CARNIVAL CORP
Form 10-Q
September 30, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended August 31, 2016
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-9610	Commission file number: 001-15136
Carnival Corporation (Exact name of registrant as specified in its charter)	Carnival plc (Exact name of registrant as specified in its charter)
Republic of Panama (State or other jurisdiction of incorporation or organization)	England and Wales (State or other jurisdiction of incorporation or organization)
59-1562976 (I.R.S. Employer Identification No.)	98-0357772 (I.R.S. Employer Identification No.)
3655 N.W. 87th Avenue Miami, Florida 33178-2428 (Address of principal executive offices) (Zip Code)	Carnival House, 100 Harbour Parade, Southampton SO15 1ST, United Kingdom (Address of principal executive offices) (Zip Code)
(305) 599-2600 (Registrant’s telephone number, including area code)	011 44 23 8065 5000 (Registrant’s telephone number, including area code)
None (Former name, former address and former fiscal year, if changed since last report)	None (Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate Web sites, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrants were required to submit and post such files). Yes No

Indicate by check mark whether the registrants are large accelerated filers, accelerated filers, non-accelerated filers, or smaller reporting companies. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filers Accelerated filers

Non-accelerated filers Smaller reporting companies

Indicate by check mark whether the registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act). Yes No

At September 23, 2016, Carnival Corporation had outstanding 537,602,085 shares of Common Stock, $0.01 par value.

At September 23, 2016, Carnival plc had outstanding 216,457,117 Ordinary Shares $1.66 par value, one Special Voting Share, GBP 1.00 par value and 537,602,085, Trust Shares of beneficial interest in the P&O Princess Special Voting Trust.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

CARNIVAL CORPORATION & PLC
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in millions, except per share data)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2016	2015	2016	2015
Revenues				
Cruise				
Passenger tickets	$3,803	$3,631	$9,217	$8,891
Onboard and other	1,146	1,102	3,047	2,918
Tour and other	148	150	190	194
	5,097	4,883	12,454	12,003
Operating Costs and Expenses				
Cruise				
Commissions, transportation and other	646	603	1,723	1,671
Onboard and other	171	170	411	395
Payroll and related	494	453	1,488	1,388
Fuel	265	345	648	996
Food	260	255	755	737
Other ship operating	643	582	1,914	1,913
Tour and other	84	82	125	129
	2,563	2,490	7,064	7,229
Selling and administrative	529	484	1,613	1,504
Depreciation and amortization	443	399	1,303	1,206
	3,535	3,373	9,980	9,939
Operating Income	1,562	1,510	2,474	2,064
Nonoperating (Expense) Income				
Interest income	2	2	5	6
Interest expense, net of capitalized interest	(61)	(53)	(168)	(167)
Losses on fuel derivatives, net	(36)	(197)	(102)	(378)
Other (expense) income, net	(2)	(12)	6	3
	(97)	(260)	(259)	(536)
Income Before Income Taxes	1,465	1,250	2,215	1,528
Income Tax Expense, Net	(41)	(34)	(44)	(41)
Net Income	$1,424	$1,216	$2,171	$1,487
Earnings Per Share				
Basic	$1.93	$1.56	$2.89	$1.91
Diluted	$1.93	$1.56	$2.88	$1.91
Dividends Declared Per Share	$0.35	$0.30	$1.00	$0.80

The accompanying notes are an integral part of these consolidated financial statements.

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CARNIVAL CORPORATION & PLC
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2016	2015	2016	2015
Net Income	$1,424	$1,216	$2,171	$1,487
Items Included in Other Comprehensive (Loss) Income				
Change in foreign currency translation adjustment	(366)	80	(294)	(738)
Other	2	21	23	(24)
Other Comprehensive (Loss) Income	(364)	101	(271)	(762)
Total Comprehensive Income	$1,060	$1,317	$1,900	$725

The accompanying notes are an integral part of these consolidated financial statements.

