

# Pricing Port Facilities and Services...a Paradigm Shift to a Seller's Market



October 24, 2006

# Today's Objective

*To facilitate your before lunch sugar low with a discourse on the application of the kinked oligopoly demand curve theory to emerging ports in the developing world and established gateway ports in the overdeveloped world!*

# Agenda

- Finish on Time.....
- .....And Have Some Fun
- Present the Bad News and the Good News
- What is a Paradigm?
- Pose a Few Questions
- Introduce a Few Concepts
- Facilitate a Discussion of One of the Most Important Tools Ports Have.....Pricing

# First, the Bad News

- I am the sole presenter for the next 90 minutes

# Now, the good news

- It is indeed a seller's market
- We will finish on time or early
- Eric and I are committed to making this interesting
- We hope you will participate

# What is a Paradigm?

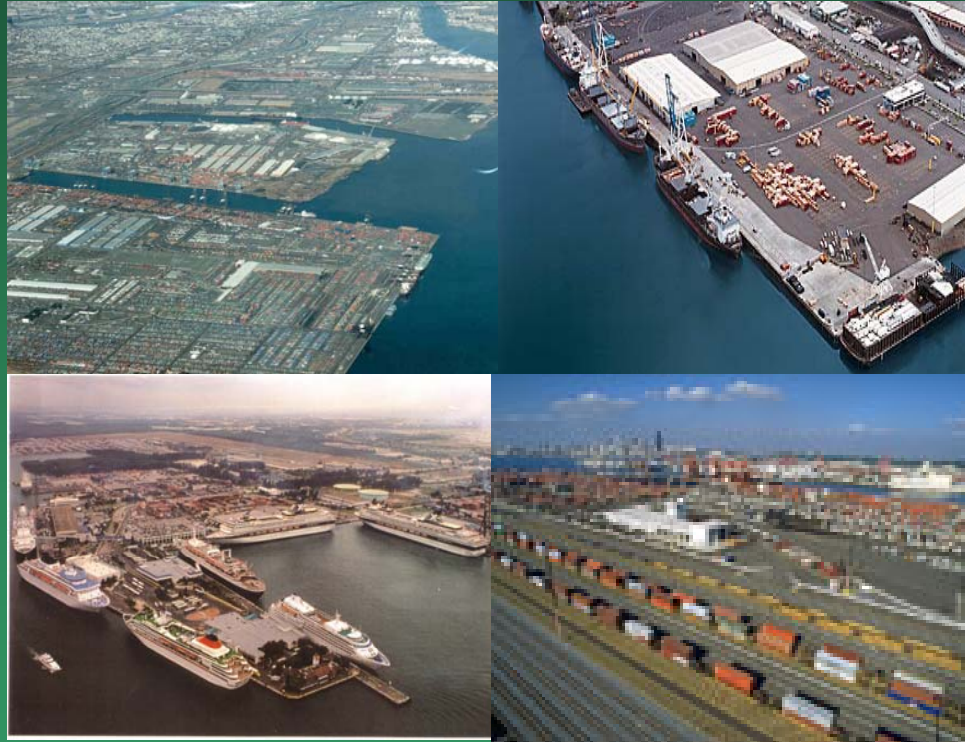


# What is a Paradigm?

- A member of the prehistoric Pterodactyl family?
- Two dimes (Brooklyneese) as in “I bet a paradimes on *Born to Win* in the 7<sup>th</sup>”.
- Webster’s Definition: ...3) a set of assumptions, concepts, values, and practices that constitutes a way of viewing reality for the community that shares them....



# The Historic Port Paradigm





# What do container customers want?

- Their own terminals
- Guaranteed berths
- Guaranteed cranes
- “Room to grow”
- Most favored nation status



# How do customers use container terminals?

- Berths: 48-60 hours per week?
- Cranes: 45-50 hours per week?
- The slots: an average of once per week?
- The rail: 2-3 times per week?
- The gates: 50 hours per week?



# What do breakbulk customers want?

- Specialized facilities
- Guaranteed berths
- Dedicated space
- “Room to grow”
- Free time
- Value added services
  - Inventory management
  - Damage repair





# How do customers use multipurpose terminals?

- Berths: 24-48 hours per week?
- The yard: multiple weeks?
- The warehouses: multiple weeks or a month at a time
- Yet the ships call every 10 days to 2 weeks

