

# **Infrastructure Australia**

## **Review of Port Balance Sheet Capacity**

**21 June 2012**

DRAFT



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SYDNEY NSW 2000

21 June 2012

Dear John

**Re: Review of Port Balance Sheet Capacity**

We are pleased to present this report to you as a summary of the findings of our review of the balance sheet capacity of the following ports:

- Melbourne
- Newcastle
- Port Kembla
- Townsville
- Fremantle
- Bunbury
- Taspots
- Port Hedland

If you have any queries regarding our report, please feel free to contact me on (02) 9322 7230.

Yours sincerely



**Liesbet Spanjaard**  
Partner  
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# 1 Background

Over recent years Infrastructure Australia has received a number of submissions from State governments seeking funding for port and port related infrastructure. As a whole these submissions point to questions about whether the ability of ports to undertake capital investment is constrained by the budgetary circumstances of governments and their desire to retain credit ratings.

The National Ports Strategy (IA / NTC 2010) argues that port infrastructure should be operated on commercial lines, which would include:

- phasing out reliance on non-commercial taxpayer support;
- explicit, transparent and commercially negotiated Community Service Obligations; and
- the ability for boards to approve capital expenditures subject to the oversight that would be expected from private sector shareholders.

Given the projected growth profile in Australia's international trade, particularly for commodities and containerised cargo, the ability of ports to operate along these lines and attract commercial finance for investment is potentially a major issue.

A first question in understanding the issues relates to the balance sheets of ports. Infrastructure Australia has asked Deloitte to undertake a preliminary review of the balance sheet capacity of a sample of Australian ports as at end of 2010-11. The review highlights what appears to be a limited capacity of some ports to fund improvements to infrastructure by using internal financial resources. Reasons for this include apparently low rates of returns on existing assets and possibly underpriced community service obligations.

The analysis is a snapshot of capacity at the date of reporting – ie. a single years data and a balance sheet at a point in time. Ports evolve and the financial position for a particular port at a particular time will reflect long term factors such as layout and historical trades, legacy arrangements and long term contracts, as well as current and intended investments. The analysis aims to identify features common or different across ports, rather than provide commentary on the ongoing financial management of any particular port.

## 1.1 Ports being analysed

The following ports are analysed in this report, representing a selection of the major Australian ports under government ownership and control. Infrastructure Australia and Deloitte did not have an a priori view as to whether particular ports have particular financial situations or growth ambitions, and ports **were not** selected on that basis. Rather, ports were selected to provide some coverage of different scales, different commodity tasks and different states. Some background to the selected ports follows.

### 1.1.1 Port of Melbourne

Port of Melbourne is Australia's largest container and general cargo port, handling around 37% of the nation's container trade. More than forty shipping lines make around 3100 ship calls a year to Melbourne, providing services to ports in all major parts of the world.

The port is at the north of Port Phillip Bay. It is serviced by more than 100 nautical miles of shipping channels and fairways between the Port Phillip Heads and the berths on the Yarra River, at Williamstown and Station Pier, Port Melbourne. The channel is owned by the Victorian channels authority.

Port container tasks have grown rapidly in recent years and strong growth is expected to continue into the medium to long term. There are current discussions about long term investments and futures for the ports including a new container terminal, potential relocation of car trades and the development of a supplementary port at Hastings. There also is consideration of reconfiguration of land side infrastructure and areas including the Dynon precinct.

### 1.1.2 Newcastle

The Port of Newcastle is recognised as one of the leading coal export ports in the world with the 2010–11 export tonnage of 108.26 million tonnes valued at \$13.55 billion. 2010–11 was the first year that coal exports through the port have exceeded 100 million tonnes and was an increase of more than 11% on 2009–10. There also is considerable trade in inputs for the mining industry.

#### Mayfield Portside Lands

Central to future development of the port is Newcastle Port Corporation's 90 hectare former BHP Steelworks site. Newcastle Port Corporation has developed the Mayfield Concept Plan for this State Significant Site. The Concept Plan shows five key precincts incorporating future trade in bulk liquids, containers, general purpose cargo, and bulk & general cargo.

Newcastle Port Corporation has a container strategy that it is continuing to implement in order to grow container trade to ultimately support the development of a container terminal on the Mayfield Portside Lands.

Newcastle is also the home berthing of P&O's 2,000 passenger Pacific Sun for the first year of a two year trial contributed to the record. Leading domestic cruise operator, Carnival Australia (parent company of P&O Cruises Australia), chose Newcastle as its first non-capital city port in Australia to home base a cruise ship.

### 1.1.3 Port Kembla

Located on the east coast of NSW, Port Kembla is one of three major ports in the state. It was established in the late 1890's to facilitate the export of coal from the mines of the Illawarra region. Since that time it has rapidly grown to accommodate both the expansion of traditional industries along with the development of new ones.