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CARNIVAL CORPORATION & PLC
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in millions, except par values)

	August 31, 2016	November 30, 2015
ASSETS		
Current Assets		
Cash and cash equivalents	$ 462	$ 1,395
Trade and other receivables, net	321	303
Insurance recoverables	102	109
Inventories	314	330
Prepaid expenses and other	355	314
Total current assets	1,554	2,451
Property and Equipment, Net	32,864	31,818
Goodwill	2,964	3,010
Other Intangibles	1,290	1,308
Other Assets	660	650
	$ 39,332	$ 39,237
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term borrowings	$ 334	$ 30
Current portion of long-term debt	739	1,344
Accounts payable	704	627
Accrued liabilities and other	1,738	1,683
Customer deposits	3,585	3,272
Total current liabilities	7,100	6,956
Long-Term Debt	8,320	7,413
Other Long-Term Liabilities	1,012	1,097
Contingencies		
Shareholders' Equity		
Common stock of Carnival Corporation, $0.01 par value; 1,960 shares authorized; 654 shares at 2016 and 653 shares at 2015 issued	7	7
Ordinary shares of Carnival plc, $1.66 par value; 216 shares at 2016 and 2015 issued	358	358
Additional paid-in capital	8,618	8,562
Retained earnings	21,488	20,060
Accumulated other comprehensive loss	(2,012)	(1,741)
Treasury stock, 114 shares at 2016 and 70 shares at 2015 of Carnival Corporation and 26 shares at 2016 and 27 shares at 2015 of Carnival plc, at cost	(5,559)	(3,475)
Total shareholders' equity	22,900	23,771
	$ 39,332	$ 39,237

The accompanying notes are an integral part of these consolidated financial statements.

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CARNIVAL CORPORATION & PLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in millions)

	Nine Months Ended August 31,	
	2016	2015
OPERATING ACTIVITIES		
Net income	$2,171	$1,487
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,303	1,206
Losses on fuel derivatives	102	378
Share-based compensation	40	38
Other, net	46	19
	3,662	3,128
Changes in operating assets and liabilities		
Receivables	(35)	(23)
Inventories	15	35
Insurance recoverables, prepaid expenses and other	(10)	94
Accounts payable	88	(23)
Accrued and other liabilities	(5)	(19)
Customer deposits	395	375
Net cash provided by operating activities	4,110	3,567
INVESTING ACTIVITIES		
Additions to property and equipment	(2,416)	(1,704)
Proceeds from sales of ships	19	25
Payments of fuel derivative settlements	(231)	(139)
Collateral proceeds (payments) for fuel derivatives	22	(22)
Other, net	(16)	35
Net cash used in investing activities	(2,622)	(1,805)
FINANCING ACTIVITIES		
Proceeds from (repayments of) short-term borrowings, net	301	(625)
Principal repayments of long-term debt	(971)	(772)
Proceeds from issuance of long-term debt	1,044	472
Dividends paid	(721)	(584)
Purchases of treasury stock	(2,110)	(166)
Sales of treasury stock	40	167
Other, net	(9)	(1)
Net cash used in financing activities	(2,426)	(1,509)
Effect of exchange rate changes on cash and cash equivalents	5	(45)
Net (decrease) increase in cash and cash equivalents	(933)	208
Cash and cash equivalents at beginning of period	1,395	331
Cash and cash equivalents at end of period	$462	$539

The accompanying notes are an integral part of these consolidated financial statements.

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CARNIVAL CORPORATION & PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
NOTE 1 – General

The consolidated financial statements include the accounts of Carnival Corporation and Carnival plc and their respective subsidiaries. Together with their consolidated subsidiaries, they are referred to collectively in these consolidated financial statements and elsewhere in this joint Quarterly Report on Form 10-Q as “Carnival Corporation & plc,” “our,” “us” and “we.”