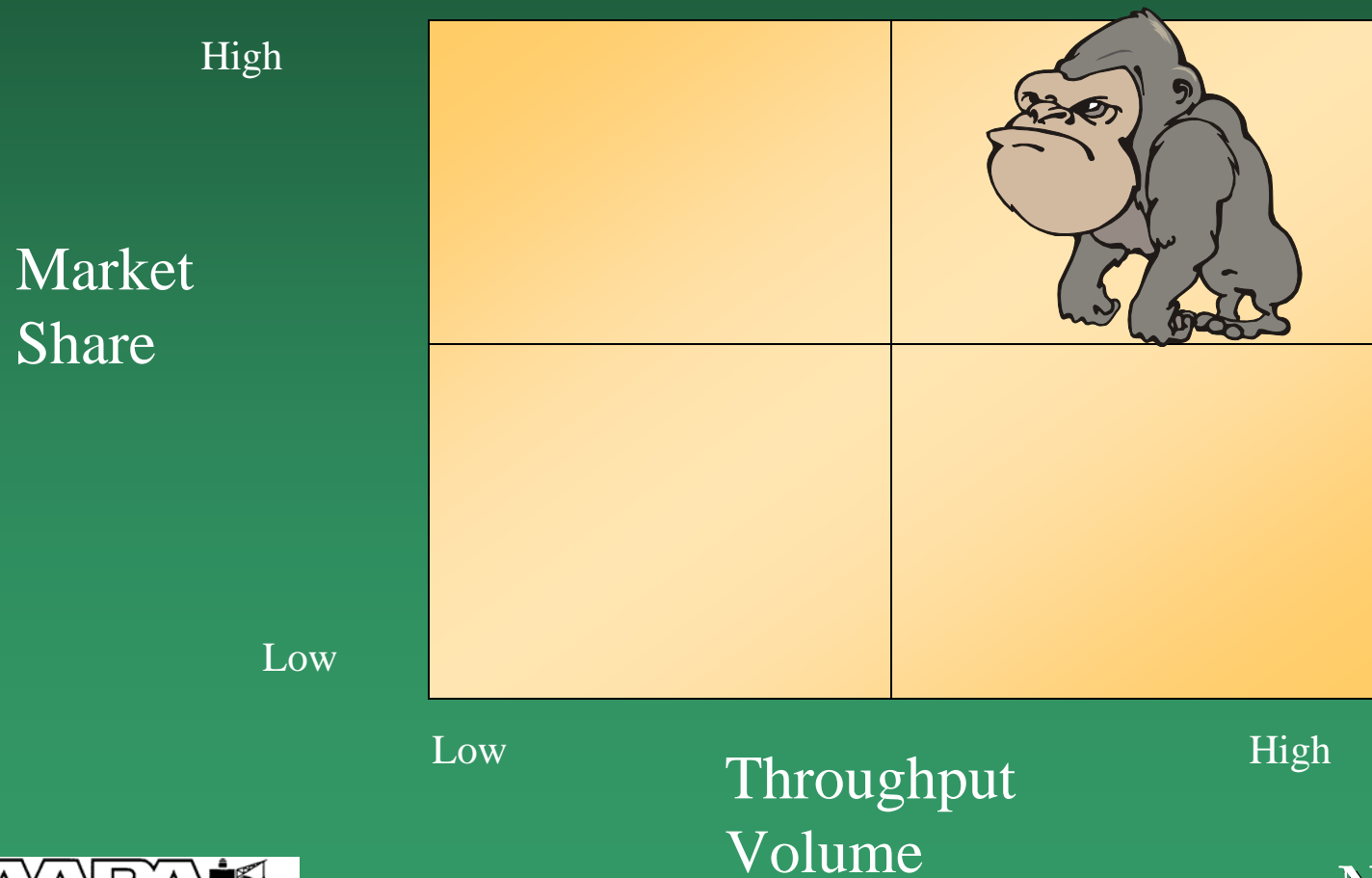


# What are customers willing to pay for

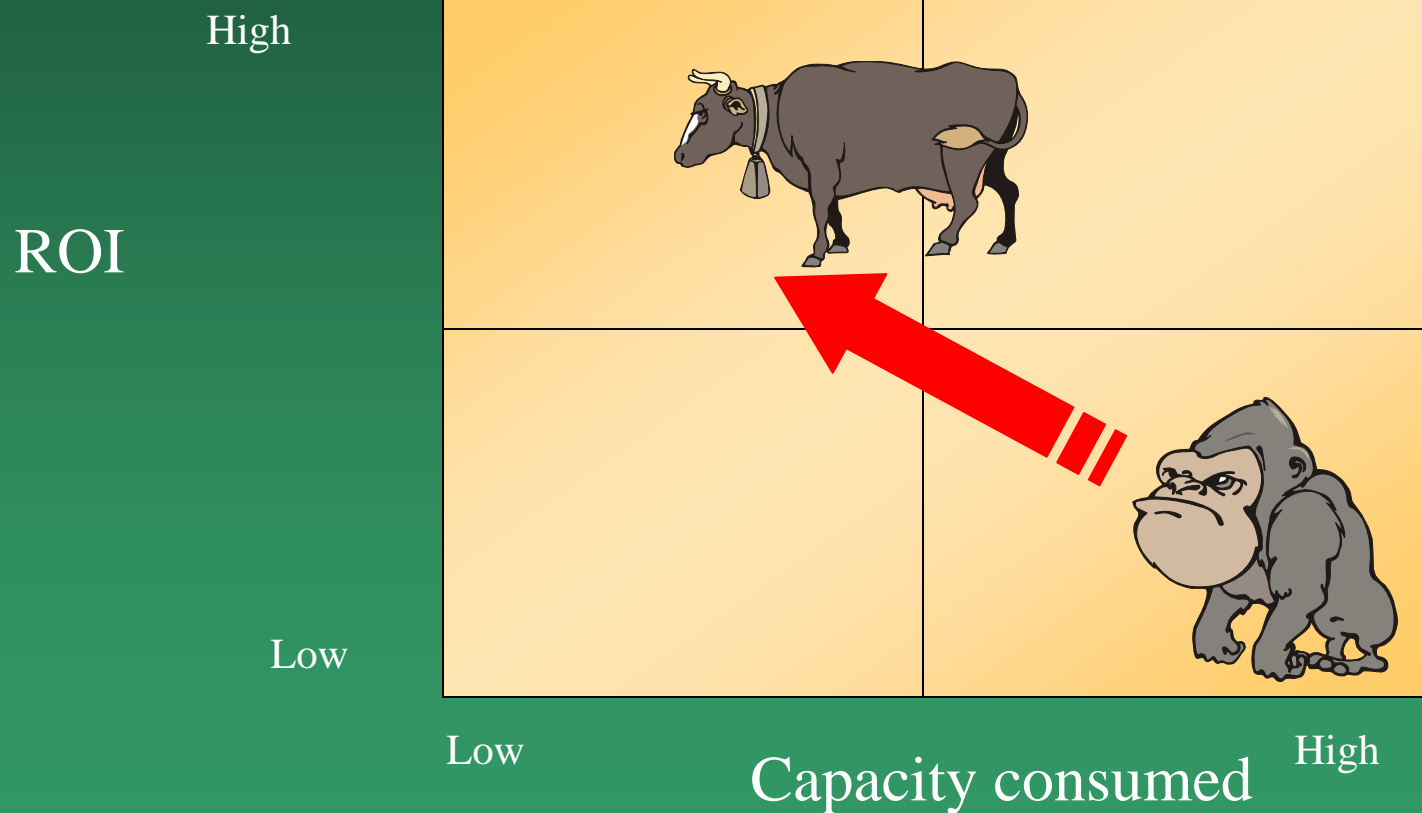
- The lowest rate...
  - In the port
  - At the other port
  - On the coast



