Containerisation International

Selling the family silver

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The real winners in the recent sales of North American container businesses have been the families and corporations that formerly owned these facilities.

The ports in which these businesses reside and the new owners of these businesses, however, have created for themselves the challenge of how to achieve acceptable returns on their investments and remain competitive in a highly contestable market which provides a multitude of routing options for container shipping lines and their customers.

By way of example, the Ontario Teacher's Pension Plan (OTPP) reportedly paid USD2.35 billion for one Canadian and two US terminal operating companies (about 24 times their 2006 earnings before interest, taxes, depreciation and amortisation – EBITDA) for net corporate assets of about USD200 million.

However, the combined businesses have a limited ability to achieve higher traffic volumes without first making major capital investments in new technology to increase the density of and automate the handling activities at each of the terminals.

In the case of the Vancouver terminals, such a step would require OTPP to replace a significant portion of the existing container-handling assets and take on the challenge of introducing automation in an environment monopolised by the International Longshore and Warehouse Union (ILWU), one of the strongest and most assertive waterfront unions in the world, especially when it comes to protecting jobs.

To achieve acceptable returns on their investments, they must also aggressively adopt significant cost reduction strategies that involve the use of automation technology, in order to improve performance and increase throughput capacity. In addition, considerable thought will have to be given to a future pricing strategy.

Moreover, the competitive environment in which the Vancouver facilities operate has changed with the recent opening of Prince Rupert's Fairview Container Terminal, which has been developed largely by public funds.

In Vancouver itself, a second terminal is expected to come on stream on Roberts Bank (Delta Port) by 2015. This will be entirely financed by the private sector.

Consequently, existing Vancouver container terminal operators are faced with the risk that their current customer base and container volumes could be diluted by the entry of these new entities.

Another competitive challenge that is likely to impact ports up and down North America's Pacific coastline is a larger Panama Canal. Principally, this is because all of these ports do to some extent rely on discretionary cargo earmarked for/originating from points closer to the eastern seaboard of the continent.

The new Panama Canal lock gates will permit the transit of 12,000TEU container ships with draughts of 15m, beams of 49m and lengths of 366m. It has led to US Gulf and east coast ports, such as Mobile and Jacksonville, to develop new generation container terminals.

Of greater significance, though, is the fact that in several cases such developments are being undertaken with ocean carriers as shareholders. In the case of Jacksonville, Tokyo-based Mitsui OSK Lines is involved (South Korea) with Hanjin Shipping Co signed up for another project in the port. Moreover already, APM Terminals – a member of the AP Moller Maersk Group - has opened a semi-automated container terminal at Portsmouth, Virginia.

While for the moment the bloom is off the US container trade due to the economic downturn, Seaport still expects average annualised growth rates of about 6% for another decade. This assumes that softness in the US housing market and the related inter-bank illiquidity crisis really does not lead to the US entering a Japan-style slump that lasts for many years.

Whereas over the last couple of decades containers handled via west coast gateways grew more rapidly than that of the Gulf and east coast ports, the 'new Panama canal' will probably lead to a more equal distribution of traffic. That will result in smaller cargo growth on the west coast, including Vancouver.

All of the above factors add to the conundrum of an owner that has purchased Vancouver port assets at inflated prices.

Indeed, if the new owners retain the manual handling systems and modus operandi presently in use at the existing Vancouver terminals, it is highly unlikely that they will be able to organise their business to accommodate future volumes. There is also a greater chance that they will become uncompetitive. This stems from the following:

- Skyrocketing development costs combined with stringent permitting requirements for any new terminal, such as T2 at Robert Banks. This will require the developer to utilise a high level of automation technology.

- Automation technology largely functions using electrically-operated rail mounted yard cranes which reduce emissions. They also enable containers to be stacked significantly more densely to minimise land requirements and the impact of the port on local habitat.

- An automated terminal requires less labour to perform container-handling activities, which translates into a lower overall operating cost.

Seaport's preliminary estimate of labour savings from utilising automated stacking cranes in the container yard, in association with manually-operated shuttle straddle carriers to perform ship and on-dock intermodal yard transfer activities, plus the adoption of automation technology for the gate, is in the order of USD50 to USD60 per container.

Whether the new owners act now or later to re-engineer their businesses to compete with new and automated terminals, the deployment of automation technology by the existing terminals is no longer just a desirable option. It is a prerequisite to enable them to compete and prosper.

The OTPP is not alone in this dilemma. The scenario applies to the other financial institutions that have paid dearly for stakes in North America's container port businesses.

These include RREEF Alternative Investments as the owners of Maher Terminals (which includes the Fairview Container Terminal in the Port of Prince Rupert) and Macquarie Infrastructure Partners, the owners of Fraser Surrey Docks Ltd. and Halterm in Halifax (NS).

The high prices paid for these stakes in Canada's container terminals businesses has also created a side effect to add to the new owner's problems. It has given cause for the municipal governments, in which the port facilities are located, to harden their position on property tax and raised the ante of the capital contributions required from port authorities and stakeholders for roads and other infrastructure related to port activities.

Let us not forget that the value of a container terminal lies primarily in its location and hence on a site owned and largely developed by a port authority. The high transaction values for minimal corporate assets imply that the container terminal sites are very valuable, while the present assessed values and implied leasehold values of port lands are much lower than those of comparable industrial land that is traded on the free market.

Hence the high transaction values of the past couple of years may lead to considerable increases in the assessed values of port land for property taxation purposes. This could lead to much higher levels of tax having to be paid on cargo-handling assets.

Similarly, the transaction prices have prompted port authorities to wonder if they are receiving appropriate compensation for the use of port lands on which container-handling facilities are located.

In the case of the Port Authority of New York & New Jersey, for instance, transactions of the past two/three years resulted in the port authority extracting transaction fees from the proponents as a condition to permitting the leases to be transferred to the new owners.

Moreover, the apparent demand for port assets and the high transaction prices explain, at least to some degree, why the Vancouver Fraser Port Authority has opted to require the full T2 container terminal development at Roberts Bank to be funded by the private sector as a kind of build-operate-transfer project.

Seaport believes that the only good to come out of the high values that financial investors have placed on port assets is that it will force a major re-engineering of the way container terminal businesses are operated. In addition to the use of new, preferably automated technology, a new paradigm in the way longshore labour is employed is expected.

While current practice involves stevedores/dockers being dispatched daily from a central hall and employers, collectively, using an industry association (BC Maritime Employers Association on Canada's West Coast) to address relational and negotiating issues with the union, this is likely to be replaced with direct contact between each employer and the union.

This will result in the creation of a permanent workforce for each terminal operating company, which in turn should lead to the creation of a more loyal and incentivised set of staff.

So are Canada's West Coast ports moving in the right direction? According to Seaport, this is an unqualified yes, albeit accidentally.

This is because the exorbitant prices paid by the investment community for port assets will force through the necessary and urgently-needed changes that will make Canada's west coast container-handling facilities more efficient and productive.

As for the future, it is not unreasonable to foresee that in a few years there will be a significant collapse in the values of port businesses. Yet another bubble.

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