Port Finance: The port property view from a public and private perspective ©

AAPA Port Finance

Norfolk Virginia

Summary

- Ports' sector performance
- Evolving supply chain
- Port's changing role
- Port property asset management
- Opportunities – a concrete example

How resilient an industry?

PORTS' SECTOR PERFORMANCE

8 June 2010

Today the focus is
on the negative

- **World Bank**:
  this recession was first decline in Global trade in 80 years.

- **IMF**:
  first contraction in global GDP since WWII.

But as Winston Churchill once said:

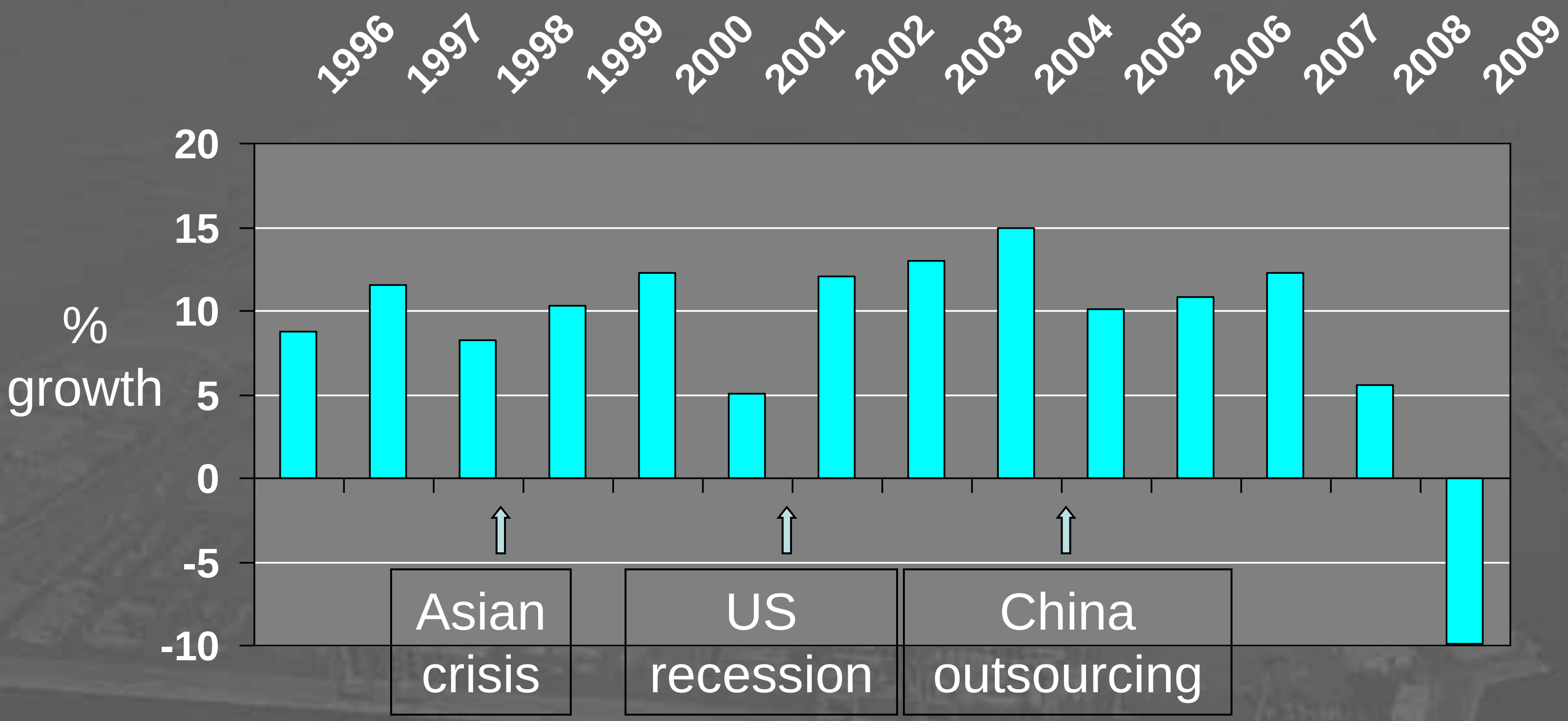
‘If you are going through hell, …

…keep going!’

What happened?

- A restructuring of massive cheap debt and bloated organisations - but work out process well underway.
- Question: Have we been too harsh with the port sector though in our negative estimates and short sightedness going forward?