# The “gorilla” paradox



# The gorilla paradox: Can we afford him?





# What do we mean by a seller's market?



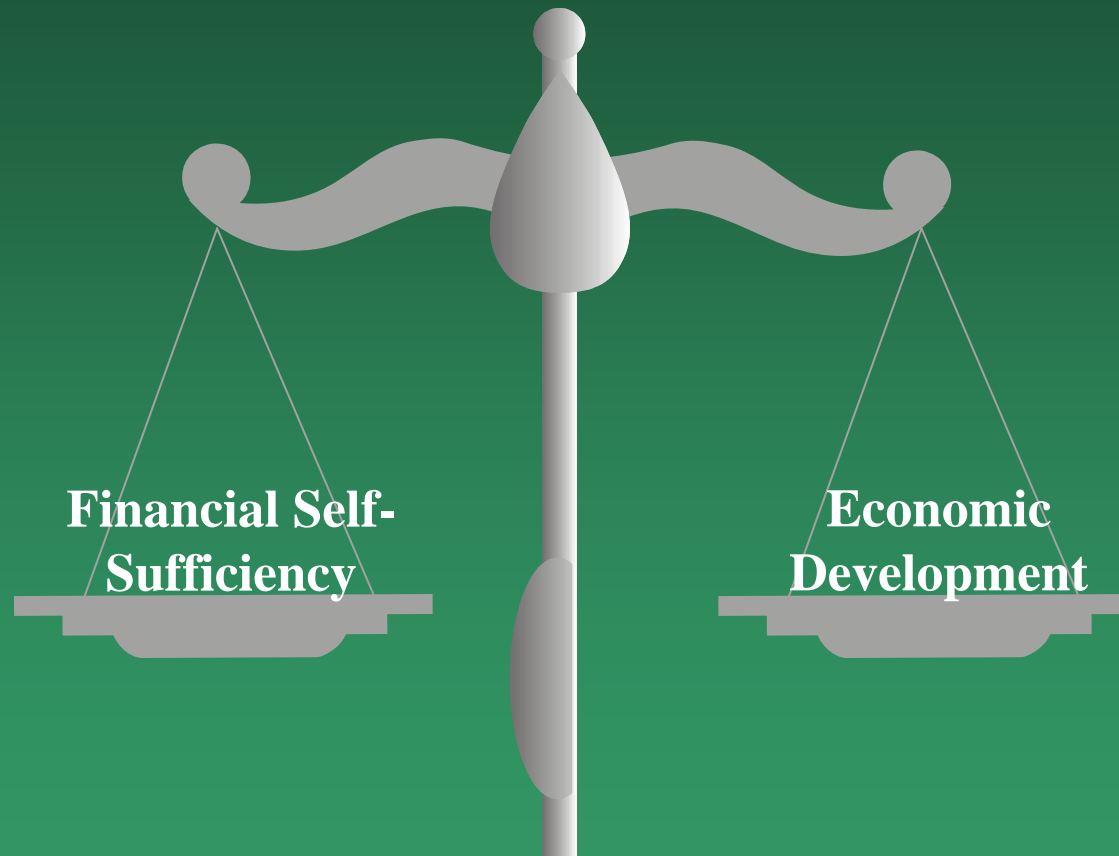
# Evidence of a Seller's Market

- P&O Ports sells for \$6.8 billion
- Financial institutions & private equity firms are investing in ports
  - Goldman Sachs consortia buys Associated British Ports for \$5.1 billion
  - Carlyle Group, Macquarie Bank, Babcock and Brown & others have reportedly been pursuing the terminal assets of OOIL, P&O Ports North America and others
- Container shipping lines are signing 10 year terminal service contracts

# Pose a Few Questions



# So What Does This Mean to the Age Old Port Dilemma?



# Questions

1. How many of your ports have DEEP POCKETS, i.e. financial resources and capital formation are not significant issues?
2. How many of your ports have a clear practical mission statement?
3. How many of your ports measure management's performance against the mission statement?
4. How many of your ports have an active strategic planning process?

# Questions

5. How many of your ports have:
- Capital investment plans driven by a strategic plan?
  - Business plans driven by strategic action plans?
  - Financial plans (not budgets) driven by strategic plans?

# Questions

6. How many lines of business do your ports have? For example: container, cruise, real estate.
7. How many of your ports measure profitability in terms of:
  - Cash flow before debt service
  - Net free cash
  - By line of business



