At The Fork In The Road

Outlook for 2012 and Beyond
AAPA Port Finance Seminar
April 18, 2012
Moffatt & Nichol Background

- ENR Top 100 company, founded in 1945 in Long Beach, California
  - Offices: US, Guam, Canada, Europe, Middle East, Latin America and the Pacific Rim
  - 500+ Employees

- M&N combines the expertise of technical and commercial specialists gained over 65 years of planning and engineering experience on over 6,000 projects:
  - Economic analyses of investment/privatization
  - Strategic development plans
  - Independent Market Consultant
  - Coastal engineering
  - Port and waterside construction (marinas)
  - Terminal design for all types of freight and passenger movement
  - Surface transportation connectivity
  - Railroads and capacity expansion
  - Environmental issues/emission modeling

American Society of Civil Engineers
John G. Moffatt – Frank E. Nichol
Harbor and Coastal Engineering Award
At The Fork In The Road

• All clear: optimism is justified but not bullishness
  • Scorecard indicates “all clear” for the US but not high growth
  • Asia will revive as the US recovers from its credit supply shock
  • Europe is in a harmless recession and will neither help nor hinder

• There is still time to change the road we’re on
  • Retiring boomers present unique challenges
  • Twin deficits: US needs to live within its means
  • Emerging markets need to become less export dependent
  • Resource constraints need to be dealt with

• The new operating environment is still emerging
  • Shorter supply chains
  • Exports
  • Near-sourcing
- Financial sector took out the housing and energy markets before collapsing
- Federal Reserve realized its Lehman error too late
Emerging Markets Have “Driven” The Global Recovery

- Emerging markets have helped but do not lead the global economic recovery
- China and India are unlikely to sustain their support since
  - 30% to 50% of their GDP is investment spending, global average is 20%
  - China’s growth is still largely dependent on exports
- Developed economies need to take the lead
The US accounts for 20% of World GDP

US consumers account for 70% of US GDP, or 14% of World GDP
Private Sector Has Led Employment Recovery

- Private sector efforts were offset by public sector cutting 500K jobs since Jan 2010
- Employment recovery so far has been weaker than in previous cycles
Investment and Exports Have Led The US Recovery

Exporting industries have led the recovery and have also been investing:

Agriculture, Energy, Automobiles and Machinery for Construction, Transportation and Agriculture
Container Volumes Weaker Than Expected in 2011

- Weak import volumes were not in line with consumer spending trends
- Container volume growth in 2011 was led by exports
The World’s Population Is Aging

- Older populations spend more on services and earn higher wages
- Manufacturers move operations to fast growing but lower income locations
• Since 1980 recovery in employment to pre-recession levels has lengthened
US Consumers Are Deleveraging

- It will take some time for the debt-to-income ratio to become sustainable
• Including oil, the goods deficit is 4.8x the services surplus, 2.8x excluding oil

• Increased import dependency is unavoidable – the US needs to export more and reduce oil consumption
• US dollar could appreciate as exports increase
US Export Candidates

- Bulk commodities and specialized capital goods (project cargo) fit the profile of US comparative advantages

- Relative to faster growing Emerging Markets, the US has
  - A lower cost of capital, but a higher cost of labor
  - Relative abundance of scarce resources such as water
  - More advanced biotechnology
  - More reliable quality control and surveillance of compliance

- Strong Emerging Market demand for bulk is expected to continue as these economies continue to grow and migrate from rural areas to industrializing urban areas
  - Grains and oilseeds
  - Meat
  - Biofuels – wood pellets
  - Gas and Coal

- Strong bulk demand also means strong demand for capital equipment – energy, construction, agricultural

- US has to develop infrastructure to compete in the global market place
  - Highway Trust Fund is insolvent and Transportation Re-auth is overdue
Robust Emerging Market Demand for Resources

