Initiating Coverage:

Norwegian Cruise Line Holdings

A Beautiful Voyage, But Rough Seas Still Ahead

Key Take-away: NCLH and the cruise industry will likely be the last company to cleanses itself of the effects of the pandemic. Until then, it remains a company operating in an ideal industry due to favorable demographic trends and changing consumer preferences, with the plus characteristics of being the smallest of the publicly traded cruisers that can appeal to the upscale base.

Q1 2024 saw a slight hit ($0.16 adj EPS actual vs $0.12 adj EPS guidance) but the mere pennies offered as net income mask the toll the current capital structure takes on current equity holders. Here are the storylines that have and will continue to unfold this year for NCLH.

Lengthy Pandemic Recovery: NCLH experience a 90% revenue decline from 2019-2021 due to near complete closure over a 1.5 year period, yet fixed costs remained, leaving a -$2.9b EBITDA hole for the company to cover. Pursuant to its growth strategy & intensive capex nature, NCLH held an already high 3.4x net leverage in 2019, but the pandemic changed that to a staggering 7.4x net leverage. Instead of playing conservatively like its competitors and aggressively delevering, NCLH continues to keep capex elevated to meet what it believes to be surging demand for high-end cruising. With stellar execution, the company meeting its 2026 performance targets would mean a handsome reward for any investors that could stomach the rollercoaster that is NCLH's stock price.

Turmoil in the Middle East: Another key development for the cruiser is the recent geopolitical development in the Middle East. Initially following the October 7th attacks by Hamas on Israel, the Tel Aviv port call was relocated, without much fanfare. But the Houthi Rebels pledge to indiscriminately fire upon western ships saw the stock take a 13.5% tumble. The Suez Canal was no longer safe passage, causing forfeiture of revenue in the area and additional fuel costs. NCLH has grown its Mediterranean Sea offerings in recent years, and Europe is expected to constitute 27% of NCLH's total fleet deployment this year. Still, Europe's busy season is the summer so it is yet to be seen if the busy season can go on without a hitch.

Valuation: We initiate coverage with a $24 PT.

Consortium Equity Research
Consumer | Lodging & Leisure
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Stock Rating:	Equal Weight
Price Target:	USD $24.00

Price:	$19.45
Potential Upside/Downside:	23.3%
Ticker(s):	NCLH

Market Cap:	$8.3b
Shares Outstanding:	429mm
Free Float (%):	98.94%
Dividend Yield:	N/A

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Peer Comparisons

Comparable Companies					
$mm					
Ticker	**Mkt Cap**	**EV**	**P/E**	**Revenue LF**	**EBITDA LF**
Royal Caribbean Cruises Ltd. (NYSE:RCL)	$ 39,607	$ 61,162	17.3x	$ 15,330	$ 5,210
Carnival Corporation & plc (NYSE:CCL)	$ 18,308	$ 47,296	22.4x	$ 23,437	$ 5,269
Norwegian Cruise Line Holdings (NYSE:NCLH)	**$ 6,745**	**$ 20,264**	**19.6x**	**$ 9,086**	**$ 2,153**

Ticker	LTM EV/EBITDA	Gross Margin	EBIT Margin	EBITDA Margin	1 Yr Rev Growth Rate LF
Royal Caribbean Cruises Ltd. (NYSE:RCL)	11.7x	47.8%	24.1%	34.0%	27.7%
Carnival Corporation & plc (NYSE:CCL)	9.0x	51.2%	12.1%	22.5%	34.0%
Norwegian Cruise Line Holdings (NYSE:NCLH)	**9.4x**	**37.9%**	**13.3%**	**23.7%**	**26.9%**
High	11.74x	51.2%	24.1%	34.0%	34.0%
75th Percentile	10.58x	49.5%	18.7%	28.9%	30.9%
Average	10.04x	45.6%	16.5%	26.7%	29.5%
Median	9.41x	47.8%	13.3%	23.7%	27.7%
25th Percentile	9.19x	42.9%	12.7%	23.1%	27.3%
Low	8.98x	37.9%	12.1%	22.5%	26.9%