The diverse commodity base of the port today reflects the growth of the region and its potential capability to service the growing South West Sydney market.

Having recently undergone a major expansion, the port has seen a diversification of its trade base to include general and break bulk cargoes and motor vehicle imports. This development, which included the construction of 3 new berths and the development of 53 hectares of land, has allowed the port to become the largest vehicle importing hub in Australia. It is also the principal grain export port for producers in Southern and South-Western NSW. The port has plans to develop container facilities.

### 1.1.4 Townsville

Port of Townsville is the third largest seaport in Queensland after Port of Brisbane and Gladstone. Port of Townsville handles numerous imports and exports mainly, Mineral Ores, Fertiliser, Concentrates, Sugar and Motor Vehicles. It also handles visiting US Navy and RAN ships usually picking up soldiers or for RnR in Townsville. The port is rated as capable of handling 4 Panamax vessels at any time.

At present the Mt Isa to Townsville Economic Zone is developing a long term plan for the minerals supply chain that uses Townsville as the export point.

The port has plans for additional berths (six) and land reclamation (approximately 100ha) to accommodate a forecast increase in trade through the construction of a new outer harbour. Deepening and other minor modifications to the approach channels (the Platypus and Sea Channels) will also be required to improve accessibility for vessels and allow for increased shipping movements.

### 1.1.5 Fremantle

Fremantle Ports operates on commercial principles as a Western Australian Government Trading Enterprise with responsibility for facilitating trade through the State's biggest general cargo port.

The Inner Harbour at Fremantle handles almost all of the container trade for Western Australia. It also provides facilities for motor vehicle imports, livestock exports, other general cargo trades, cruise ships and visiting naval vessels.

The Outer Harbour, about twenty kilometres to the south at Kwinana, is one of Australia's major bulk cargo ports handling grain, petroleum, liquid petroleum gas, alumina, mineral sands, fertilisers, coal, sulphur and other bulk commodities.

The State Government-owned port is a mix of facilities and services managed by Fremantle Ports and private operators. Fremantle Ports provides and maintains shipping channels, navigation aids, cargo wharves at common user areas and leased terminals, the Fremantle Passenger Terminal, road and rail transport infrastructure within the port area and other port infrastructure such as storage sheds, water, power and public amenities.

Three of the jetties in the Outer Harbour are operated by private companies, generally under Special Agreement Acts with the State. They are the Alcoa, BP Refinery and CBH jetties. The Kwinana Bulk Jetty and the Kwinana Bulk Terminal are operated by Fremantle Ports. Services such as towage, pilotage (under contract to Fremantle Ports), line boats and bunkering are provided by the private sector.

### 1.1.6 Bunbury

Bunbury is the second largest city in Western Australia and is the centre for the South West region as an industrial, tourism and commercial base. The Port of Bunbury is situated in the southwest corner of Western Australia, 170 road kilometres south of the state capital, Perth.

The south west region is rich in mineral sands mining, bauxite mining and alumina refining and also woodchips production. Alumina makes up approximately 70% of the port's exports followed by mineral sands and woodchips.

Good rail and road links enable the Port to capitalise on cargo throughput and the strategic location provides a natural distribution point which embraces mining, manufacturing, agricultural and pastoral areas. Trade grew to 13.9 million tonnes in 2009/10. A number of passenger vessels have made visits and the port argues for its potential to become a container location.

### 1.1.7 Tasports

Tasports is a State-Owned Company responsible for the management of 12 Tasmanian ports, including the major ports at Hobart, Devonport, Burnie and Bell Bay. Tasports operates across a large geographic base with diverse operations. Tasports' services include pilotage, security, navigation, port control, cargo handling and operations, and emergency response. Tasports also provides cold storage and warehousing, along with quarantine services, towage and salvage and floating plant for marine engineering, construction and coastal haulage. Not restricted to seaports, Tasports also manages the Devonport Airport.

Tasports recorded statewide freight volumes of 13.5 million tonnes, and while consistent with 2010, have continued to reduce from 16.2 million in 2008. Reductions have been experienced across all commodities, but particularly bulk commodities.

### 1.1.8 Port Hedland

The Port Hedland Port Authority (PHPA) is the largest bulk minerals export Port in the world. It serves the mineral rich Eastern Pilbara region in Western Australia. Its major export commodity is iron ore. In 2004/05 it was also the first Port in Australia to exceed the 100 million tonnes throughput milestone, and finished marginally below the 200 million tonne milestone in 2010/11.

The PHPA is a statutory authority owned by the Western Australian Government and has a charter to operate along commercial lines. One of the PHPA's major functions is the control of all shipping through the Port. The PHPA facilitates trade through the Port in a safe and efficient manner, and minimises the impact of Port activities on the environment. The PHPA aims to maximise the loaded capacity of ships through the use of world leading technology that allows the PHPA to maintain minimum safe under keel clearances. The PHPA also has a responsibility to plan for and manage new developments whilst protecting the environment of the Port.