# Questions

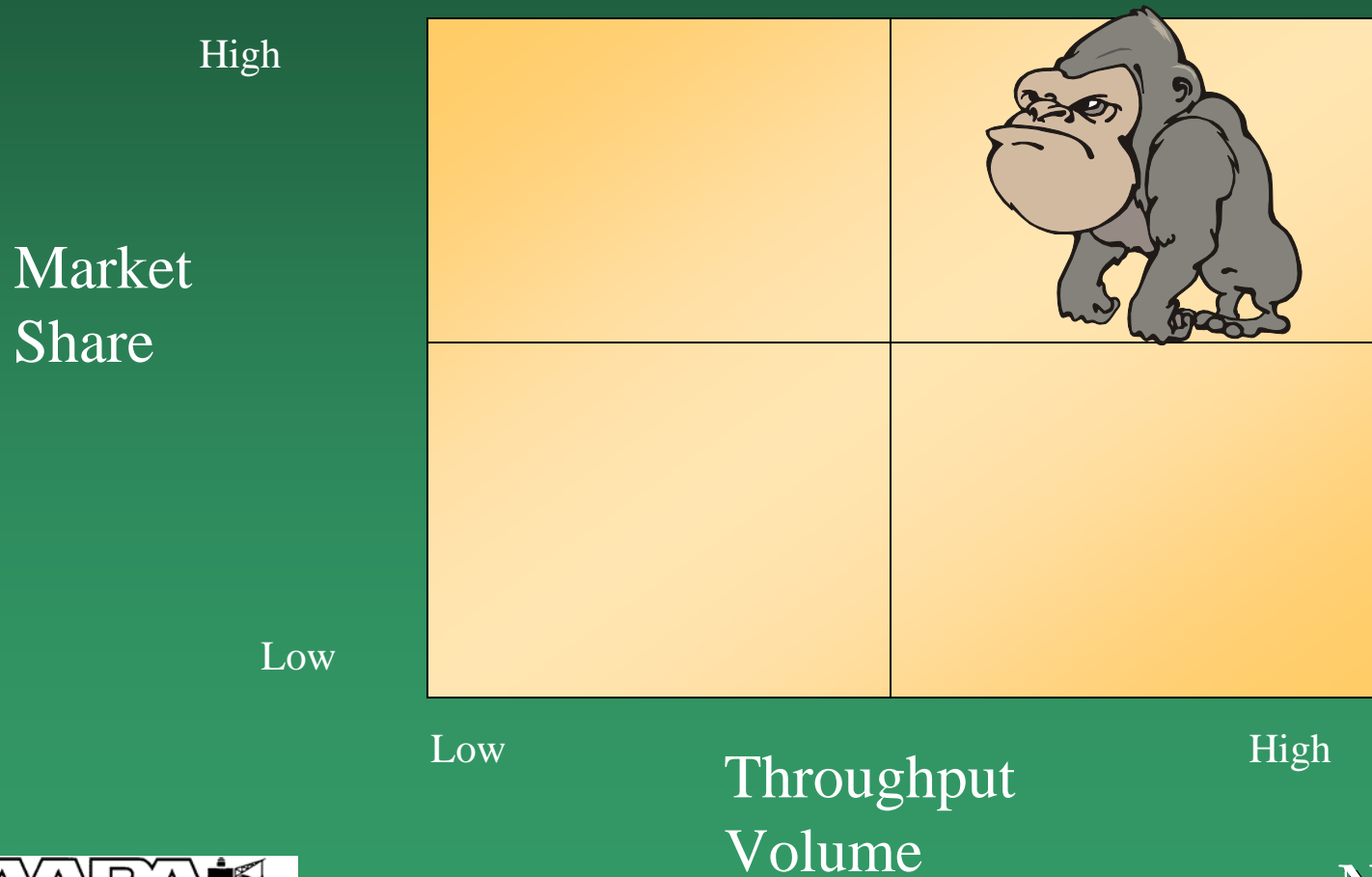
8. How many of your ports have a pricing strategy based on:
- The port's strategic and financial plans?
  - Line of business profitability?
  - Last year's performance
  - The tariff?

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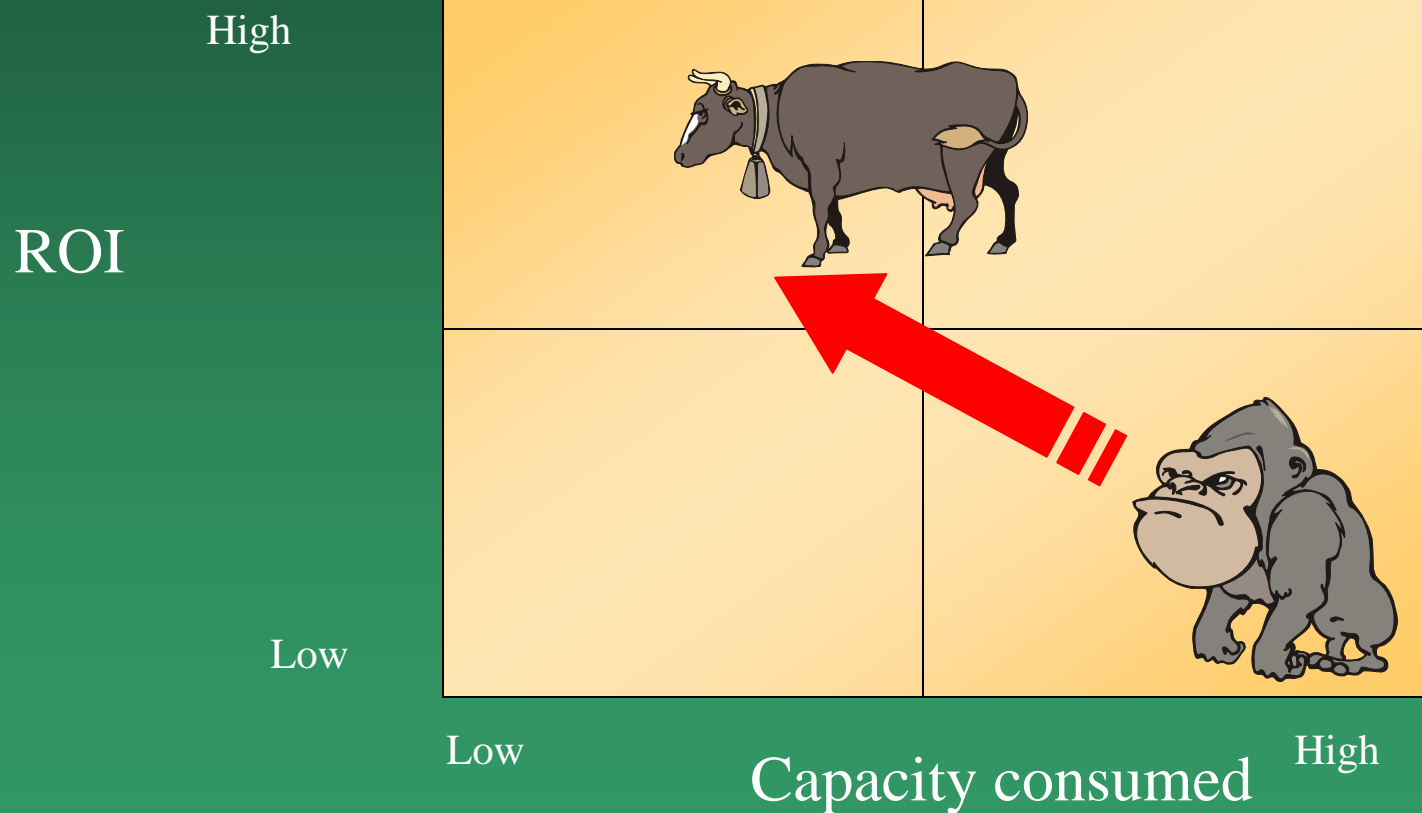
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# What Are We Selling? What Should We Be Selling?

