before tax of € 17.5 million in January to June, compared with a loss of € 1.0 million in the first half of 2007. This strong result was achieved despite group-wide fuel costs rising 64% from € 15.2 million to € 24.9 million. The 1981-built, 24,000 gross ton ms Normandy was sold at a profit of € 3.8 million, as it had become surplus to the group's requirements. The ship has been replaced on the route by the € 51 million ms Oscar Wilde, acquired in 2007 from Color Line, for whom the 1987-built, 31,360 gross ton ship traded as ms Kronprins Harald. The number of passengers carried fell 1.2% to 681,000, while total cars carried in the first half of 2008 were 169,000, down 2.3% year-on. The freight market has slowed, reflecting the economic backdrop, and Irish Ferries' volumes were down 3.1% to 127,000 units when compared with the first half of 2007.

LD Lines, which is part of the French Louis Dreyfus group, will expand its service network on the English Channel next year with a fourth link. The ms Norman Spirit, which currently operates on Portsmouth-Le Havre service, will be replaced on the Western Channel and is then expected to be transferred to operate the new Dover-Boulogne route. The ship has a capacity for 1,850 passengers, 700 cars and 110 freight vehicles. "We are delighted to have now received confirmation from the Port of Dover that our new Dover-Boulogne route has official approval, and we look forward to a very positive, long-term working relationship with the Port Authority," said LD Lines' Chief Executive Officer, **Christophe**

Santoni. "Our entry into the highly competitive short-sea, cross-channel ferry business is a major development for LD Lines. We are convinced that the service will undoubtedly attract new freight and tourist customers, which will benefit both Dover and Boulogne as departure and destination ports." In the first year of operation, the company expects to carry in the region of 120,000 freight vehicles, 133,000 cars and 400,000 passengers.

Meanwhile, Norfolkline, which is part of the Copenhagen-based A.P. Moller-Maersk group, has agreed to reopen service between Zeebrugge and Rosyth next spring. The company has chartered a ropax newbuilding currently under construction from Epic Shipping in the UK. Superfast Ferries closed its own service between the Scottish and Belgian ports recently, marking its withdrawal from services outside the Mediterranean.

In the summer, Aker Yards (now STX Europe) and P&O Ferries signed a contract for building two large car-passenger ferries for the Dover-Calais service. The total contract price for both vessels is approximately 360 million, and they are scheduled for delivery in 2010 and 2011, respectively. The contract includes options on a further two vessels of the same design. The vessels will be built in STX Europe Rauma shipyard, creating some 1,800 man-years of work.

Becoming the largest ferry in the English Channel means a 49,000 gross ton vessel with a length of 210 meters and having 2,700 lane meters of vehicle space. There will be space for more than 180 freight vehicles and additionally for up to 195 cars. The vessels will be capable of carrying up to 2,000 passengers. They will be as environmentally friendly as possible, offering significant advances in fuel efficiency through a hydro-dynamically efficient hull form that will optimize performance with minimum fuel consumption.

P&O Ferries' newbuildings most expensive ships in the Channel

These two ships are the largest and most expensive Channel ferries ever ordered and according to **Johan Snellman,** Vice President of Sales at STX Europe, it is quite possible that the two options attached to the order will be taken up. "If you think that the company has a fleet of 26 ships and if you estimate an average life cycle of 25 years, this would mean placing one new order each year," he told CBR, adding that the last newbuildings for P&O Ferries were the 59,925 gross ton pair ms Pride of Hull and ms Pride of Rotterdam of 2001-2002. Their 2,700 lane-meter capacity is vastly higher than the 1,560 lane meters on the 1987-built ms Pride of Dover and ms Pride of Calais, showing a tendency toward bigger units and an unchanged or slightly lower number of sailings as a result.

The two ships are about as long as the current port infrastructure allows, and coping with strong winds often experienced in the region is a major design issue. Both ships will be designed to meet Safe Return to Port regulations, whereby a ship must remain afloat and operational even if any compartment was damaged rather than just remain afloat as present requirements dictate. Snellman points out that although companies such as Sea France, Norfolk Line, Tallink, Color Line and Viking Line have invested in new tonnage, major operators such as Scandlines, TT-Lines and, on the passenger side, DFDS have not placed orders for quite some time. At some point, ships should become due for replacement at these companies, too.

The price of 360 million for the two P&O ferries' ships is the highest ever paid for a Channel ferry: Per ship, it is higher than the 165 million Tallink has paid for cruise ferries like the similar-sized ms Galaxy. A sharp rise in the cost of components and materials, such as special steel and copper, plays a significant role in this, said **Esko Nousiainen,** Director of the Finnish air conditioning supplier Koja Marine. "Some prices have risen two to threefold in the past three years. Although they have come down slightly now, I don't think anybody expects that they will fall to the levels seen before the rise started," he said. "Perhaps many ferry owners were reluctant to place orders at current high prices, and the P&O Ferries' contract may act as an indicator that the industry has accepted the new situation. If you need new ships, they will be expensive."