# 2 Analysis

## 2.1 Methodology

### 2.1.1 Ratio Definitions

Our ratio analysis methodology is broadly in line with the methodology used by the Productivity Commission research paper into the *Financial Performance of Government Trading Enterprises 2004-05 to 2006-07* (“the Productivity Commission Report”). The following ratios have been calculated for each port in order to provide an insight into their financial capacity.

#### **Financial Management**

The following ratios provide information about the capital structure of the ports and their ability to meet the costs of servicing debt and other liabilities as they fall due

##### Debt / Equity

This is the ratio of total debt to shareholders equity in the entity. This is an indicator of the level of debt within the entity, and the capacity for further debt to be raised. The average Debt / Equity ratio across the comparable companies can provide an indication of the level of debt that can be raised by a prudent manager.

##### Debt / Total Assets

This is the ratio of total debt to total assets of the entity. This is an indicator of the level of debt within the entity, and the capacity for further debt to be raised. The average Debt / Total Assets ratio across the comparable companies can provide an indication of the level of debt that can be raised by a prudent manager.

##### Interest Coverage Ratio

The interest coverage ratio is the ratio between EBIT and the interest payable on debt. This is a measure of the entity’s ability to service the level of debt it has on its balance sheet. Where this ratio is low, it is unlikely that further debt can be raised, as investors will not see that sufficient cashflow will be available to repay the debt. The average Interest Cover Ratio across the comparable companies can provide an indication of the level of interest cover that is required.

##### Debt Coverage

The debt coverage ratio is the ratio between operating cashflow and the total amount of debt. This is a measure of the entity’s ability to service the level of debt it has on its balance sheet. Where this ratio is low, it is unlikely that further debt can be raised, as investors will not see that sufficient cashflow will be available to repay the debt. The average Debt Cover Ratio across the comparable companies can provide an indication of the level of debt cover that is required.

##### Current Ratio

The current ratio is the ratio between current assets and current liabilities. It is a measure of the entity’s ability to repay its debts due in the next 12 months. Where this ratio is low, the entity will need to focus on its cashflows in the next 12 months to ensure that it can remain solvent – if this is the case it will be difficult to fund further investments. The average Current Ratio across the comparable companies can provide an indication of the level of coverage required.



Quick Ratio

The quick ratio is the ratio between liquid current assets and current liabilities. It is a measure of the entity's ability to repay its debts in an extreme situation where lenders require repayments for the year to be accelerated. Where this ratio is low, the entity will need to focus on its cashflows to ensure that it can remain solvent – if this is the case it will be difficult to fund further investments. The average Quick Ratio across the comparable companies can provide an indication of the level of coverage required.

**Profitability**

The following ratios are examined in order to analyse the profitability of the ports. The Productivity Commission Report discusses profitability of Government Trading Enterprises (GTE's) as follows:

*Profitability reflects a GTE's ability to generate earnings from the capital invested in its activities. Profitability should be sufficient to provide owner-governments with a return similar to that available from alternative investments with similar risk profiles.*

*... A commercial rate of return would equate at least to the risk-free rate of return on capital plus a margin reflecting the non-diversifiable market risk inherent in the investment. The 10-year Australian Government bond rate is widely used as the risk-free rate of return benchmark.... Given the non-diversifiable risk inherent in any business activity, it is reasonable to expect that GTEs should be generating returns on assets above the risk-free rate.*

Return on Assets

Return on Assets is the ratio between net income and total assets of the entity. This is an indicator of the level of profitability of the entity. Where profitability of a new investment is low, it is unlikely that further investment can be undertaken without external support, as investors will not see that sufficient cashflow will be available to repay them a sufficient return. The average Return on Assets ratio across the comparable companies can provide an indication of the level of profitability expected by investors.

Return on Assets (EBIT basis)

Return on Assets is the ratio between EBIT and total assets of the entity. This is an indicator of whether assets are being used efficiently. Where EBIT is low, it may indicate that either prices being charged are too low, volume is low relative to capital costs or that capital costs are overvalued.

Return on Equity

Return on Equity is the ratio between net income and shareholders equity in the entity. This is an indicator of the level of profitability of the entity. Where profitability is low, it is unlikely that further investment can be undertaken without external support, as investors will not see that sufficient cashflow will be available to repay them a sufficient return. The average Return on Equity ratio across the comparable companies can provide an indication of the level of profitability expected by investors. Return on equity is also dependent on capital structure, with lower levels of gearing resulting in lower return on equity.

## 2.1.2 Information Sources

In order to conduct our analysis we have utilised publicly available information, specifically from annual reports and the relevant port web site.