Basis of Presentation

The Consolidated Balance Sheet at August 31, 2016, the Consolidated Statements of Income and the Consolidated Statements of Comprehensive Income for the three and nine months ended August 31, 2016 and 2015 and the Consolidated Statements of Cash Flows for the nine months ended August 31, 2016 and 2015 are unaudited and, in the opinion of our management, contain all adjustments necessary for a fair statement. Our interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the related notes included in the Carnival Corporation & plc 2015 joint Annual Report on Form 10-K (“Form 10-K”) filed with the U.S. Securities and Exchange Commission on January 29, 2016. Our operations are seasonal and results for interim periods are not necessarily indicative of the results for the entire year.

Accounting Pronouncements

Amended guidance was issued by the Financial Accounting Standards Board (“FASB”) regarding the accounting for Service Concession Arrangements. The new guidance defines a service concession as an arrangement between a public-sector grantor, such as a port authority, and a company that will operate and maintain the grantor's infrastructure for a specified period of time. In exchange, the company may be given a right to charge the public, such as our cruise guests, for the use of the infrastructure. This guidance required us to record certain of the infrastructure we had constructed to be used by us pursuant to a service concession arrangement outside of property and equipment. On December 1, 2015, we adopted this guidance and, accordingly, reclassified $70 million from Property and Equipment, Net to Other Intangibles on our November 30, 2015 Consolidated Balance Sheet (see “Note 4 - Nonfinancial Instruments that are Measured at Fair Value on a Nonrecurring Basis”).

The FASB issued amended guidance regarding accounting for Interest - Imputation of Interest, which simplifies the presentation of debt issuance costs. The guidance requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability. This guidance is required to be adopted by us in the first quarter of fiscal 2017, and will be applied on a retrospective basis. The adoption of this guidance is not expected to have a significant impact on our Consolidated Balance Sheets.

The FASB issued amended guidance regarding accounting for Intangibles - Goodwill and Other - Internal-Use Software, which clarifies the accounting for fees paid in a cloud computing arrangement. The amendments provide guidance to customers about whether a cloud computing arrangement includes a software license or if the arrangement should be accounted for as a service contract. The amendments will impact the accounting for software licenses but will not change a customer's accounting for service contracts. This guidance is required to be adopted by us in the first quarter of fiscal 2017 on either a prospective or retrospective basis. The adoption of this guidance is not expected to have a material impact to our consolidated financial statements.

The FASB issued amended guidance regarding accounting for Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. When effective, this standard will replace most existing revenue recognition guidance in U.S. generally accepted accounting principles ("U.S. GAAP"). The standard also requires more detailed disclosures and provides additional guidance for transactions that were not comprehensively addressed in U.S. GAAP. This guidance is required to be adopted by us in the first quarter of fiscal 2019 by either recasting all years presented in our financial statements or by recording the impact of adoption as an adjustment to retained earnings at the beginning of the year of adoption. We are currently evaluating the impact this guidance will have on our consolidated financial statements.

The FASB issued guidance regarding accounting for Leases, which requires an entity to recognize both assets and liabilities arising from financing and operating leases, along with additional qualitative and quantitative disclosures. This guidance is required to be adopted by us in the first quarter of fiscal 2020. We are currently evaluating the impact this guidance will have on our consolidated financial statements.

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Other

Cruise passenger ticket revenues include fees, taxes and charges collected by us from our guests. The portion of these fees, taxes and charges included in passenger ticket revenues and commissions, transportation and other costs were $148 million and $141 million and $407 million and $398 million for the three and nine months ended August 31, 2016 and 2015, respectively.

NOTE 2 – Unsecured Debt

At August 31, 2016, our short-term borrowings consisted of euro- and U.S. dollar-denominated commercial paper of $246 million and $85 million, respectively, and euro-denominated bank loans of $3 million with an aggregate weighted-average floating interest rate of 0.2%.

In February 2016, we issued $555 million of euro-denominated, publicly-traded notes, which bear interest at 1.625% and are due in February 2021.