## The Theory

- Value, i.e. market access
  - Capacity
  - Time is money
  - Reliability
  - Cost effectiveness

## The Practice

- Infrastructure & economic development
- At or below fair market value, i.e. the value the customer extracts or realizes
- At or below:
  - Full cost
  - Direct cost
  - Variable cost

# Introduce Some Concepts



**1. Profitability?**

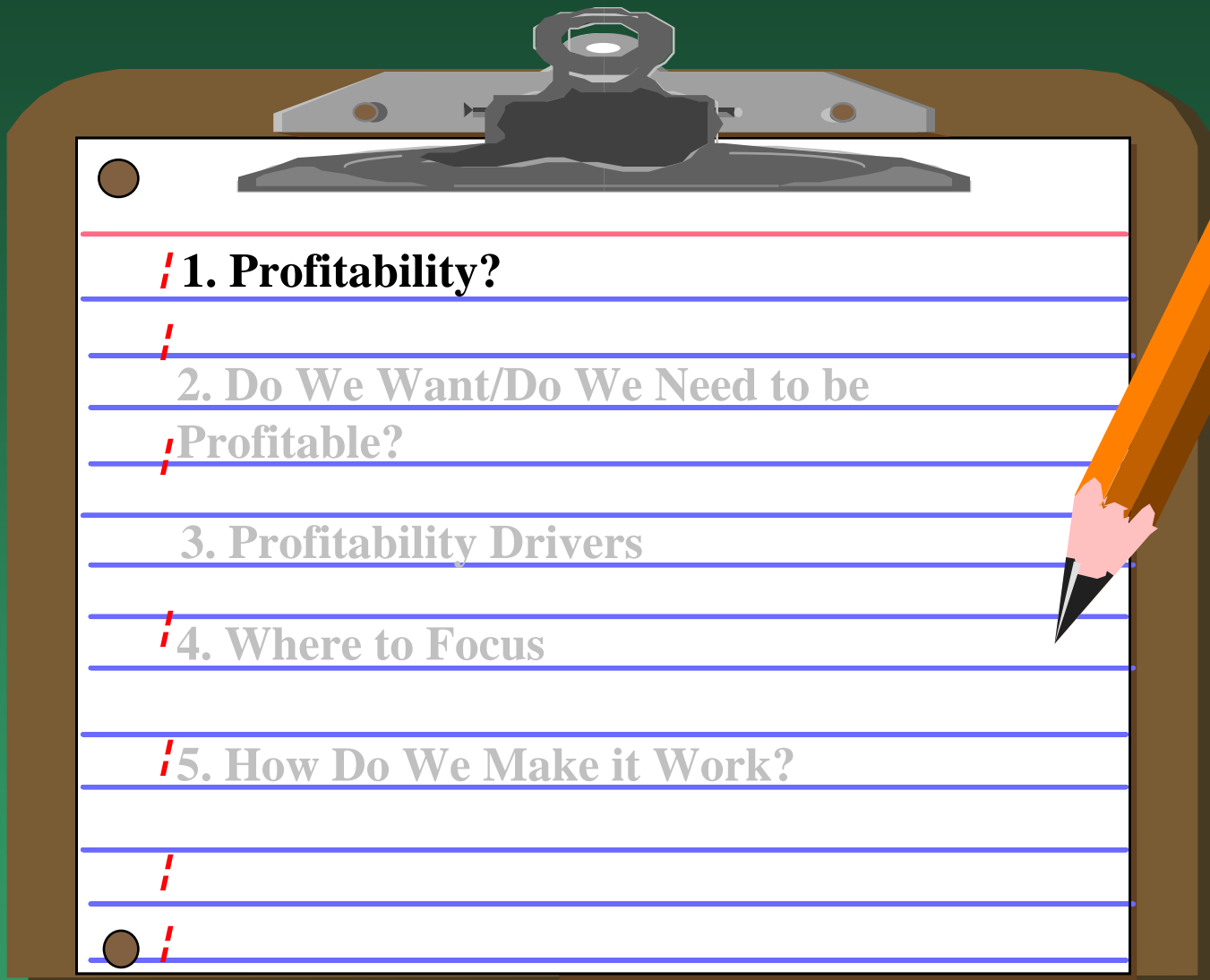
**2. Do We Want/Do We Need to be Profitable?**

**3. Profitability Drivers**

**4. Where to Focus**

**5. How Do We Make it Work?**





**! 1. Profitability?**

**! 2. Do We Want/Do We Need to be Profitable?**

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**! 5. How Do We Make it Work?**

# Profitability is not

- ✓ Market share
- ✓ Economic development as historically practiced in the industry
- ✓ Covering variable costs
- ✓ Net income

# Profitability is :Net Cash Available for Investment

Operating Income

+ Non cash charges

+ Depreciation

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Operating Cash flow

- Interest Expense & Income

- Payments in lieu of taxes

- Principal Repayments

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Net **Internal** Cash Available for Investment

+ External Funding Sources (Taxes, Grants, Gifts, etc.)

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Net Cash Available for Investment



! 1. Profitability?

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# Do We Want/Need to Be Profitable?



# Do We Want/Need to Be Profitable

## Do We Want to be Profitable

- It sounds good in today's seller's market
- It provides flexibility
  - To focus on what we think is important
  - Lessens strings attached to external financing
- It is more predictable

## Do We Need to Be Profitable?

- Legislative mandate (e.g. Canada Marine Act)
- Board policy
- Market reality: We are on our own
  - No parental support
  - Poorly positioned for grants
  - No external funding sources, e.g. taxes



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# Profitability Drivers

## Revenue Side

- Strategy
- Market fundamentals
- Customers
- Competitors
- Politics
- Regulation
- Volume

## Cost Side

- Capital investment costs
- Operating costs
- Financing costs
- Asset utilization

# What are the Real Costs?

## Infrastructure

- Dredging
- Permits & mitigation
- Planning & engineering
- Off-sites
  - Road
  - Rail
  - Utilities