### 2.1.3 Guidance on Potential Debt Capacity

As part of our analysis we perform some simple calculations to provide guidance on the potential capacity of each port to invest with existing equity resources (ie by using debt). This is done by determining the increase in debt necessary to bring each ratio to the average level calculated for a range of ports including some international ports. This is a very rough rule of thumb, and the actual debt capacity for each port will depend on a range of factors individual to that port. It can also be seen that the results vary widely depending on which ratio is examined (reflecting the different circumstance of each port).

## 2.2 Comparison international ports

In order to provide indicative estimates of the average ratios across the industry, a selection of international firms in the port industry have been analysed. These provide a baseline of the potential range of ratios that can be expected, since these businesses share many of the opportunities and risks of port authorities.

The following firms were included for comparison purposes:

### 2.2.1 Port of Singapore

The Port of Singapore refers to the collective facilities and terminals that conduct maritime trade handling functions in Singapore's harbours and which handle Singapore's shipping. Currently the world's busiest port in terms of total shipping tonnage, it also transships a fifth of the world's shipping containers as the world's busiest container port, half of the world's annual supply of crude oil, and is the world's busiest transshipment port. It was also the busiest port in terms of total cargo tonnage handled until 2005, when it was surpassed by the Port of Shanghai. Thousands of ships drop anchor in the harbour, connecting the port to over 600 other ports in 123 countries and spread over six continents.

### 2.2.2 DP World

DP World operates more than 60 terminals across six continents, with container handling generating around 80% of its revenue. In addition, the company currently has 11 new developments and major expansions underway in 10 countries.

DP World aims to enhance customers' supply chain efficiency by effectively managing container, bulk and other terminal cargo. Its team of nearly 30,000 people serves customers in some of the most dynamic economies in the world.

The company constantly invests in terminal infrastructure, facilities and people, working closely with customers and business partners.

In 2011, DP World handled nearly 55 million TEU (twenty-foot equivalent container units) across its portfolio from the Americas to Asia. With a pipeline of expansion and development projects in key growth markets, including India, China and the Middle East, capacity is expected to rise to around 100 million TEU by 2020, in line with market demand.

### 2.2.3 Port of Lyttelton

As the major deep-water port in the South Island of New Zealand, Lyttelton is at the hub of trade and plays a vital role in the global transport network. Lyttelton's container terminal provides specialised cargo handling and stevedoring services for containers and plant hire. It is supported by their inland container storage and repair facility CityDepot.

On the water, full marine services are provided including the provision of tugs, pilots to escort ships into and out of the port, staff to assist with ships' lines when ships are berthing, and security.

Their coal facility is the largest in New Zealand and over two million tonne is exported each year. Facilities for loading and unloading bulk products such as petroleum, fertiliser, gypsum, cement, logs, conventional break-bulk, imported vehicles and fishing are also provided.

The company employs approximately 420 full-time staff in operational, management and administration roles. It has approximately 900 shareholders with majority ownership being held by Christchurch City Holdings Limited.

## 2.2.4 Port of Auckland

Port of Auckland (PoA) provides a full range of cargo-handling and logistics services at two seaports – one on the east coast adjacent to the Auckland central business district, the other on the west coast in Onehunga – and a strategically located inland port at Wiri, South Auckland.

By value of trade handled, PoA is New Zealand's most significant port. In 2010, it handled cargo valued at 13% of the country's total GDP - twice as much as any other New Zealand port.

Auckland is New Zealand's largest container port, handling more than 867,000 TEU per annum.

The Multi Cargo Facility handles 2.8 million tonnes of bulk and breakbulk (non-containerised) cargo each year, including over 70% of the total vehicle imports to New Zealand.

Ports of Auckland Limited was formed in 1988 and is today 100% owned by Auckland Council Investments Limited, a council controlled investment company.

## 2.2.5 Port of Sydney

### Port Botany

Located 12 nautical miles south of the entrance to Sydney Harbour and the city's central business district the facilities at Port Botany consist of two (soon to be three) container terminals and a bulk liquids berth - complemented by container support businesses, bulk liquid berth storage facilities and private berths at Kurnell.

The facilities at Port Botany now account for over 70 per cent of Sydney Ports Corporations total trade throughput.

### Sydney Harbour

Sydney Harbour's commercial wharves are located less than 10km from bluewater shipping and handle a wide range of vessels through its 11 berths, including dry bulk, bulk liquids, general cargo and cruise. Facilities covering a total of 41.7 hectares are located in Walsh Bay, Glebe Island/White Bay and Circular Quay. Private facilities are located at Gore Cove and Blackwattle Bay.

## 2.2.6 Port of Toronto

The Port, one of Canada's largest major inland ports, is situated on the northwest shore of Lake Ontario. Its location at the doorstep of downtown Toronto provides access to 25 per cent of Canada's population and is no more than 1300 km from many of North America's largest cities. Port users take advantage of this unique proximity to transportation services of marine, rail and major highways.