Source: S&P NetAdvantage

Industry Overview

Competitive Landscape: Norwegian operates in a semi rigid triopoly that is the cruising industry. The three publicly traded pure-play cruise lines are Norwegian, Royal Caribbean ($RCL), and Carnival Cruise Lines ($CCL). Additionally, there are Disney Cruise Lines, owned by $DIS, and Virgin Voyages, which is private. NCLH is the smallest of the big three players and has been throughout its history. It also tends to service a more upscale, older demographic, compared to CCL, which appeals mostly to younger families, and RCL, which as the largest player, appeals to all demographics.

An Industry Marked by the Aftermath of the COVID Travel Shutdown: The biggest stories for the big three cruiser to this day continues to surround their ability to recover their balance sheet to pre-pandemic levels. Left unable to operate for 18 months due to travel restrictions, significant amount of debt was incurred to maintain financial solvency. NCLH's TTM Operating Cash Flow may be at an all-time high, but its TTM Net Income remains lower than every year from 2015-2019, due to NCLH's constant need to raise new debt to pay off prior lenders. NCLH could have chosen a more rapid deleveraging strategy, like RCL & CCL, but management believes the risk of playing their growth story to upsize and upscale their fleet will return outsized rewards. However, the downside case then becomes that NCLH needs a stable operating environment until 2027, once most of their maturity wall will have passed.

Fleet: Differentiation comes largely from brand and quality, a large part of which is played out by how new and intricate its fleet is. Given such, capex tends to be ~20-30% of revenue, serving as a constant constraint on profits. For fleets looking to modernize or grow, like NCLH's 5 year plan lays out, capex can border on ~30% of revenue. Thus, even in a normal operating environment, cruise lines will remain in a leveraged position (NCLH for example had a ~4x Debt/EBITDA entering the pandemic).

Positive Trends: Despite the troubling financial positions the big three players are in, the operating performance should continue to improve throughout the decade. This is helped by a broadly stronger consumer spend relative to pre-pandemic, as well as a shifting trends towards spending on experiences over items. As of now, cruising represents only 2% of the tourism industry, and leadership believes there is chance for this number to increase as supply moves to match the new demand in the coming years.

Company Overview

Company Description: Norwegian Cruise Lines Holdings is Norway-founded, Miami headquartered cruise liner that is fourth globally in terms of annual passengers. Under its umbrella is its flagship Norwegian Cruise Line (85% of passengers), its upscale Oceania Cruises (10% of passengers), and its ultra-luxury Regent Seven Seas Cruises (5% of passengers). It operates on a global scale, and in 2024, it deployment will be roughly 28% Caribbean, 27% European, 23% Other North America, and 26% Other (Mostly Asia & Africa).