## Terminal

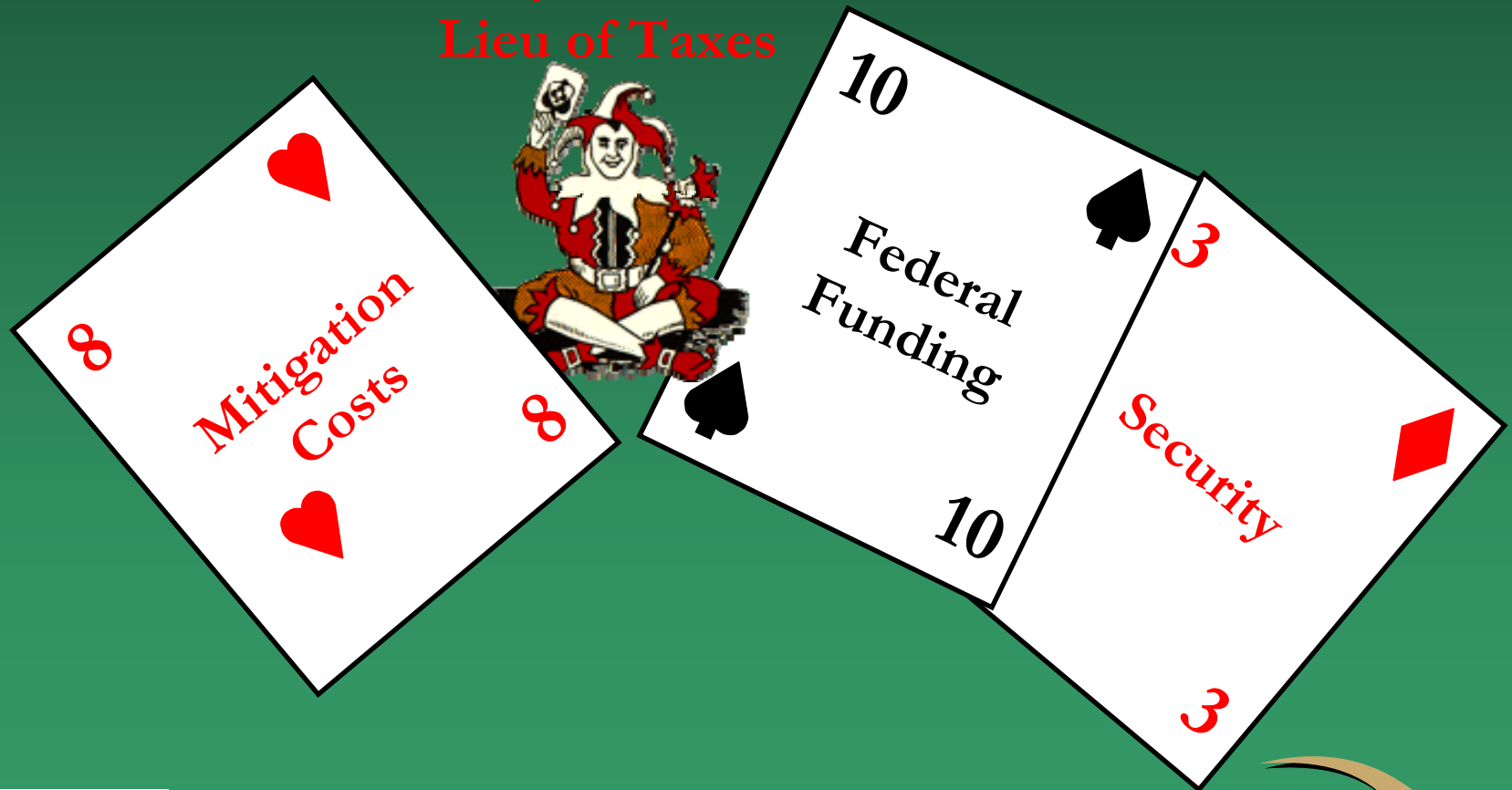
- Previous improvements
- As built costs
- Replacement Cost
- Debt service costs
- Return on investment