In April 2016, we borrowed $379 million under an export credit facility, the proceeds of which were used to pay for a portion of AIDA Cruises' ("AIDA") AIDAprima purchase price. Of this facility, a portion bears fixed and a portion bears floating interest rates. The facility is due in semi-annual installments through August 2027.

In May 2016, we entered into four export credit facilities that will provide us with the ability to borrow up to an aggregate of $2.3 billion. Proceeds from these facilities will be used to pay for a portion of the purchase price of four cruise ships, which are expected to be delivered between February 2019 and September 2020. These borrowings will be due in semi-annual installments through September 2032.

In May 2016, we exercised our option to extend the termination date of our multi-currency revolving credit facility from June 2020 to June 2021. In addition, the total capacity of the revolving credit facility increased to $2.6 billion (comprised of $1.9 billion, €500 million and £169 million).

In July 2016, we borrowed $110 million under a euro-denominated, floating rate bank loan, due in July 2021.

In July 2016, we entered into a $168 million euro-denominated, fixed rate bank loan, which was drawn in September 2016 and is due in September 2020.

In July 2016, we entered into a $100 million, floating rate bank loan, which is expected to be drawn in November 2016, and is due in November 2021.

In August 2016, we canceled an export credit facility that provided us with the ability to borrow up to an aggregate of $201 million to pay for a portion of the purchase price of a Seabourn ship, which is expected to be delivered in November 2016.

In August 2016, we extended the termination date of a $100 million, floating rate bank loan, from October 2016 to October 2021.

We use the net proceeds from our borrowings for general corporate purposes and purchases of new ships.
NOTE 3 – Contingencies
Litigation
The UK Maritime & Coastguard Agency and the U.S. Department of Justice are investigating allegations that Caribbean Princess breached international pollution laws. We are cooperating with the investigations, including

conducting our own internal investigation into the matter. The ultimate outcome of this matter cannot be determined at this time; however, we do not expect it to have a material impact on our results of operations.

In the normal course of our business, various claims and lawsuits have been filed or are pending against us. Most of these claims and lawsuits are covered by insurance and the maximum amount of our liability, net of any insurance recoverables, is typically limited to our self-insurance retention levels. We believe the ultimate outcome of these claims and lawsuits will not have a material impact on our consolidated financial statements.

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Contingent Obligations – Lease Out and Lease Back Type ("LILO") Transactions

At August 31, 2016, we had estimated contingent obligations totaling $364 million, excluding termination payments as discussed below, to participants in LILO transactions for two of our ships. At the inception of these leases, we paid the aggregate of the net present value of these obligations to a group of major financial institutions, who agreed to act as payment undertakers and directly pay these obligations. As a result, these contingent obligations are considered extinguished and neither the funds nor the contingent obligations have been included in our Consolidated Balance Sheets.

In the event that we were to default on our contingent obligations and assuming performance by all other participants, we estimate that we would, as of August 31, 2016, be responsible for a termination payment of $13 million. In January 2016, we elected to exercise our options to terminate, at no cost, the LILO transactions as of January 1, 2017 for one ship and as of January 1, 2018 for the second ship.

In advance of the termination dates, if the credit rating of one of the financial institutions who is directly paying the contingent obligations falls below AA-, or below A- for the other financial institution, then we will be required to replace the applicable financial institution with another financial institution whose credit rating is at least AA or meets other specified credit requirements. In such circumstances, we would incur additional costs, although we estimate that they would not be significant to our consolidated financial statements. The financial institution payment undertaker subject to the AA- credit rating threshold has a credit rating of AA, and the financial institution subject to the A- credit rating threshold has a credit rating of A+. If our credit rating, which is BBB+, falls below BBB, we will be required to provide a standby letter of credit for $27 million, or, alternatively, provide mortgages for this aggregate amount on these two ships.