The industry's silver lining: Riding out recessions…

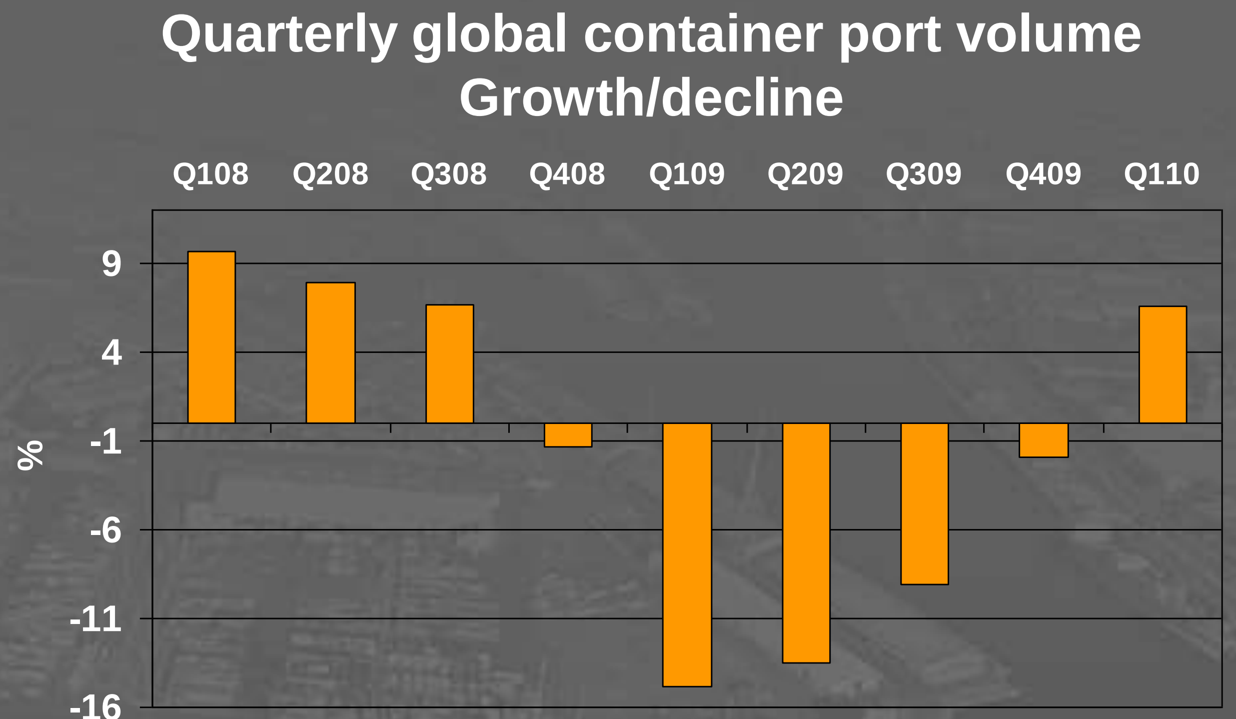


Source: Drewry Shipping Consultants Ltd

The global container port industry has shown resilience against recessions in the past – 2009 was different though; but its forecasted turnaround indicates a resilient sector.

Last quarter of 2008, first quarter 2009

- US sub-prime mortgage crisis hit mid 2007!
- Recession started to bite the last quarter of 2008 and hit hard in 1H 2009
- But the banking crisis in the second half of 2008 was the really critical factor



Source: Drewry Shipping Consultants Ltd

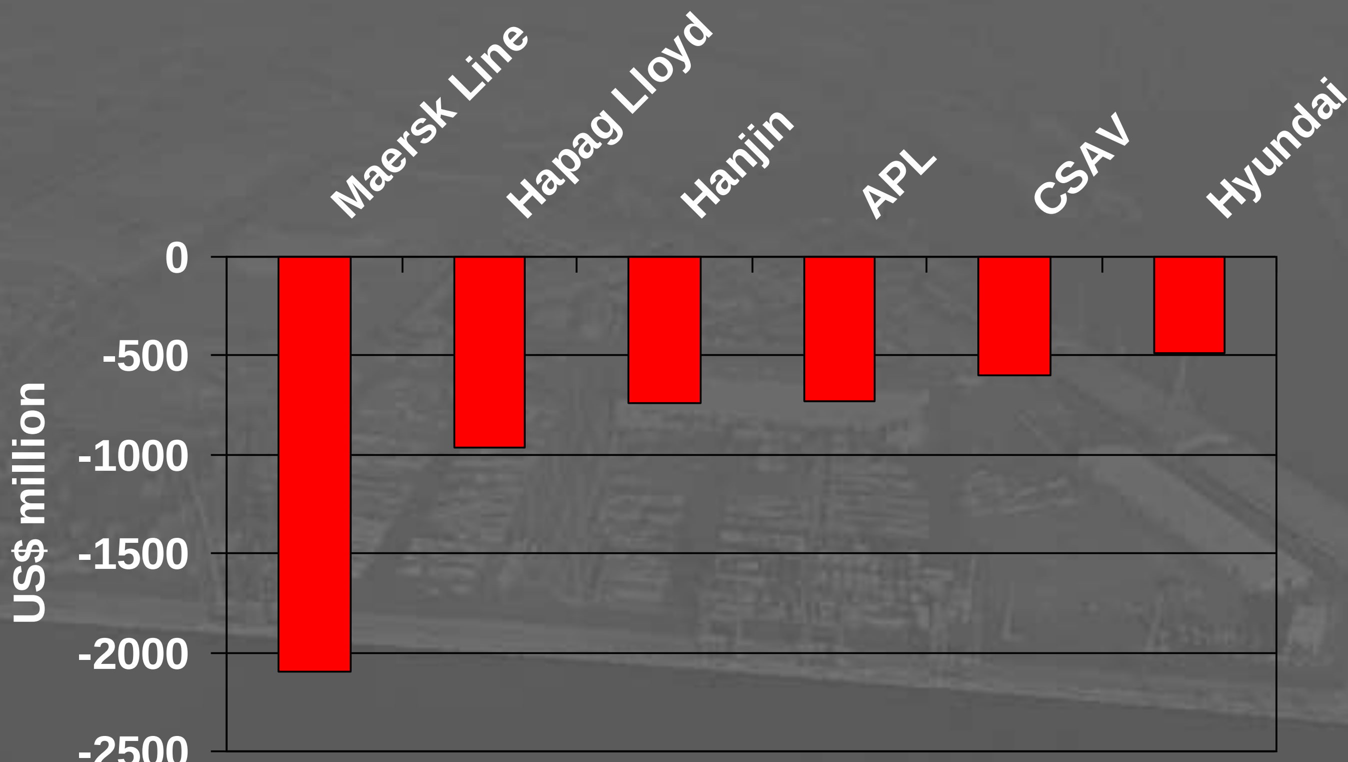
The port industry's resiliency

- 1982 worst year prior to this recession with 4.2% annual growth. By 2012 TEU traffic volumes will exceed 2008.