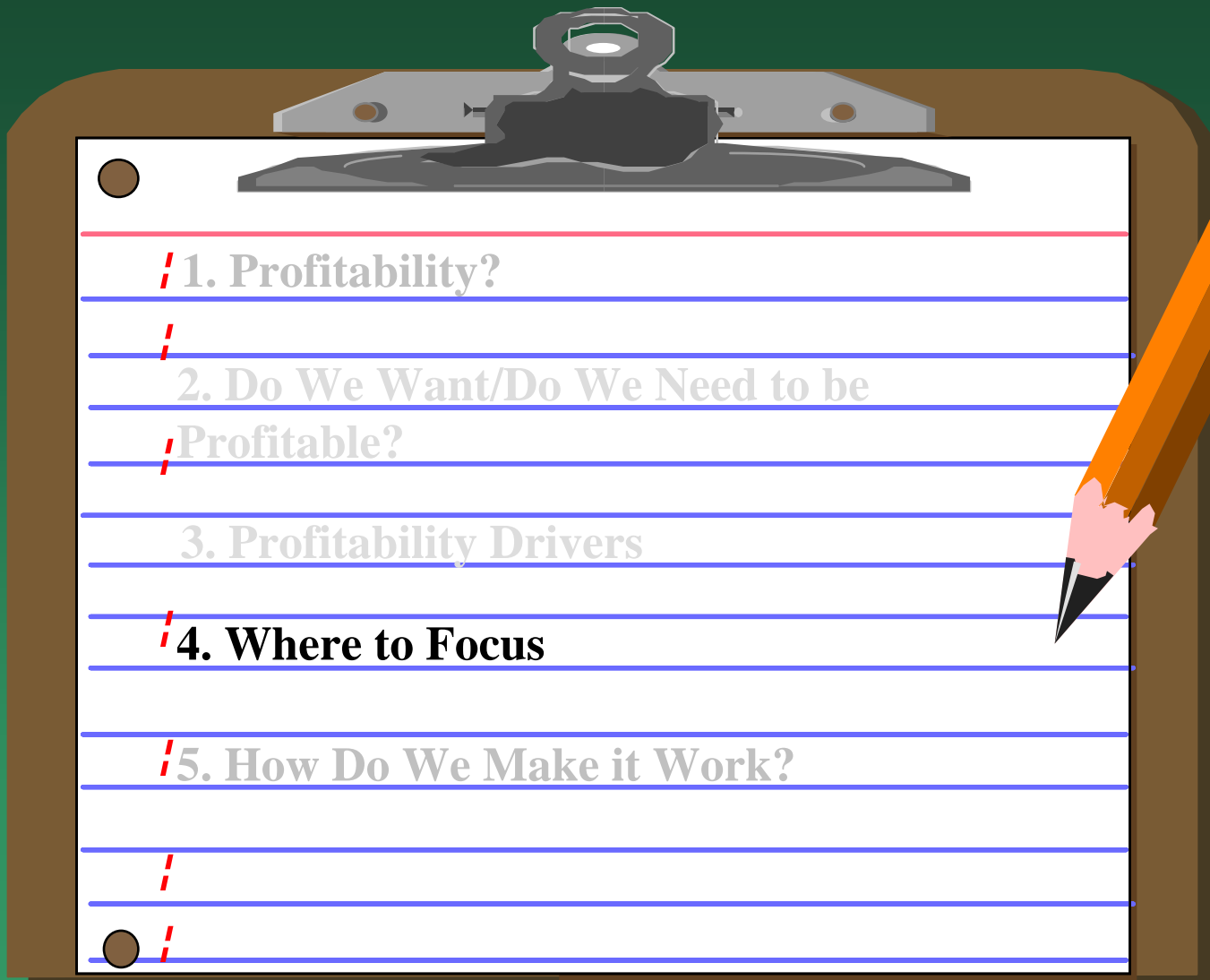
## Life Cycle Costs

- M&R
- Customer Service
- Regulatory & environmental
- Leasehold improvements
- Financial

# Some of the Wild Cards Affecting Port Profitability

Payment in  
Lieu of Taxes





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# A Systemic Approach To Pricing Requires

- ✓ Sustained commitment driven by senior management leadership and accountability
- ✓ A cross-functional team
- ✓ A good financial and management information system
- ✓ An evolutionary rather than revolutionary approach

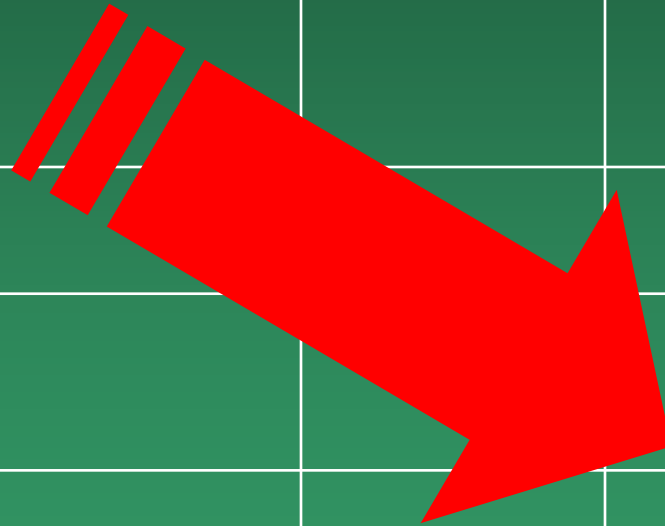
# Cross-functional team



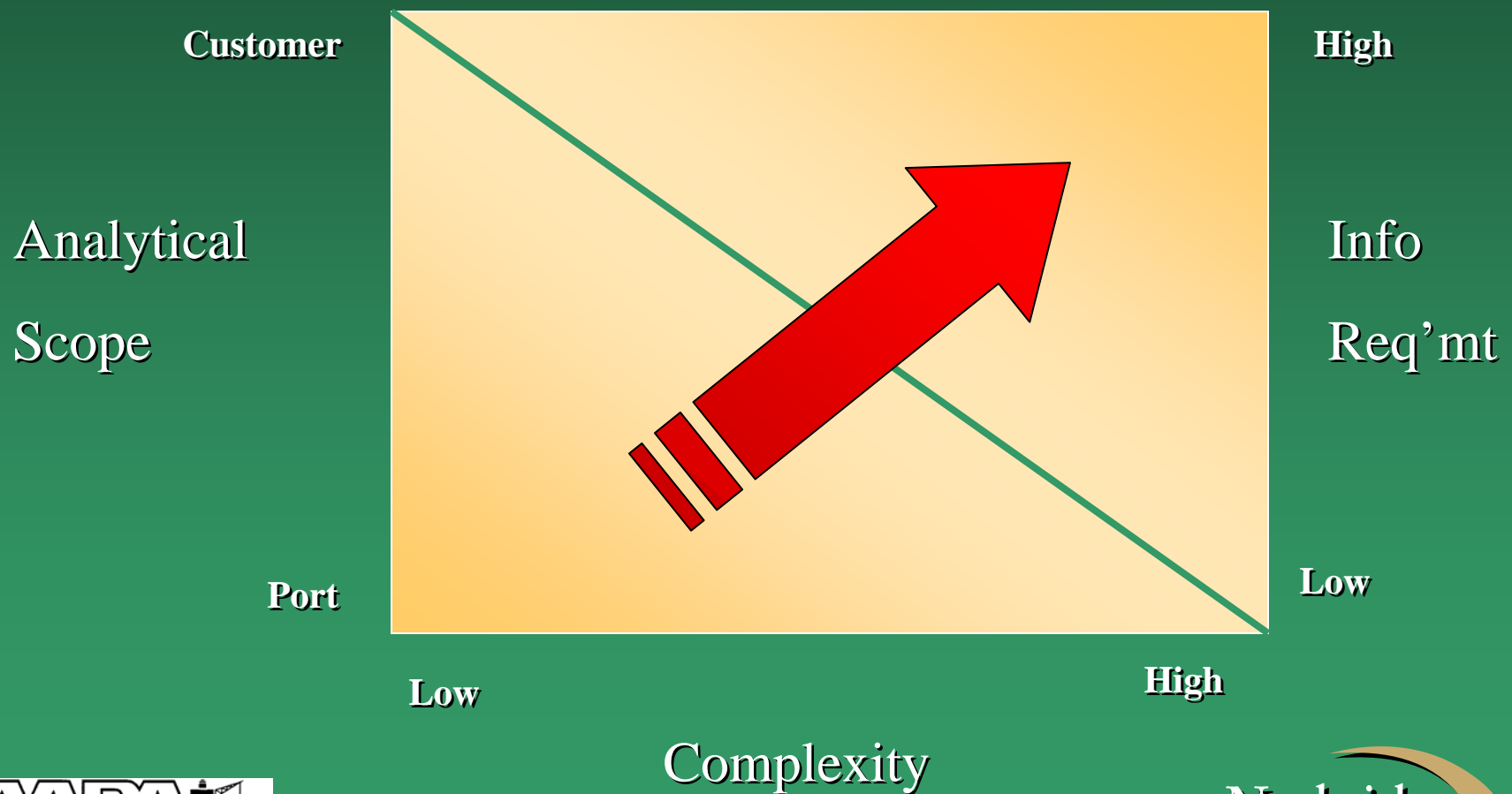
- **CEO: leadership/accountability**
- **Finance: thought leadership**
- **IT: data, implementation**
- **Marketing & Sales: market realities**
- **Operations: asset utilization**
- **Engineering: asset investment requirements**