Last year the Port of Toronto moved 1.5 million tonnes of bulk cargo and also handles project cargo such as windmills, power plant components and locomotives.

The Port of Toronto is owned and operated by the Toronto Port Authority (TPA), with the marine terminals operated in partnership with Logistec Inc. The TPA maintains a paved facility of over 50

acres (20 hectares) located adjacent to downtown Toronto. The yard provides convenience, with excellent access to the railroads, as well as all major highways.

The TPA was established for the purpose of operating the Port of Toronto, one of Canada's major commercial ports. TPA is a Federal Public Authority and is self-financing. The Port Authority possesses legislated responsibility for all its port activities related to shipping, navigation, transportation of passengers and goods, and the handling and storage of cargo. It owns and operates the Billy Bishop Airport, the Port of Toronto (consisting of Marine Terminal 51, Warehouse 52 and the International Marine Passenger Terminal), the Outer Harbour Marina and the Works & Environmental Services Department.

### 2.2.7 Port of Vancouver

Port Metro Vancouver is responsible for the operation and development of the assets and jurisdictions of the combined former Fraser River Port Authority, North Fraser Port Authority and Vancouver Port Authority. Port Metro Vancouver is a Federal Public Authority and is self financing.

Positioned on the southwest coast of British Columbia in Canada the port jurisdiction covers more than 600 kilometres of shoreline.

As the fourth largest tonnage port in North America, Port of Vancouver offers 28 major marine cargo terminals and three Class 1 railroads.

Port Metro Vancouver's deep-sea terminals offer virtually no draft restrictions, Super Post-Panamax capacity and extensive on-dock rail facilities. The Port's freshwater facilities offer integrated services for the automobile and coastal forest industries, and for short-sea shipping. Port Metro Vancouver serves as homeport for the Vancouver-Alaska cruise industry.

As the most diversified port in North America, Port Metro Vancouver operates across five business sectors: automobiles, breakbulk, bulk, container and cruise.

## 2.3 Results

### 2.3.1 Summary Results

The table below summarises the results of the analysis, broken down into the ports being analysed, the additional comparison ports and averages for each group of ports.

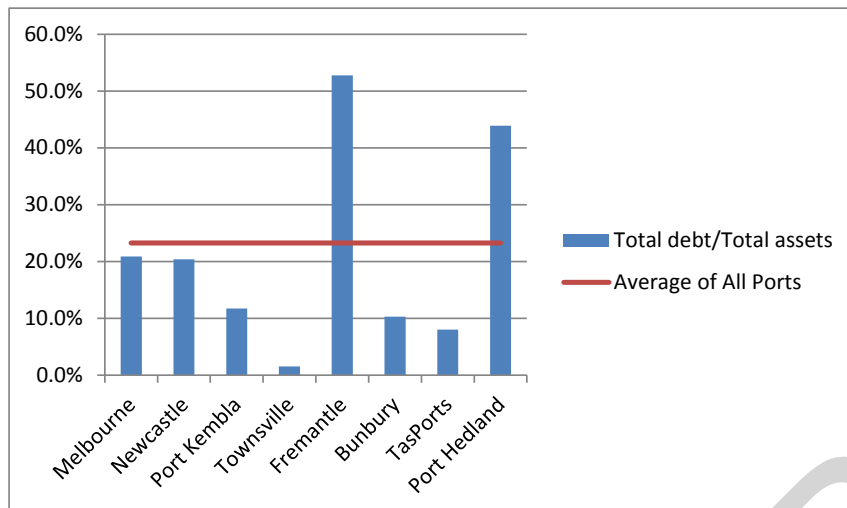
	Ports Under Analysis							
	Melbourne	Newcastle	Port Kembla	Townsville	Fremantle	Bunbury	TasPorts	Port Hedland
Total debt/Shareholder's equity	50.9%	54.3%	19.9%	7.7%	147.9%	11.8%	10.4%	168.0%
Total debt/Total assets	20.9%	20.4%	11.8%	1.5%	52.7%	10.3%	8.0%	43.9%
Return on assets	1.7%	2.8%	3.8%	2.6%	2.6%	2.4%	0.1%	0.7%
EBIT Return on assets	3.9%	5.7%	6.3%	3.9%	5.5%	9.9%	0.6%	4.2%
Return on equity	2.6%	4.5%	4.9%	3.9%	7.2%	2.8%	0.2%	2.5%
Interest coverage ratio	2.42	3.55	6.69	23.54	3.11	16.71	1.02	1.33
Debt coverage	0.19	0.28	0.54	2.56	0.10	0.96	0.08	0.10
Revenue/Total assets	0.10	0.15	0.11	0.14	0.33	0.23	0.33	0.21
Current ratio	0.67	0.57	2.80	2.28	1.00	10.12	1.66	1.65
Quick ratio	0.65	0.57	2.78	2.02	0.97	8.74	1.03	0.76