Source: Drewry

8 June 2010

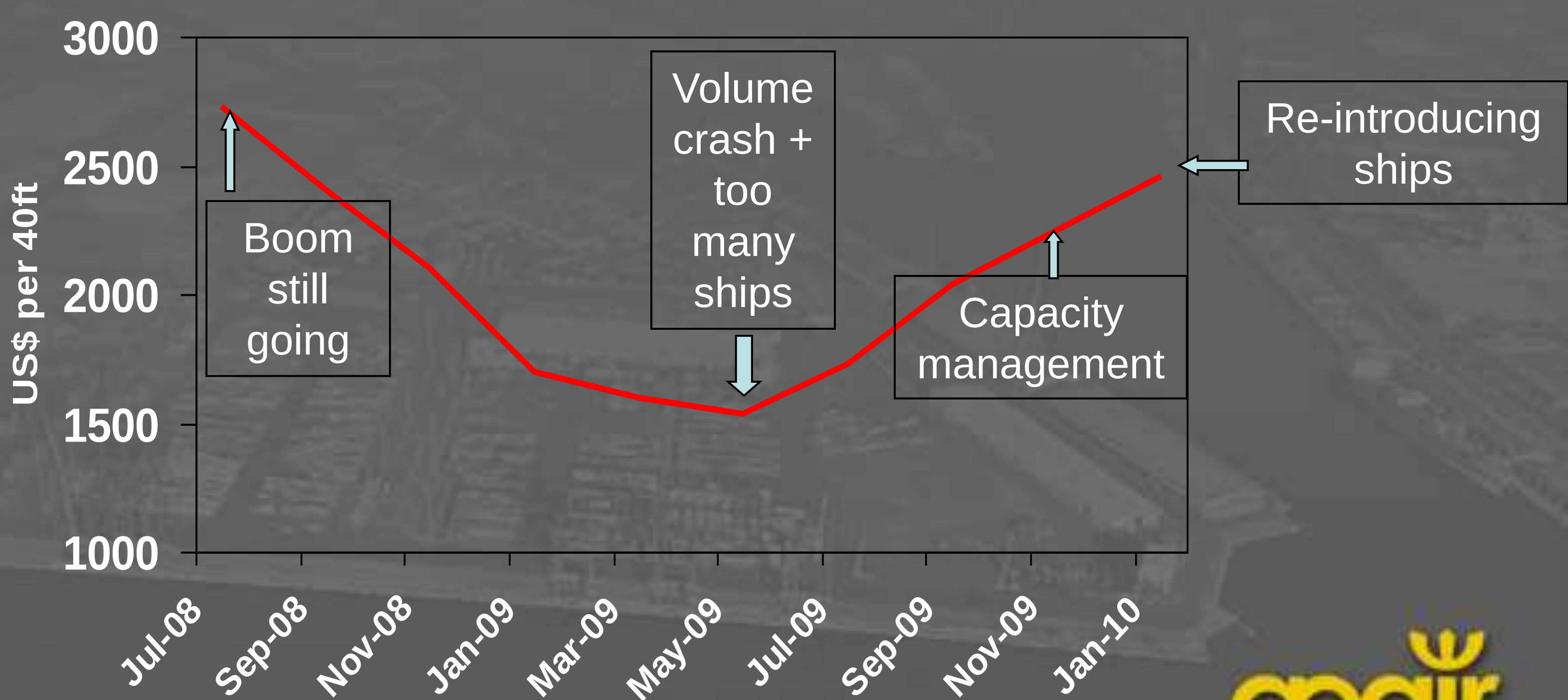
Contrast with liner shipping margins – examples of 2009 losses



Source: Drewry Shipping Consultants Ltd

But freight rates recovering – for now…

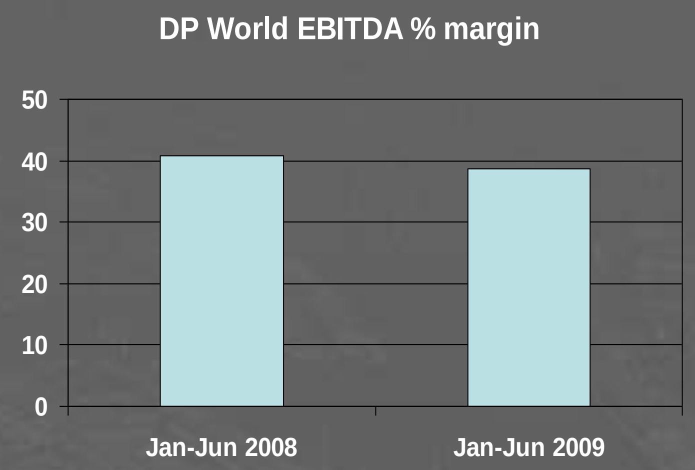
Drewry Global Freight Rate Index

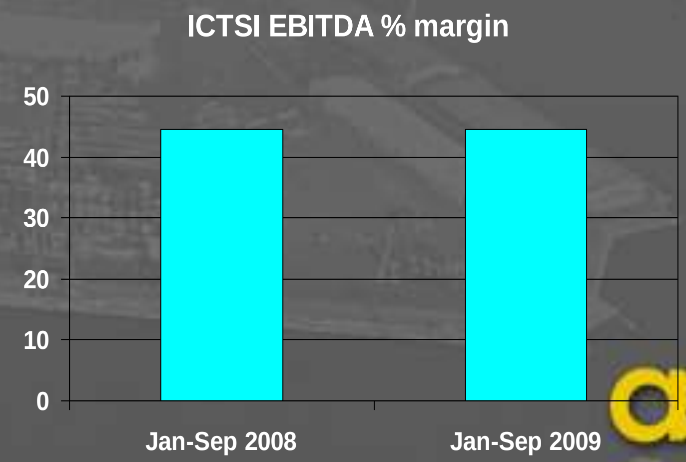


Source: Drewry Shipping Consultants Ltd

Defending container terminal profit margins

- Volumes, revenue and absolute profitability were down in 2009
- Margins were generally maintained though, e.g.
  - o DP World
  - o ICTSI
- A profit margin was still there – in the worst year the container port industry has ever experienced



