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Trends affecting the port sector – opportunities and risks
Speech by Clemence Cheng
Managing Director, HPH Central Europe

Ladies and gentlemen,

The annual ESPO conference is now firmly established as the pre-eminent port policy event in Europe. It is a great honour to be asked to address the conference and I would like to thank the Chairman and Secretariat for inviting me to speak to you today.

When considering the topic of this session; Trends Affecting the Port Sector – Opportunities and Risks, we need to do so in the light of recent developments in European ports policy as well as the current state of the economy.

The problems that have beset the global economy in recent years have had fundamental and wide-reaching implications for the ports sector. The recent worldwide recession, and the subsequent period of austerity in which many European countries find themselves, has an obvious impact on the ability, and willingness, of the public sector in some countries to fund port developments.

Government budgets are tight everywhere. However, across the globe, we are seeing very different growth rates in different economies and it may be that the challenge of attracting investment will be greatest in the more mature economies where future growth is likely to be slower.

Whereas the developed economies, such as those of North America, Europe and Japan are currently growing, if at all, at not more than 2%, the emerging economies of Asia, Latin America and Russia are growing at between 4 to 8% annually.

The Euro zone is expected to go into a mild recession in 2012 and more severely in the crisis-hit economies of Greece, Italy, Spain and Portugal. Notwithstanding some positive news recently, downside risk remains high with forecasts typically being revised downward in the face of delays in structural reforms and in financial and fiscal integration.

Another impact upon the financing of ports has been the very high prices that have been paid to acquire port companies by some investors. In recent years we have seen investors such as pension funds or international infrastructure funds seeking secure, if not necessarily sensational, future cash flows. Infrastructure assets, including ports, have been seen as very attractive in this regard.

This has had the effect of driving up the cost of port assets, which, from the seller's perspective, may be an attractive proposition, but one that may come with some hidden costs and consequences for the industry and broader society.

Take Australia's Patrick Corporation as an example. In 2006, it was acquired by Asciano, at 19 times EBITDA multiple. Other than those synergies which were thought would be created, the most obvious consequences that one can see is that almost 1 billion Australian Dollar write-down in its carrying value in subsequent years, and the group's operating profit being eliminated by huge funding costs.

At the time this deal broke the record for port assets valuation. However, new records came one after the other. Also in 2006, Ontario

Teachers' Pension Fund acquired Oriental Overseas' North America terminals at 24 times EBITDA multiple and in 2007, Deutsche Bank acquired Maher Terminal in New York at 19 times EBITDA multiple. There were a few recent acquisitions in Europe that were transacted at similar mouth-watering level.

Bearing in mind that most of these acquisition targets were mature assets in stable economy with less volume growth potential, such high multiples mean investors will need a relatively long period to achieve payback on their investments.

High acquisition prices usually result in satisfied sellers and investment bankers. However, they also result in high interest expenses for the acquisition financing and greater likelihood of subsequent write-downs, even if not as severe as in Asciano's case. Another consequence of such high transaction prices is that investors' resources for further investment, which is crucial to the continuing success of the terminals, will most likely be reduced. This may mean that new owners are not able to operate ports in the most effective manner and with the latest technology.

We have also seen a few investors with little or no port experience enter the market, pay top price for assets, discover belatedly that they have over-paid, and then disappear again, in pretty short order. For me, this is pretty strong evidence that some recent pricing of port assets has been unrealistic and that the overpricing does not work in the interest of investors or the industry itself.

Let me now focus on the investor requirements. I know that the current port policy debate is the subject for tomorrow's sessions but the outcome of this debate is relevant when considering the financial aspects of European seaports.

The bottom line for investors is … **THE BOTTOM LINE**, and policy issues can have a real impact upon the ability of investors to achieve the bottom line that makes a return on their investments - a key measure of whether an investment has been successful, or not, to a private investor.

Investors like a stable and predictable regulatory environment. This is especially true in ports where investments are made in assets that cannot be easily be picked up and transferred to another jurisdiction.

We hear a lot about port operational efficiency, or labour efficiency in ports, but it is just as important to the future health of European ports that we have an industry that also benefits from a high degree of capital efficiency.

If capital doesn't work hard and give investors the returns they need, the industry will not attract the investment it requires; and if the industry cannot attract investment then the consequences for the European economy are, potentially, very serious.

The European Commission has an obvious role to play in providing a regulatory regime that removes impediments to investment. And that means, generally, removing the bureaucratic burden, not adding to it. The European Commission should not concern itself with the minutia of port operations. That should be left to the experts – many of whom are in this room. The regulators should limit their involvement to the bigger picture and the creation of a market free from internal distortions – the fabled level-playing field.

Since the last proposed Ports Package, the Commission has adopted a 'soft-law' approach to ports. Despite a global economic recession and the Euro-zone crisis, European ports are working well. And if something works, it is best to leave it alone.

There has been much debate within ESPO, as well as elsewhere within our industry, about the recently published proposal for a horizontal directive on service concessions. Without pre-empting the debate on whether or not all terminal concession contracts should be covered by this directive, it is however, welcoming to note that the Commission has taken this message of stability and predictability on board.

It is quite right that the Commission has stated that the Directive will not be retrospective, and that it will not seek to unravel or modify concessions entered into by two parties in good faith. To have done so would seriously undermine the attractiveness of Europe as a good place to invest.