	Comparison Ports						
	Singapore	DP World	Lyttelton	Auckland	Sydney	Toronto	Vancouver
Total debt/Shareholder's equity	725.2%	223.0%	42.3%	2.5%	118.3%	31.7%	21.8%
Total debt/Total assets	43.5%	40.1%	24.9%	1.3%	33.4%	19.0%	17.3%
Return on assets	6.3%	2.3%	3.9%	6.3%	3.3%	7.5%	6.6%
EBIT Return on assets	7.7%	4.1%	7.4%	10.8%	5.6%	9.5%	7.5%
Return on equity	13.5%	5.3%	6.7%	11.6%	6.5%	12.5%	8.3%
Interest coverage ratio	4.31	2.08	4.47	3.73	7.00	12.92	16.66
Debt coverage	0.18	0.10	0.30	8.49	0.17	0.50	0.43
Revenue/Total assets	0.22	0.16	0.38	0.22	0.12	0.34	0.16
Current ratio	1.13	3.04	1.84	0.59	3.46	2.59	1.35
Quick ratio	1.10	1.82	0.80	0.46	3.46	1.74	1.35

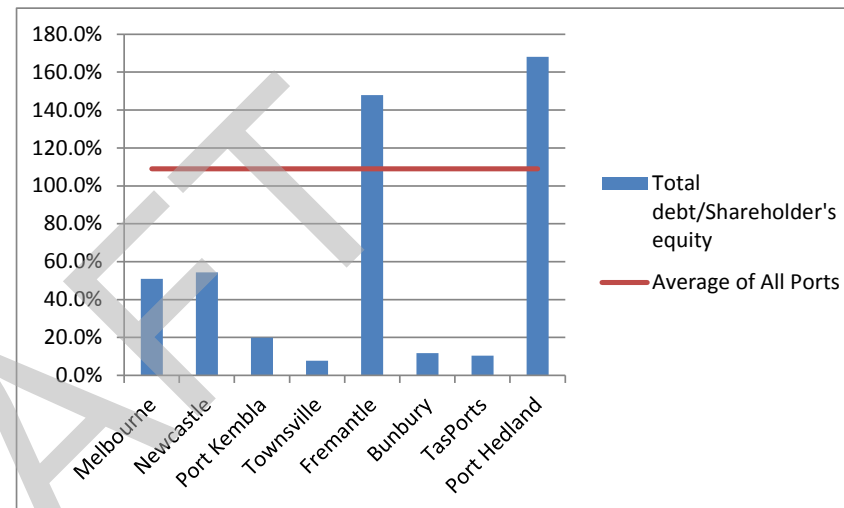
	Average of Ports Under Analysis	Average of Comparison Ports	Average of All Ports
Total debt/Shareholder's equity	58.9%	166.4%	109.1%
Total debt/Total assets	21.2%	25.6%	23.3%
Return on assets	2.1%	5.2%	3.5%
EBIT Return on assets	5.0%	7.5%	6.2%
Return on equity	3.6%	9.2%	6.2%
Interest coverage ratio	7.30	7.31	7.30
Debt coverage	0.60	1.45	1.00
Revenue/Total assets	0.20	0.23	0.21
Current ratio	2.59	2.00	2.32
Quick ratio	2.19	1.53	1.88

### 2.3.2 Comparison Against Other Ports

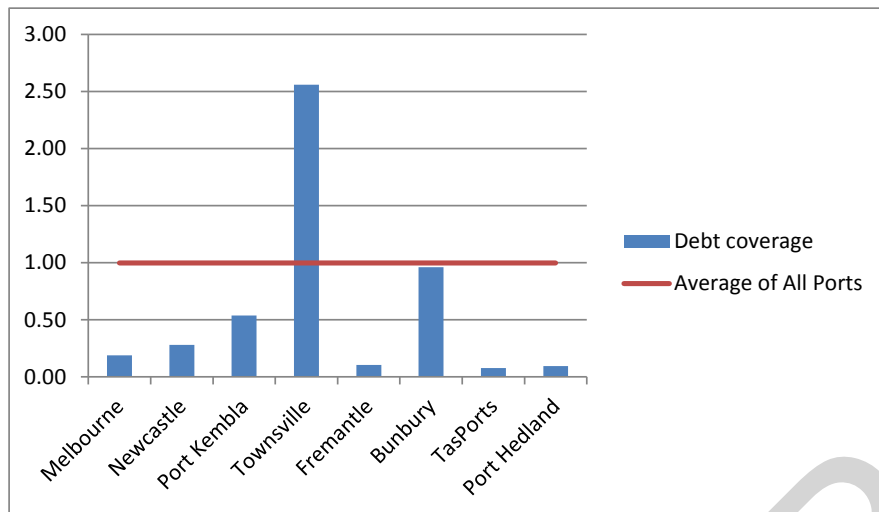
The following charts show a comparison between the ratios for each port (column charts) against the average of all ports (the line charts). The gap between the results for each of the ports and the average provides an indication of the additional gearing that may be possible.