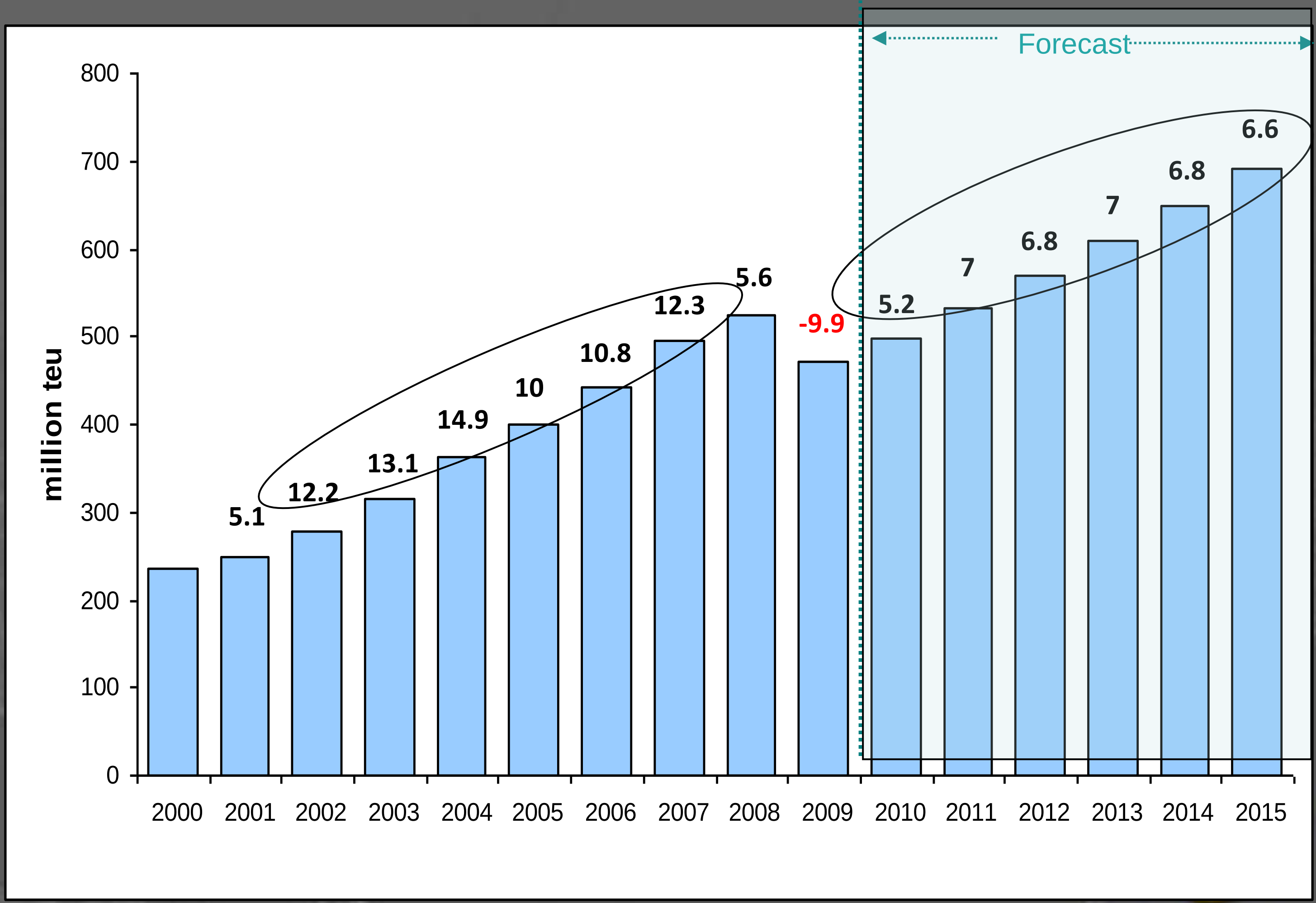


Source: Drewry Shipping Consultants Ltd

Forecast global container port demand growth to 2015: 3 year comeback - now that's industry resilience

Numbers on top of bars indicate percentage y-o-y growth

What is the "new normal"?



Source: Drewry Shipping Consultants Ltd

Forecast demand highlights

	2010	2011	2012	2013	2014	2015
North America						
North Europe						
South Europe						
Far East						
South East Asia						
Mid East						
Carib/C.America						
S.America						
Oceania						
South Asia						
Africa						
Eastern Europe						
World						

Shaded cells show when throughput levels are expected to return to peak of 2007/08

Eastern Europe may be beyond 2015

Source: Drewry Shipping Consultants Ltd

And the continuing need to compress it

EVOLVING SUPPLY CHAIN

8 June 2010

Growth in container ship size

Year	Average ship size (teu)	Largest ship in world fleet (teu)
1980	375	3,057
1990	1,355	4,409
2000	1,741	7,200
Current	2,191	13,500+

Source: Drewry Shipping Consultants Ltd

Growth in containership size

Source: Drewry Shipping Consultants Ltd

Emma Maersk (PS) class

8 June 2010

Hinterland reach

- Big ships only work as part of a global network. They need to reach deep into the hinterland to be financially viable.
- Big ships are inflexible - could be a serious liability in a downturn; the bigger the ship the larger the risk.
- Big ships need deeper water, bigger cranes, longer berths, bigger container yards, in short – more port infrastructure and land in the port and throughout the logistics chain.
- Increased time in port can quickly outweigh economies of scale.