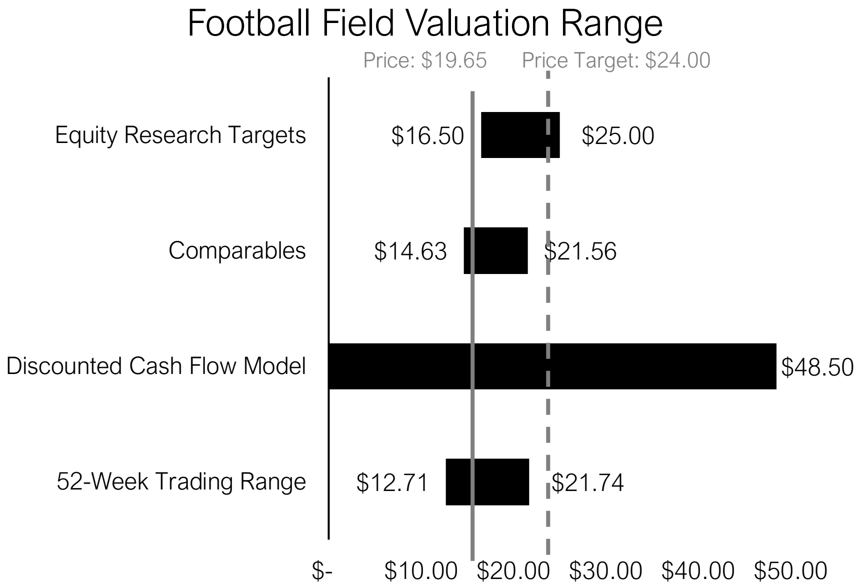
Booking: Under previous CEO Frank Del Rio, NCLH embarked on a mission to lead the industry in prebooked positions. Generally, they offer more discounts and incentives to ensure that ships are booked fully and early. In most periods, the full and early booking will lead to higher revenue but lower gross margins, as incentives like free drinks raise COGS. However, over the past few quarters, the early booking has pulled NCLH from a position of strength to relative weakness. Most of the busy summer 2024 season was booked in H1 2023 for NCLH, when economic sentiment and household spending was depressed with the cautionary belief of an impending recession. However, when the soft landing came into view, CCL & RCL were able to benefit from a more eager consumer and translate that to a higher Net Yield, thus grossing higher margins. This is likely a one-off pain for NCLH, if the opposite were to occur, where cruise goers book NCLH tickets at high prices, only for macro conditions to deteriorate, NCLH would see a net financial benefit relative to its competitors.

Nimble: A benefit NCLH enjoys relative to its peers is its relatively smaller and nimbler fleet, that has historically been able to reposition itself around the world, as opposed to the bigger cruisers which necessitate an infrastructure buildout to support its dozens of ships. This capability should favor NCLH as new regions become trendy. For example, Europe has steadily increased its share of fleet deployment, and it is seen as likely by travel experts that the US tourist’s preference for Southeast Asia will only grow in the coming years, providing an opportunity for NCLH. As airfare is one of the items experiencing price drops during an otherwise moderate inflationary environment, the cost to fly to a foreign destination for a cruise can be offset by a cheaper operating environment for the company.

7/21/2024

Investment Thesis & Valuation

Our analysis gives NCLH a price target of $24.00 and an equal weight rating.



Potential Downsides to Our Rating

Textbook Cyclical industry: The composition of an economically cyclical industry (selling a luxury travel experience), with the balance sheets that cruise lines possess, due both to the COVID related shutdown, and the generally incredulously high Capex and deprecation rates, creates a company with now a significant amount of systematic risk attached. This can make Norwegian, as well as its competitors, untouchable to the defensive investor whose theses steer them away investments that possess significant potential price depreciation. Norwegian's success hinders on a continued, elevated consumer spend to be able to service its debt balance and newbuild financing.

Further Geopolitical Risk: While Norwegian has now experienced setbacks in its itineraries due to geopolitics, namely in the Middle East, there is no reason that a further deterioration is out of the picture. Outside of its Caribbean operations, all bodies of water it operates in are within a relative proximity to adversaries of western business, who could initiate threats similar to the Houthis.

<u>Our Price Target: $24.00</u>

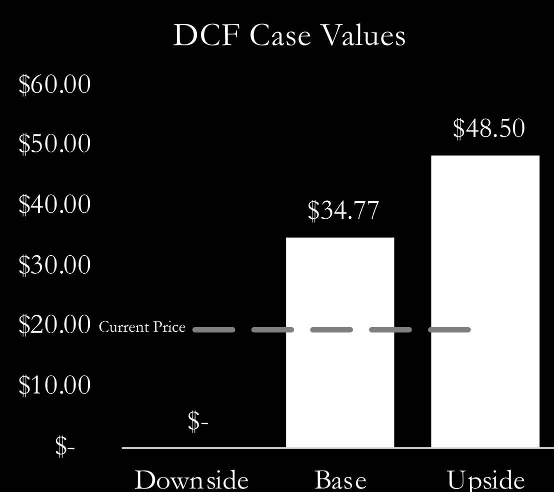
Our PT is based on the idea that a majority of possible operating environments should yield an intrinsic value far exceeding the share price, but the possible risk of bankruptcy hinders an NCLH trade near that number, which we estimate to be a base value of $35.00

<u>Our Upside Case: $48.50</u>

Our upside case is based on nearly full execution of management targets, a Net Yield CAGR of 3.5%, a stabilization of capex & interest expenses, and a reduction of net leverage to 2.2x.