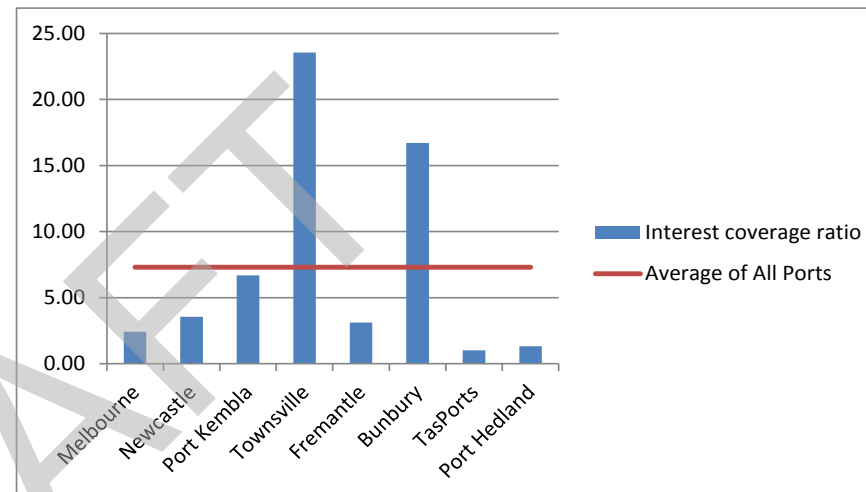
Total Debt / Total Assets: In this chart a lower ratio represents a greater ability to obtain additional debt. It can be seen that TasPorts, Bunbury and Port Kembla have low levels of gearing, while Townsville has virtually no debt on its balance sheet. Fremantle and Port Hedland are significantly above the expected level – indicating that these ports are unlikely to be able to raise additional debt without a corresponding equity injection.



Total Debt / Shareholders Equity: In this chart a lower ratio represents a greater ability to obtain additional debt. It can be seen that Townsville, TasPorts, Bunbury and Port Kembla have low levels of gearing, while Fremantle and Port Hedland are significantly above the expected level – indicating that these ports are unlikely to be able to raise additional debt without a corresponding equity injection.

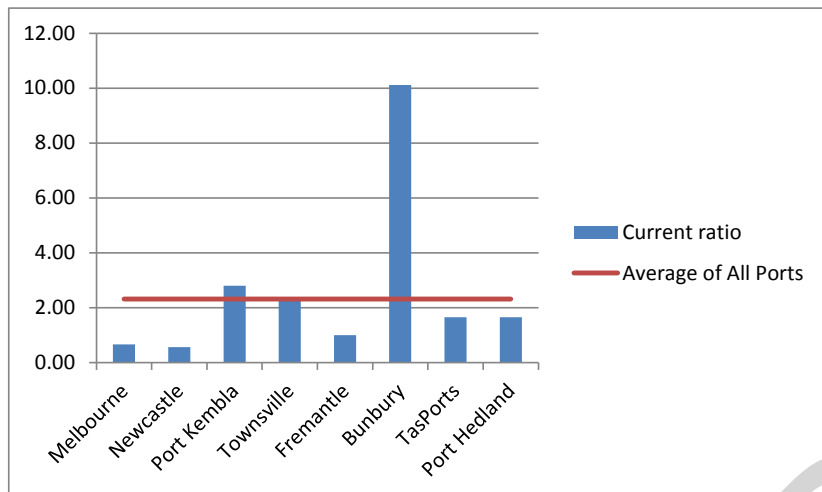


Debt Coverage: In this chart a higher ratio represents a greater ability to obtain additional debt. Townsville is much higher than expected, indicating an ability to raise further debt. Bunbury is in line with expectations, while all other ports have very low ratios due to relatively low operating cashflows. Fremantle, TasPorts and Port Hedland in particular are very low, indicating high gearing (Fremantle / Port Hedland) or low operating cashflows (TasPorts).