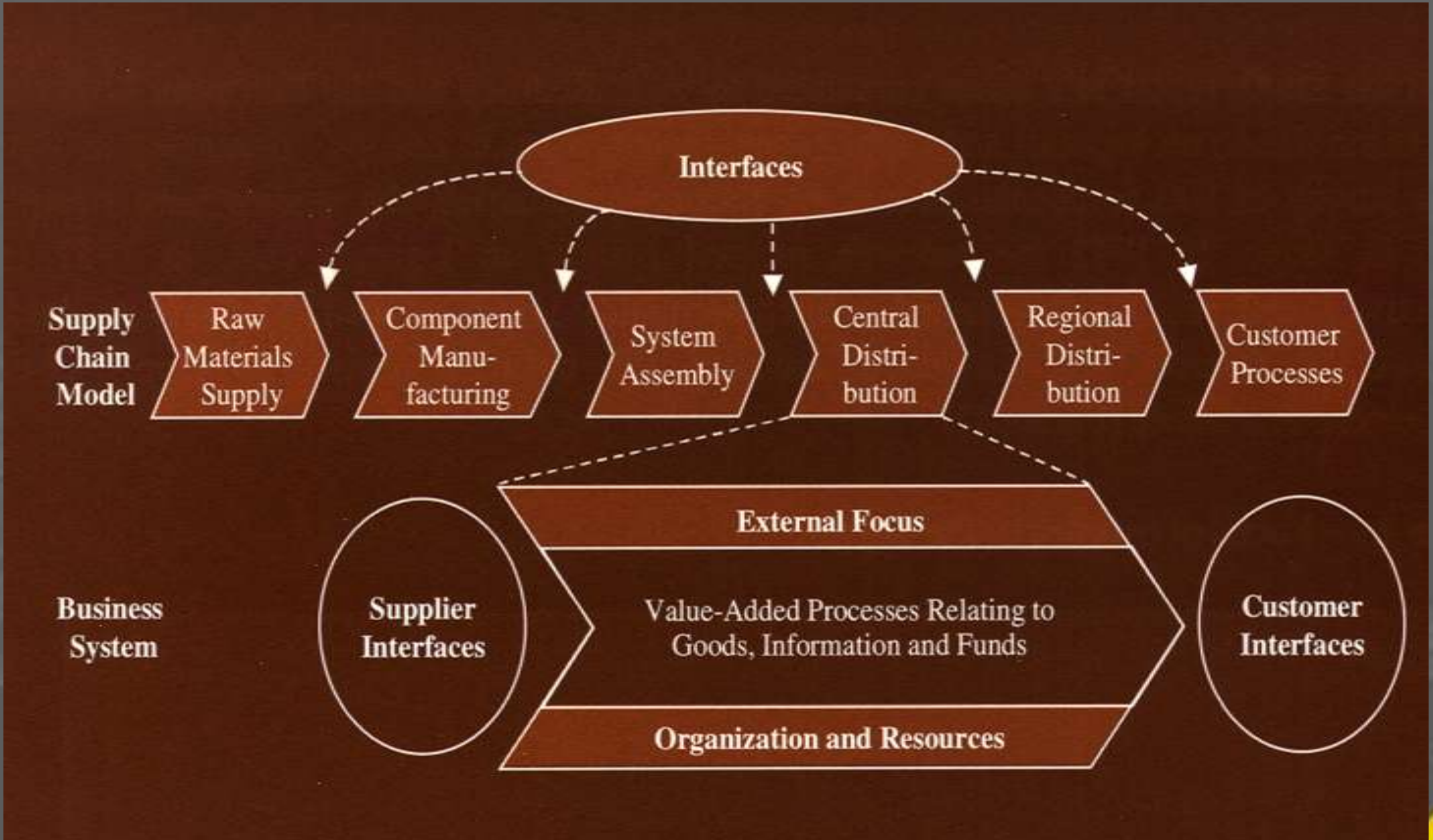
Port property –
the new strategic asset

- 8,000 TEU ship requires 100 acres to keep container flow inbound smooth; most large ports are land constrained.
- Throughput per acre is key to making customers happy and money eg, in US about 4,000 – 5,000 TEU/acre yet in Europe and Asia 10,000 TEU/acre and higher is not unusual

Role of Property Today in Ports and Logistics Properties

- Property: largest asset on port's balance sheet - typically financially underperforming.
- Port property: from admin function to strategic asset.
- Governments: lack capital, ports now stand alone profit centres.
- Ports: now asset managers.
- Port property: needs to be leveraged at market value to release needed equity.

Shortening the logistical supply chain:
Requires intermodality and real estate



Source: A.T. Kearney

To address the new realities

PORTS' CHANGING ROLE

8 June 2010

Port Authorities

- Specialisation → Regionalisation
- Transport node → Transport nexus
- Port operator → Asset manager

Ports: No longer business as usual

Due to:

- Escalating property costs
- Land shortages
- Threatening economic obsolescence
- Security and ecological constraints
- Profitability & productivity demand
- Regionalisation

Port Life Cycle

- Establishment, development, maturity, demise
- Functional obsolescence
  - Eg, ship size requiring deeper harbours & more land
  - Intermodal requirements and pressures
- Economic obsolescence
  - Increasing values of waterfront urban land

Ports – now nodes in an ever expanding and integrating global supply chain

- Within present supply chain weakest link are ports and their inability to process more throughput.
- Just in time is now ‘integrated time’, requiring more specialised facilities such as ‘fast buildings’.
- Property and its management at, near and related to ports is key to addressing these issues.