<u>Our Downside Case: $0</u>

Our downside case expects default on interest payments. If EBITDA were to have a roughly -5% CAGR over the next three years, by 2027, the company would have to add on significantly more debt to finance capex & going operations, something few lenders would be willing to take on for a company we would project to have an 8.5x net leverage.



Changing Consumer Preference: NCLH and its peers have been beneficiaries of the rising popularity of cruises among western consumers for years now, crediting NCLH with the ability to materially increase Net Yield beyond the CPI. A reversal of this trend would be substantial and eliminate the ability for NCLH to greatly improve its margins. To prevent such developments, NCLH must constantly innovate in terms of entertainment, ship designs, and itineraries, which can be costly.

Projections

Income Statement ($mm)	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**	**CAGR%**
Revenue	8,550	9,418	9,818	10,500	11,221	2.3%
Gross Profit	5,681	6,394	6,775	7,255	7,765	2.6%
EBITDA	1,862	2,275	2,602	2,840	3,097	4.6%
EBIT	924	1,451	1,709	1,739	1,925	9.0%
Pre-Tax Income	205	705	892	913	1,018	121.8%
EPS (reported) $	0.39	1.34	1.70	1.72	1.90	115.8%

Margin Data	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**	**AVG%**
EBITDA Margin (%)	21.8%	24.2%	26.5%	27.1%	27.6%	25.4%
EBIT Margin (%)	10.8%	15.4%	17.4%	16.6%	17.2%	15.5%
Pre-Tax Margin (%)	2.4%	7.5%	9.1%	8.7%	9.1%	7.3%
Net Income (%)	1.9%	6.1%	7.4%	7.0%	7.3%	6.0%

Valuation Metrics	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**	**AVG%**
P/E	51.4x	14.4x	11.3x	11.2x	10.1x	19.7x
EV/Sales	3.7x	2.3x	2.2x	2.0x	1.9x	2.4x
EV/EBITDA	16.0x	9.3x	8.2x	7.5x	6.9x	9.6x
FCF Yield	-1.6%	2.6%	-2.6%	-18.6%	-11.9%	-6.4%

About $NCLH

Norwegian Cruise Line Holdings Ltd. ($NCLH) is a leading global cruise company operating three distinct brands: Norwegian Cruise Line, Oceania Cruises, and Regent Seven Seas Cruises. Founded in 1966 by Knut Kloster and Ted Arison, the company is headquartered in Miami, Florida, and is renowned for its innovative Freestyle Cruising concept, which allows passengers greater flexibility in dining and entertainment. NCLH's fleet comprises over 28 ships, offering a variety of cruise experiences from contemporary and premium to luxury. Over the years, the company has grown through strategic initiatives and mergers and acquisitions, including the notable acquisition of Prestige Cruises International, the parent company of Oceania Cruises and Regent Seven Seas Cruises, in 2014. This acquisition expanded NCLH's market presence and diversified its offerings. NCLH continues to innovate and expand its fleet, focusing on enhancing passenger experiences and maintaining a strong market position in the cruise industry.

Disclosures & Ratings

Consortium Equity Research does not hold any professional relationships with any reported equities. **Overweight** means the analyst team believes the stock price will outperform the coverage industry (TMT, Healthcare, Industrial, Consumer) in the next 6-12 months. **Equal Weight** means the team expects performance in line with the industry. **Underweight** means the team expects underperformance relative to the industry.