Recent times have not just seen newbuilding prices rise: Operating expenses soared with the cost of bunkers, which are sliding now in a sharp reversal from all-time high levels. However, the outlook has deteriorated for many companies in tandem with a weakening economic cycle. The Danish DFDS group issued a profit warning on August 14, saying that increasingly challenging trading conditions forced it to revise downwards both its profit and revenue growth forecasts. "Pre-tax profit is adjusted downwards from approximately DKK500 million to a level of DKK325 million to DKK375 million. Revenue growth is expected to be approximately 2%. Growth of 3-5% was previously expected. Operating profit before depreciations (EBITDA) is expected to be 15-20% lower than in 2007. An increase of 0-2% was previously expected," DFDS said in a statement.

Furthermore, on August 30 its DFDS Seaways unit closed the Newcastle-Bergen cruise ferry service and put the 1981-built, 34,093 gross ton ms Queen of Scandinavia up for sale or charter. In addition, the company will cut some 70 jobs at DFDS Seaways. "These actions are necessary measures in order to turn around DFDS Seaways' economy and to create long-term, sustainable development," commented Chief Executive Officer Niels Smedegaard. A rumored acquisition of Norfolk Line, which operates ferry services between the UK and the Continent and the UK and Ireland, appears to be on the back burner.

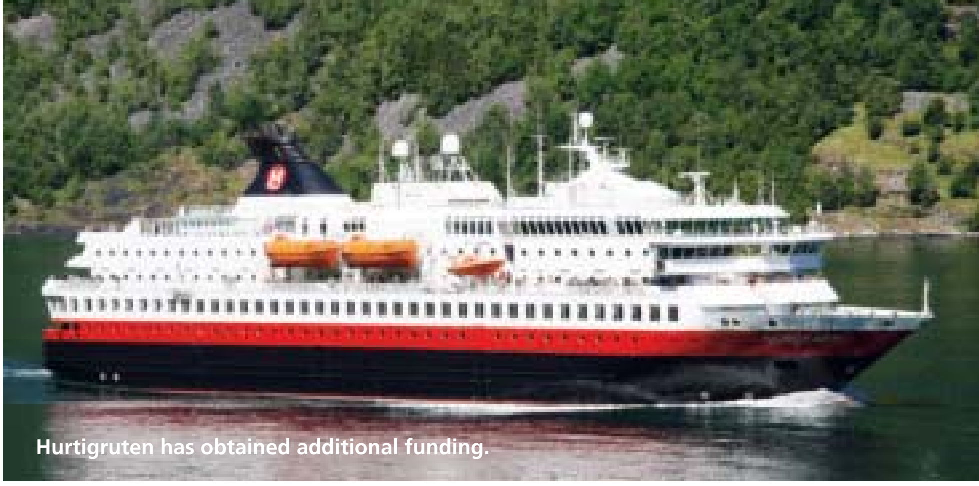
"DFDS Seaways has not, unlike the profitable freight operations of the group, generated shareholder value for a number of years," said **Johannes Moller,** shipping analyst at Danske Market Equities in Copenhagen. "They currently operate two routes. The one between Copenhagen and Oslo probably generates an okay return on capital employed. However, if we'll head for a sharp recession, they may close the route between the UK and the Netherlands," Moller said. From a shareholder point of view, it would be ideal if DFDS divested its cruise-ferry operation, but Moller said it is hardly realistic to think that this would happen.

Profit warnings and service closures in Scandinavia

A number of shareholders that jointly represent more than half the shares in Mols Linien, the listed Danish domestic ferry operator, have put their holdings up for sale, making the company a target for consolidation. Mols Linien operates five ferries on three domestic ferry services, and it has been pre-qualified to submit a bid to operate a concession between the Danish

P&O Ferries recently ordered two ferries from STX Europe.

mainland and the island of Bornholm in the Baltic Sea as well. Handelsbanken Capital Markets is acting on behalf of the shareholders who want to sell their holdings, and Mols Linien said several potential buyers have emerged for the shares. These are believed to include Clipper Group, the Bahamas-based, Danish-owned shipping company that has stated a strategy to gather Danish domestic ferry companies under its umbrella in order to build stronger entities. Mols Linien posted a first half pre-tax loss of DKK35.5 million against a profit of DKK18.8 million year-on as the high cost of bunkers hit its bottom line.



Hurtigruten has obtained additional funding.

High operating costs with no duty-free or international crew plus a new Nox tax hit Norwegian coastal express ferry and destinational cruise operator Hurtigruten, which may lay up two of its ships in order to stem losses. The board also approved a plan to cut NOK150 million per year in sales and administration expenses, Hurtigruten said in a statement. The company operates a fleet of 11 ships that provide a daily link in both directions along the west and north coasts of the country between Bergen and Kirkenes. A roundtrip voyage takes 11 days. The company held talks with the government, which subsidises the service, that led in a NOK150 million increase in funding. Had such funding not become available, two ships wouold have been taken out of service.