Regionalisation

- Ports will integrate into new freight paradigm (major impact on land usage).
- Inland distribution cost - now savings area as over water transport now a commodity.
- Constraints (political, ecological, economic) will force hinterland expansion and access
- All requires substantial use and need for real estate facilities

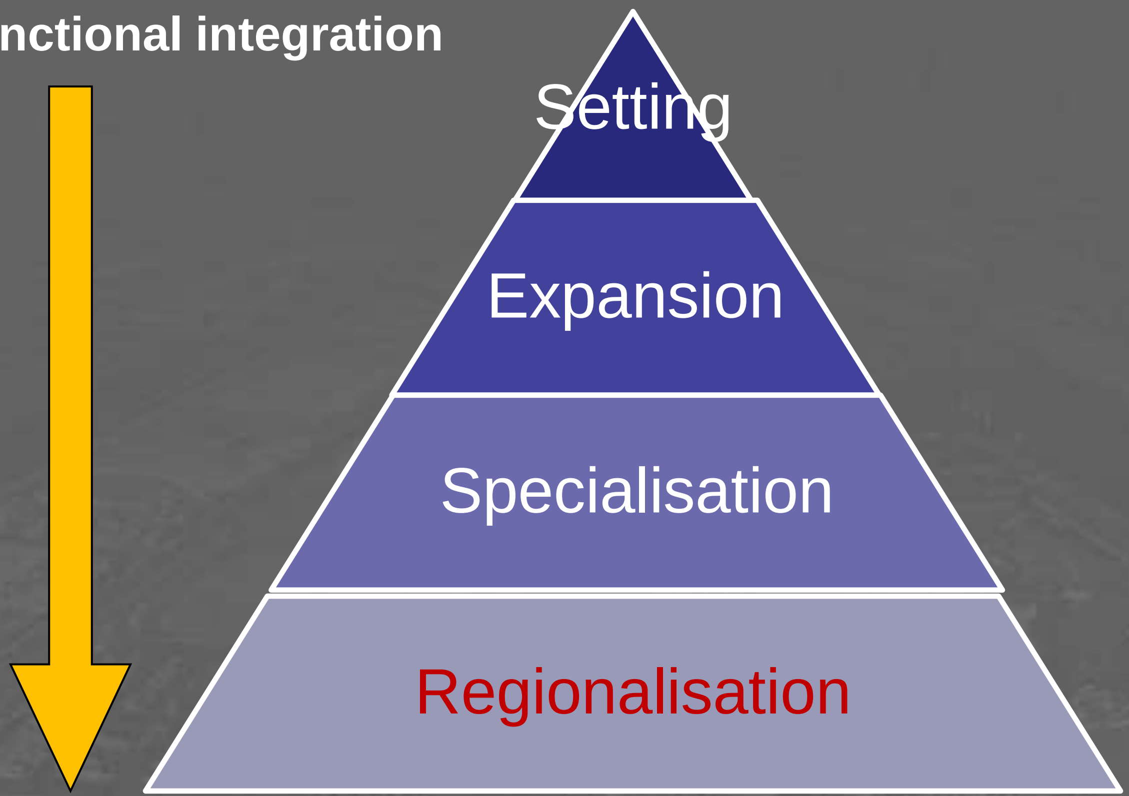
Regionalisation (cont.)

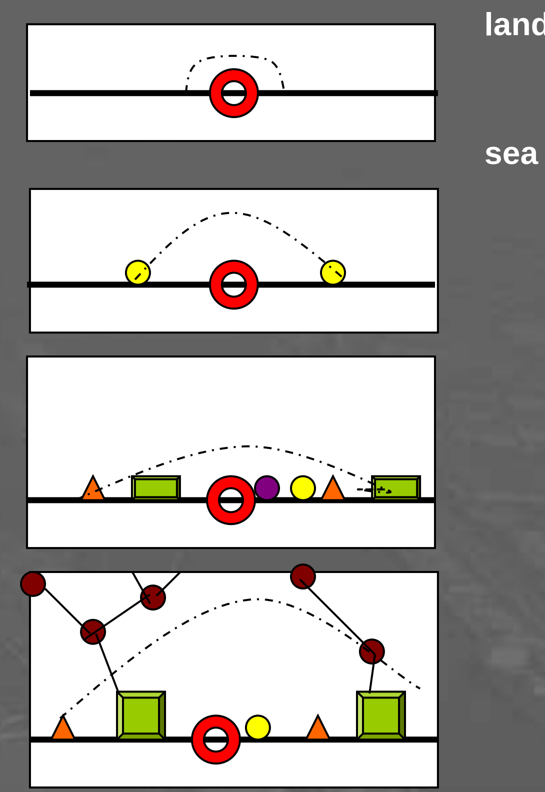
- Corridors and inland terminals – cornerstones in port regionalisation.
- Inland ports critical to in maintaining major seaport efficiency, attractiveness and competitive advantages (eg velocity/productivity).

(excerpts from: Notteboom T E, Rodrigue J E, 2005 (revised), Port Regionalization: Towards a New Phase in port Development, Maritime Policy & Management

Regionalisation: heavily dependent on property

Level of functional integration





Port
Container
Bulk

Freight dist centre
General cargo
Reconversion
Freight corridor
Urban area

Evolution of a Port

James Bird, Anyport, Notteboom, TE, Rodrigue, J P, Port Regionalisation: Towards a New Phase in Port Development, Maritime Policy & Management, 2005

8 June 2010

Minding a port's largest asset

PORT PROPERTY ASSET MANAGEMENT

8 June 2010

Port Property

Port Authorities (PA's) control significant strategically located waterfront **property**, which typically:

- Is largest asset on balance sheet.
- Financially underperforms
- Operationally underutilised.
- Is viewed as an administrative function - not a strategic asset.