Contingent Obligations – Indemnifications

Some of the debt contracts we enter into include indemnification provisions obligating us to make payments to the counterparty if certain events occur. These contingencies generally relate to changes in taxes or other changes in laws which increase our lender's costs. The indemnification clauses are often standard contractual terms and were entered into in the normal course of business. There are no stated or notional amounts included in the indemnification clauses, and we are not able to estimate the maximum potential amount of future payments, if any, under these indemnification clauses. We have not been required to make any material payments under similar indemnification clauses in the past and we do not believe a request for material future indemnification payments is probable.

NOTE 4 – Fair Value Measurements, Derivative Instruments and Hedging Activities

Fair Value Measurements

U.S. accounting standards establish a fair value hierarchy prioritizing the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 measurements are based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access. Valuation of these items does not entail a significant amount of judgment.
- Level 2 measurements are based on quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active or market data other than quoted prices that are observable for the assets or liabilities.
- Level 3 measurements are based on unobservable data that are supported by little or no market activity and are significant to the fair value of the assets or liabilities.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent and knowledgeable market participants. When quoted prices are not readily available, our own assumptions are set to reflect those that we believe market participants would use in pricing the asset or liability.

The fair value measurement of a financial asset or financial liability reflects the nonperformance risk of both parties to the contract. Therefore, the fair value measurement of our financial instruments reflects the impact of our counterparty's creditworthiness for asset positions and our creditworthiness for liability positions. Creditworthiness did not have a significant impact on the fair values of our financial instruments at August 31, 2016 and November 30, 2015. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. Accordingly, certain estimates of fair value presented herein are not necessarily indicative of the amounts that could be realized in a current or future market exchange.

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Financial Instruments that are not Measured at Fair Value on a Recurring Basis

The carrying values and estimated fair values and basis of valuation of our financial instrument assets and liabilities not measured at fair value on a recurring basis were as follows (in millions):

	August 31, 2016				November 30, 2015			
	Carrying Value	Fair Value Level 1	Level 2	Level 3	Carrying Value	Fair Value Level 1	Level 2	Level 3
Assets								
Cash and cash equivalents (a)	$242	$242	$—	$ —	$647	$647	$—	$ —
Restricted cash (b)	37	37	—	—	7	7	—	—
Long-term other assets (c)	108	1	73	34	119	1	87	31
Total	$387	$280	$73	$ 34	$773	$655	$87	$ 31
Liabilities								
Fixed rate debt (d)	$5,274	$—	$5,631	$ —	$5,193	$—	$5,450	$ —
Floating rate debt (d)	4,119	—	4,054	—	3,594	—	3,589	—
Total	$9,393	$—	$9,685	$ —	$8,787	$—	$9,039	$ —

(a) Cash and cash equivalents are comprised of cash on hand and at November 30, 2015 also included a money market deposit account and time deposits. Due to their short maturities, the carrying values approximate their fair values.

(b) Restricted cash is comprised of a money market deposit account and at August 31, 2016 also included funds held in escrow.

(c) Long-term other assets are substantially all comprised of notes and other receivables. The fair values of our Level 2 notes and other receivables were based on estimated future cash flows discounted at appropriate market interest rates. The fair values of our Level 3 notes receivable were estimated using risk-adjusted discount rates.

(d) Debt does not include the impact of interest rate swaps. The fair values of our publicly-traded notes were based on their unadjusted quoted market prices in markets that are not sufficiently active to be Level 1 and, accordingly, are considered Level 2. The fair values of our other debt were estimated based on appropriate market interest rates being applied to this debt.

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Financial Instruments that are Measured at Fair Value on a Recurring Basis

The estimated fair value and basis of valuation of our financial instrument assets and liabilities measured at fair value on a recurring basis were as follows (in millions):

	August 31, 2016			November 30, 2015		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets						
Cash equivalents (a)	$220	$ —	$ —	$748	$ —	$ —
Restricted cash (b)	25	—	—	22	—	—
Short-term investments (c)	—	—	21	—	—	