• Since the middle of the last decade commodity prices have soared

• Not just speculation but supply-demand balance and infrastructure
• Lack of investment in inland waterway infrastructure is a significant bottleneck
Lack of investment in inland waterway infrastructure is a significant bottleneck.
• US has the highest rate of agricultural productivity in the world
• Nations with fastest growing consumption have lowest productivity
# Shares and Containerization of US Grain Exports

## Shares of US Grain Exports

<table>
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<tr>
<th>Port</th>
<th>2003</th>
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## Containerization of Grain Exports By Port

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<th>Port</th>
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<th>2004</th>
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<tr>
<td>Total All Ports</td>
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<td>Columbia-snake</td>
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<tr>
<td>Los Angeles, CA</td>
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<td>New Orleans, LA</td>
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<td>Norfolk, VA</td>
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<td>San Francisco, CA</td>
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<td>Seattle, WA</td>
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• Since 1993 the growth in oil consumption has come from Developing Economies
• Since 2008 Emerging Markets consume more oil than Developed Economies
Shifts in Offshoring: Mexico may get some more

Talk of shifts in offshoring locations have multiple risk drivers:

- **Demand**: Uncertain consumer demand outlook
- **Credit**: Tight credit conditions for OEMs & suppliers
- **Labor**: Costs & discontent in offshore locations
- **FX**: Currency fluctuations less predictable and increase hedging costs
- **IP**: Difficulty in enforcing IP protection
- **Quality**: Some manufacturers have experienced “quality fade” with offshore production resulting in recalls and lawsuits

**Mitigation steps:**

- **Shorten the supply chain**: Use of near-sourcing options may reduce working capital requirements (cash) and offset labor cost differentials

While most key border crossing volumes have been stable, the Laredo crossing has experienced double-digit growth since mid-2009.

### Loaded container movements at US border crossings

Since June 2009, average growth: 19.6%

Loaded truck containers per month

Source: US Bureau of Transportation Statistics, Moffatt & Nichol Analysis
Retailers Are Maintaining Lower Inventory Levels

- Wholesale inventories are now back in line with pre-2008 levels
- Retail inventories are much lower than before 2008
Imported Containers And Retail Sales Disconnected

• Based on retail sales, peak season container imports should have been higher
• US domestic production is unlikely to have filled the gap… Mexico?

What were importers afraid of?
Low wages in emerging markets are partly due to their younger populations.

Outsourcing services maturing markets more cheaply and accesses growing markets.

Low wages in Latin America indicate they are prime locations for manufacturing “near-sourcing”.

Source: UN-ILO, Business Monitor, Moffatt & Nichol
- KCSM/KCS benefits from near-sourcing growth
- Lazaro Cardenas has direct rail access to the KCS/KCSM rail system
- Direct rail access to the Southeast and Midwest US is also possible with a border crossing at Laredo, Texas
Mexican Pacific Coast Ports’ Volumes and Growth Rates

- Ensenada: 143,660 TEU, CAGR 2000-2010 18%
- Mazatlan: 21,730 TEU, CAGR 2000-2010 3%
- Manzanillo: CAGR 2000-2010 13%
- Lazaro Cardenas: CAGR 2000-2010 2%
- Veracruz: 662,537 TEU, CAGR 2000-2010 2%
- Salina Cruz: 5,434 TEU, CAGR 2000-2010 100%
- Mexican Pacific Coast Ports’ Volumes and Growth Rates

- Veracruz: 796,011 TEU, CAGR 2000-2010 0%
- Manzanillo: 662,537 TEU, CAGR 2000-2010 2%
- Salina Cruz: 5,434 TEU, CAGR 2000-2010 100%
- Veracruz: 796,011 TEU, CAGR 2000-2010 0%

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Summary

• Positive near term trends with US leading global recovery
• Inflation driven by rising costs and demand is a medium term risk
• Structure of global supply chains is changing
  • It is hard to succeed by looking backwards

Thank you for your attention
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