# What are the pricing options?

	Port	Division	LOB	Terminal	Customer
Port					
Division					
LOB					
Terminal					
Customer					



# What are the options-practical vs theoretical?





# Potential Pricing Opportunities

- Terminal component
- Day of week
- Time of day
- Asset utilization with escalating floor
- Terminal/component sharing
- Operating investments vs capital investments

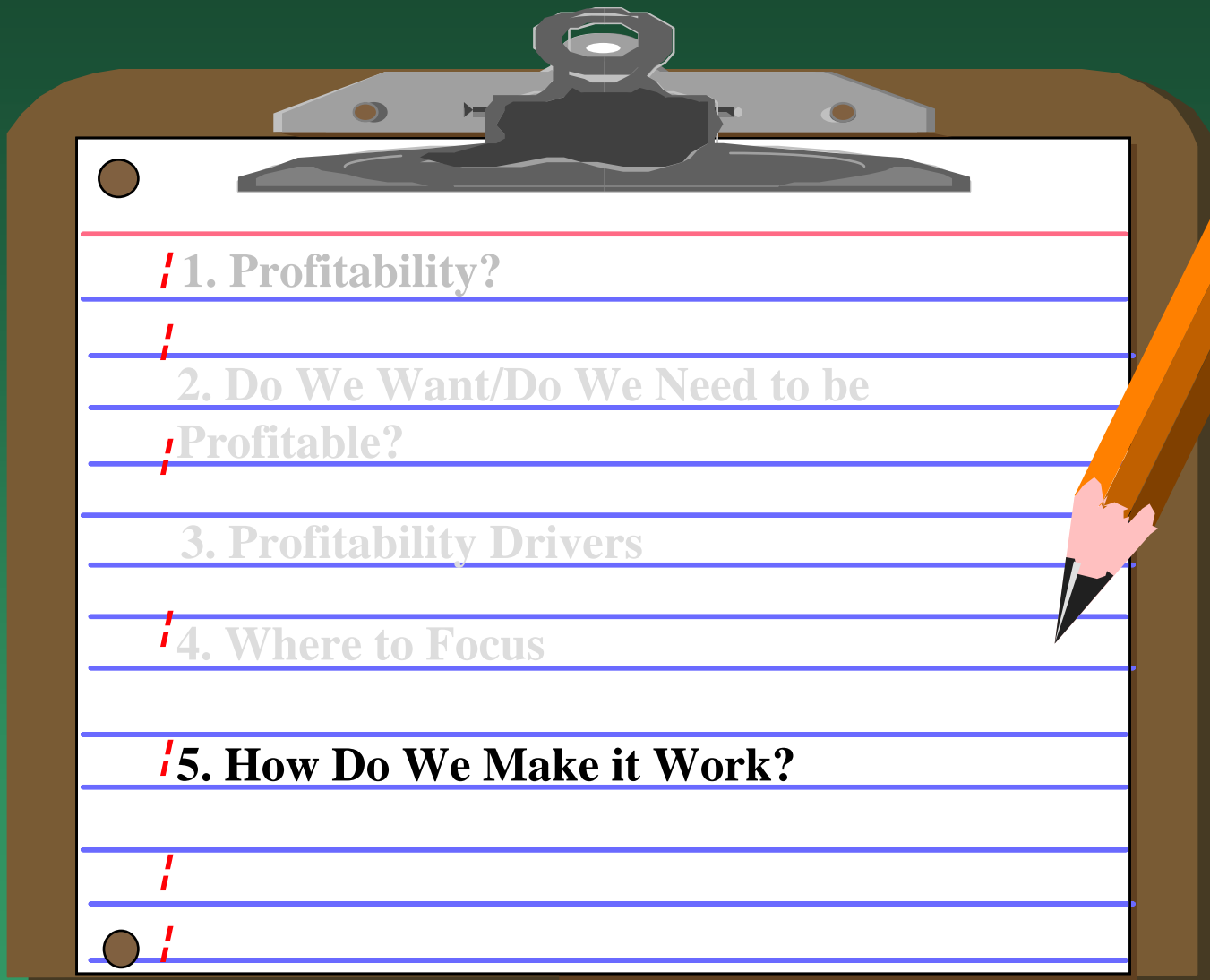
# Density + Velocity + Pricing = Long-Term Viability

- We need to consider pricing on a vertical rather than a horizontal basis
- We need to consider pricing on a time rather than a facility basis



# What are the some of the practical issues?

- Assets
  - Types: dedicated, discreet use of shared, shared
  - Values
  - Allocation basis
- Linking asset use to asset allocation
- Corporate allocations
- Information = A<sup>3</sup>
  - Availability, Accessibility, Accuracy



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# How do we make it work?

- Clear, articulated purpose
  - Strategically
  - Tactically by Line of Business
- Accountability:  
performance is rewarded  
based on the bottom line
- Consistency
- A phased-approach
  - Where are we losing the most
  - What do we control
  - What are the market  
circumstances
  - Contract renewal



# Have a contingency plan

- Can we afford to lose this customer?
- Can we afford to keep this customer?
- What do we do if we lose this business?
  - Who is the next best customer(s)?
  - What are the diversification opportunities?
  - How do we reduce costs?
  - Sale?