Why PA's need to manage port properties professionally?

- Changing role: operators to asset managers
- Congestion pressures, supply chain compression, requirements of 'big' ships, regionalisation
- Land constrained ports must improve productivity and 'velocity' to remain 'economically' viable
- Better manage security, ecological, logistical and quality of life constraints
- Now profit centres - must maximise revenues & values to facilitate access to private capital to modernise & expand

To maximise profit and asset values PA's must:

- Develop 'asset management skill sets
- Manage 'property' as a strategic asset
- Be financially disciplined with property to optimise land usage based on 'economic value added' contributions eg, increasing velocity by moving distribution and warehousing to hinterlands, closer to intermodal access points

PA's property management challenges

- Overarch property objectives with port's overall business strategy and mission
- Asset management Procedures (EVA)
- Financial engineering to access available, lower cost, private capital and financial markets

EVA: Benefits from managing for value - refocus, reconfigure, re-engineer

Shareholders:
- Higher value
- Higher returns

Port:
- Enhanced viability
- Inward investment
- More competitive
- More profitable
- More valuable

Clients:
- Better service
- Better price
- Better productivity

Community:
- Sustainability
- Economic contribution
- Jobs

Asset Management

"The acquisition, administration, re-development, re-use and disposition of real property assets in such a manner that the owner's business mission, goals and objectives are supported and achieved in the long run and add economic value."

Effective property asset management requires:

- Property **asset management plan**
- Operational **controls** to execute plan
- ‘M**arket driven**’ property decisions
- Ability negotiate and structure complex property decisions – **financial engineering**
- Benchmarking
- Overarching core business mission

Overarching port property objectives with the port's

Port property strategies need to:

- Support the port's core business
- Create synergies and competitive advantages with port operations
- Increase port's operational efficiency, address client needs
- Make most of existing logistical infrastructure and changes - regionalisation

Cooling off now but will come back with a vengeance

INVESTMENT DEMAND FOR YOUR PORT ASSETS

8 June 2010

Infrastructure trends and opportunities – the money is there

- OECD estimates **US$70 trillion required for infrastructure development and improvement – 2030.**
- Average size of infra fund now US$3.3b from US$159m in ’03; ‘Dry Powder’ for 2012 – US$100b.
- Current financial crisis has resulted in less debt - opening door for more equity participation.
- Although assets are priced at more realistic levels there are also lower return (IRR) expectations as well in the 15%-18% from 18%-20% in the 2006-2008 period.

The interest by the sector for PPP’s and direct investment is there…

- **‘Private/Public financing of freight transportation infrastructure is a compelling need that is being inadequately addressed.’**
  Critical Issues Impact in the Freight Transportation in the Southeast Region, CIFTS, Issue 4 – Fall 2009

Comparative infrastructure yields with port investments

Asset segment	Risk	Avg cash yield (yrs 1-5)	Avg leveraged IRR	Capital appreciation potential
Toll roads	Low	4%-9%	8%-12%	Limited
Seaports	Medium	4%-7%	15%-18%	Yes
Merchant power stations	High	4%-12%	15%-25%	Yes

Source: JP Morgan

Container terminal valuations

- The days of port business valuations at over 20x EBITDA are over – at least for the time being
- No real new benchmark deals yet; sentiment is 8-12x EBITDA is now the ballpark (but no substitute for a full DCF analysis)
- Share prices of quoted port companies still seem low relative to the companies' earning power and resilience e.g.
  - DP World floated at $1.36 per share in Nov 2007, fell to under 20 cents a share in Q109 before recovering to around 50 cents recently (04 10)
  - ICTSI was at over 30 Pesos per share a year ago and fell as low as to around 10 in Q109. Has since improved to around 22 (04 10)

A decidedly different exercise

VALUATION & APPRAISAL OF PORT PROPERTY

8 June 2010

On what basis do you value port property?

- On its ability to generate a cash flow
- The strength of the lease covenant
- Lease terms and conditions eg, rent reviews, pass throughs, etc
- Income versus comparable as there are very few port properties sold.

What property rights can be valued

- Fee Simple - freehold
- Leased Fee Estate – leasehold
- Both represent substantial equity

- At ports typically one sees leasehold interests as land continues to be owned in freehold by the port authority

Valuation Challenges

- Valuations of port properties need to be benchmarked with like kind properties, most probably not found ‘outside of the fence’ but across the world
- Valuations need to concentrate on the specialised economic use of both the port and its location therein, along with commensurate risk levels

Underestimating the Value of the Land

- PA's underestimate value of landholdings by structuring leases based on throughput, outdated 'rules of thumb' and uncorroborated benchmarks for property values and yield rates
- PA's lease properties as **incentives** rather than sound business practice – short sighted.

Measures of Investment performance?

Capitalization Rate:	NOI/Price
Equity Div. Rate:	BTCF/Equity
Debt Coverage:	NOI/Mtg Pmt

Net Present Value

Internal Rate of Return

Modified IRR

Profitability Index

Cash Flow from Operations

Cash Flow from Resale

What's in a lease?

Gross Lease (expenses paid by lessor owner)

Net Lease (expenses paid by lessee tenant)

Term, options, rent reviews, expansion, cancellations

What should be in a lease?

Costs

- Cost of capital?
- Inflation?
- Capital sinking fund for renovations and updates?
- Repair & maintenance?
- Operating costs eg, common area maintenance, security, electricity?
- Insurance, taxes, etc?

Revenue

- Return on investment?
- Return on equity?
- Developers profit?
- Demand/supply balance?
- Throughput charges?

Without consideration of the above will you really be making any money on a capital asset?