The issue of prolongation, however, remains. If European ports are to remain as efficient as they are currently – [and they are for the most part very efficient, I sometimes think that, as an industry, we are a little shy about making this point] - they need constant reinvestment. A concession regime that does not allow concession holders the opportunity of knowing that they have rights of renewal, under certain conditions, will starve the industry of investment, and damage the ability of European ports to compete in a global market.

I also hope we will soon see some progress with the state aid dossier. I know this has been the subject of debate for many years but if the European port industry is to be as effective as possible, the importance of clarifying what is and what isn't state aid becomes even more important.

Public port authorities invest in new facilities for a variety of reasons, and the ways in which state aid is given can, of course, take a multitude of forms. The incentive for the private sector to invest in ports is really very simple; it is the prospect of making a return on its capital.

The primary objective for public sector investment may not necessarily be to make a financial return, but may be to help generate local economic activity, to create jobs, or to secure some competitive advantage for local firms over their competitors elsewhere. In a competitive industry, any of these incentives will have implications for the financing of ports within the same market. Once again, these implications are likely to be heightened in a time of austerity and restricted growth.

Ports do not, in themselves, generate demand for their services. They deal with a derived demand driven by the health of the economy in their hinterland. Using subsidies to encourage investment in a location in which the market is not willing to invest will positively discourage, and possibly prevent, the market from investing in other, more attractive locations. The consequence can be that ports for which there is little demand get built, but those for which there is demand don't. This is not efficient.

In the current climate, one has to question the wisdom of public port authorities pressing ahead, or subsidising, large capacity expansions when it is highly unlikely there will be the near-term demand for the facilities being created. This is happening today, and not just in Europe. Some European port authorities are even investing public money overseas – how can that be right.

Some of this may be beyond the jurisdiction of the European courts, but I cannot see how investments made by the public sector that would not be financed by the private sector could be considered to be anything but state aid. I also don't buy the argument that terminal facilities funded at least in part from the public purse, may have been subject to public tender and that, therefore, there is no question of state aid. Excess capacity driven by port authority ambitions for league table purposes is never a good reason for investing public money.

I recently heard a public port authority justify its plan to create more capacity by arguing that at x% utilisation the existing private terminal operator in the port could break even. I believe that port authority is missing the point. Firstly, an investment that only breaks even without making a reasonable return is unacceptable to a private investor. More importantly, while a private operator can accept the commercial risk of running a terminal with volume fluctuation due to market forces, it cannot accept a structural change in the market brought on by a public sector authority.

I hope DG COMP will get to grip with these issues very soon.

Port investment subsidised by state aids has wide implications. If a particular country decides to invest huge public money to create capacity on, at best, speculative ventures, this will impede the ability of other neighbouring or competing countries to raise funds for their own ports. This will be exacerbated if the neighbouring countries rely upon private sector funding for investment or if their debt burden means that they simply don't have the public money to compete with the same levels of expenditure.

This raises the possibility of a two-track Europe, with those that can afford it creating surplus capacity that undermines investment in those that cannot, but need it.

Some might say that we already have a two-speed Europe imposed by a number of barriers that prevent all ports (both North and South) from competing in the larger European market. These include infrastructure, bureaucracy and market inefficiencies. All of these problems need to be resolved in a co-ordinated way if the European transport network is to work efficiently.

For example, there is a lack of integration of operations in the European rail network that serves some ports in the South. This needs to be addressed. The TEN-T network is helping in this regard – and I support the call from ESPO to ring-fence the 32 billion euros budget for Connecting Europe, and for policy-makers to recognise the vital role that rail infrastructure plays in ensuring growth in the EU. But there is no point spending billions of euros on rail infrastructure if varying customs procedures exist across Europe or difficulties in accessing publicly owned track in competition with the national operator mean the infrastructure cannot be used effectively.

This is not an argument for 'positive discrimination', far from it. But there needs to be a level playing field by bringing the infrastructure, procedures and market structures in the South to the same level as the North. That will then allow the Southern ports to integrate within the European market and compete on equal terms.

It is important that these issues are tackled because we currently find ourselves in a very challenging economic environment, and one thing I do see happening in future years, as a result, is the greater involvement of the private sector in European ports.

Many European countries are suffering with public debt issues, and in these circumstances pouring ever greater levels of public money into ports may not be tenable. It may be that some governments will look at their ports and, much like the UK has already done, seek to privatise assets as a way of raising capital for other priorities.

However, we need to remember that we do not exist in a bubble. Apart from competing with higher growth developing economies for fund, as an industry, we are also competing with other sectors for investment. Global investors can, and will, compare the returns they can get from investments in ports with investments in other forms of infrastructure such as water, gas, and power generation or distribution.

When listed utility companies in Europe are generating around 9% earnings yield with steady growth prospects, sensible investors will soon move away from port investments if we can only offer them 4-5% yield based on current assets pricing.

To conclude, if the future of the European port industry is to rely to a greater extent on the private sector – and that seems reasonable in the current climate – then conditions in the industry need to be set that will induce private sector involvement.

In setting the conditions to encourage investment in European ports to ensure the port sector is capable of meeting the growth in demand forecast for the coming years, what we need is less bureaucracy, not more, and the creation of a stable and predictable investment climate. For that we need clarity on what constitutes state aid in our sector, a resolution to the problem of the prolongation of concessions and a regulatory regime that delivers an open market free of unnecessary or restrictive barriers to entry. Once this level playing field is created across the European member states it will allow investors the security and stability they need to make a return on their investments and invest in our ports.

Thank you very much.