Kystlink, the Norwegian ferry company that acquired the 1980s-built ms Fantaasia from Tallink earlier this year, closed its service between Langesund in southern Norway and Hirtshals in Denmark in October after it experienced just more than half the passenger and freight volume as in August. This was largely due to the fact that Color Line introduced two 33,000 gross ton fast ropaxes on its southern Norway to Denmark services earlier this year, while Kystlink's ferry, the 16,000 gross ton ms Kongshavn, is 28 years old.

Still, the first half of year was a tough one also for Color Group, parent company of the Oslo-based ferry company Color Line. The group reported a pre-tax loss that widened to NOK76 million from NOK15 million, as the high cost of bunkers and reorganising operations affected its bottom line. The company has closed short-haul services from Oslo and laid up (later sold) the 1981-built ms Prinsesse Ragnhild, which was last used on a service from Bergen in Norway to Hirtshals in Denmark, now also terminated. At the same time, it has introduced two fast SuperSpeed ropax ferries of 33,000 gross tons on a service from Norway to Denmark. The number of passengers carried rose by 1% to 1.85 million, while that of freight units increased by 22.9% to 7,528. The company now has six ships in operation compared to 10 a year ago. Color Group, which is a privately owned company, described the year so far as the most challenging in its history and forecast a weakening of its full-year results.

Stiff competition in the Baltic

In the Baltic, chilly winds blow as well. A ferry service launched by newcomer Stella Line between Helsinki and St Petersburg closed on August 8 after just two months. Stella Naves Russia acquired the 1980-built ms Christian IV from Color Line in May for € 13 million and renamed the 1,800-passenger vessel as ms Julia prior to opening the service in July. The cull of services in the Gulf of Finland was not limited to this as two fast-ferry operators, Nordic Jet Line and SuperSeaCat, also bowed out of the scene. The former said it terminated its season in September, earlier than originally planned, but SuperSeaCat was placed into liquidation and ceased trading. The Helsinki-Tallin trade has employed a host of vessels from old cruise ferries to new ones, catamaran and monohull fast ferries and even hydrofoils. The introduction of Tallink's fast ropax ferry ms Superstar and Viking Line's ms Viking XPRS has, however, raised the stakes, and some observers say more operators will be pushed out of the trade.

Tallink Grupp, the Estonia-based ferry company that is the biggest player in the Northern Baltic, averted a strike in mid-September by accepting a pay deal that will raise wages by 40% over three years, Baltic Business News reported. Wages will rise by 25% in 2009. It operates most of its fleet of 10 cruise ferries and eight ropax vessels under the Estonian flag. Wages of Estonian ratings have been significantly lower than those in Finland and Sweden whose flags Tallink's ships also use, while officers' wages are roughly on the same level in all three countries. Two months earlier, the company warned that significantly increased fuel costs, higher interest costs and weak traffic volumes on some routes will hurt its performance. The board forecasts that net profit for the financial year to August 31 will fall to less than € 30 million from € 67 million in the previous financial year The EBITDA figure will fall up to 15% from € 159 million, but net sales will increase to € 780 million from € 761 million.

"Since the start of the current financial year in September 2007, the price of the fuel for our vessels has increased by approximately 115% until today. The average fuel price in the third quarter was about 93% higher than in the third quarter of last financial year. Significant additional fuel price increase of about 40% has taken place during the past four months," Tallink said. Traffic levels between Finland and Sweden, operated by the Tallink Silja subsidiary, have not matched expectations as IT problems related to a new system have hurt bookings.

Delivery of the 48,000 gross ton cruise ferry ms Baltic Princess from Aker Yards Finland was delayed until earlier this month, which delayed a planned fleet reshuffle. "While old vessels are prepared for sale, other possible scenarios, including sale of any vessels, charters or reroutings, could be considered as well in order to optimise the fleet usage and company's operations. The overall target is to improve the company's return by optimising or eliminating poorly performing business units and activities," Tallink said.

Viking Line, its principal competitor, stated on September 15 that a rise in financing costs following the delivery of a new ferry and the continued high cost of bunkers offset higher volumes and yields. Net profit fell to € 14.3 million in nine months to July 31 from € 16.8 million in the same period last year. The number of passengers carried rose by 8% to 4.62 million. The company now has a combined 50.3% market share on the routes that it operates, an increase of one percentage point from the same period last year. It has gained market share mainly from Silja Line, now owned by the Estonian ferry group Tallink. The board repeated its earlier view that Viking Line's results for the full financial year would decrease from a net profit of 13.8m in 2006/2007 as a result of the high cost of bunkers, which has a significantly adverse effect on the company's performance. ■