Where ports and the private sector meet

OPPORTUNITIES – A CONCRETE EXAMPLE

8 June 2010

Opportunities

- Maximise port's value through land banks
- Create new revenue streams focused on value added activities
- Release tied up capital to expand/modernise port
  - Raise off balance sheet debt & equity with:
    - **PPP – Public Private Partnerships**
    - **L-T ground leases**
    - **Build-to-suits**

Opportunities

- Create port competitive advantages by:
  - Integration of hinterlands and port to shorten supply chain eg, intermodal platform
  - Address client specific needs for specialised RE facilities.
  - Develop specific use, non-traditional port properties eg, distribution, to support core business.

All of which are property based

Challenge for East coast load centres post Panama Canal widening

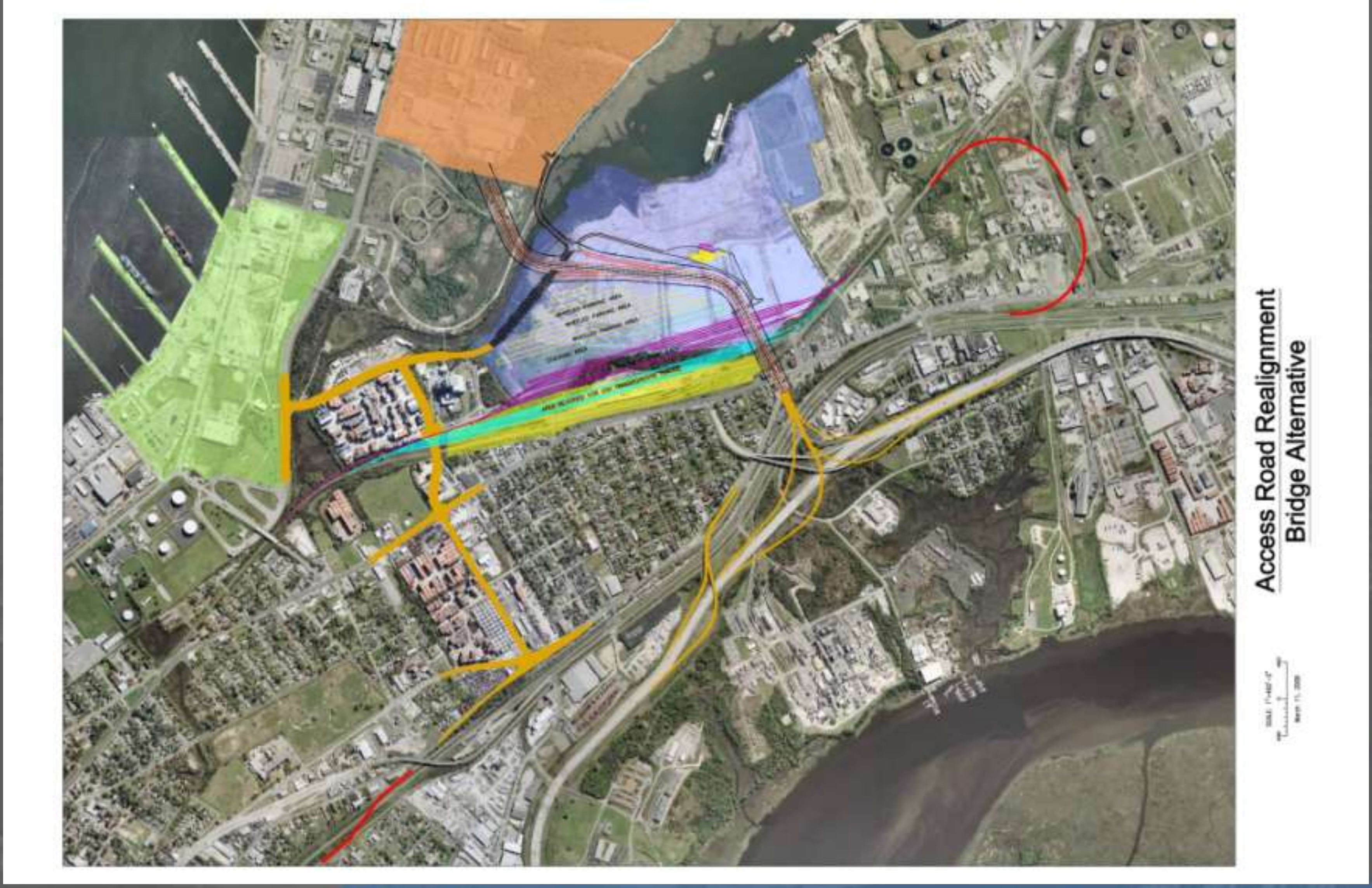
- Depth, bridge clearance and terminal capacity.
- Deep reach into the hinterlands.
- Efficiency, velocity and throughput requiring intermodal capabilities.

Port property – intermodal and value added services

- As transport costs increase (fuel, manning, etc – about US$ 50,000 to $60,000/day for an 8,000 TEU ship), local, value added service become increasingly attractive to shippers – requires land and facilities.
- Intermodal capabilities increasingly critical for viability of port transport nodes and larger ships to access hinterlands deeper.

Charleston South Carolina

Intermodal Concept Charleston South Carolina



Private sector participation in this case:

- Private sector can deliver imperative competitive advantage to a port.
- Both projects represent an investment in excess of US $600m, which will not have to come form either the port's or state's coffers or balance sheets.
- Projects will have largest positive ecological impact on the region.
- Will create the platform necessary for a viable gateway port.

Conclusion

Port Property:

a port’s largest strategic asset

'Navigating the World of Port Properties – To Maximise the Value of Ports'

Thank You

Aegir Port Property Advisers

Drewry Shipping Consultants

8 June 2010