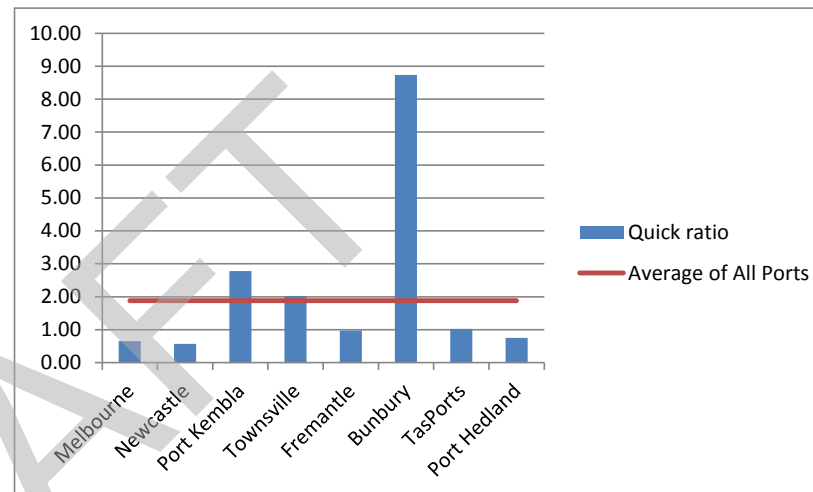


Interest Coverage: In this chart a higher ratio represents a greater ability to obtain additional debt. Townsville and Bunbury are both well above the expected level, indicating an opportunity to raise additional debt. Melbourne, Fremantle, TasPorts and Port Hedland have low ratios, indicating that the current level of debt is causing stress to their cashflows.

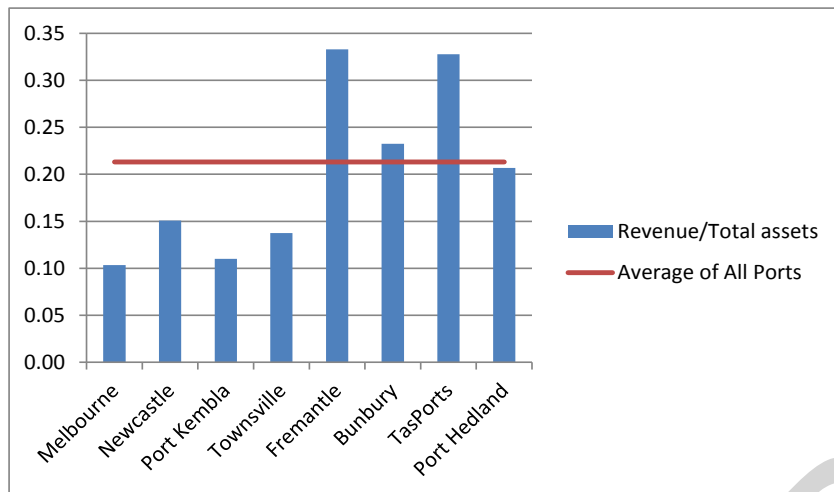




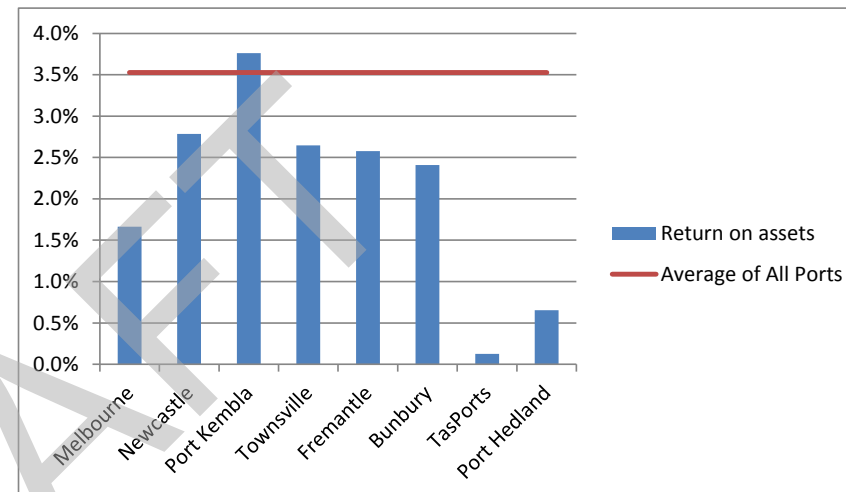
**Current Ratio:** In this chart a higher ratio represents greater cash available in the next 12 months and hence a greater ability to fund investment. Bunbury has a very high current ratio, which may be an indication that there is an opportunity for funds to be reinvested or returned to the port's owners. Melbourne, Newcastle and Fremantle have low ratios, indicating that there is not a significant amount of cash available for investment and that in the absence of profits over the next 12 months additional funding will be required.



**Quick Ratio:** In this chart a higher ratio represents greater cash available in the next 12 months and hence a greater ability to fund investment. Bunbury has a very high quick ratio, which may be an indication that there is an opportunity for funds to be reinvested or returned to the port's owners. Melbourne, Newcastle and Port Hedland have low ratios, indicating that there is not a significant amount of cash available for investment and that in the absence of profits over the next 12 months additional funding will be required.

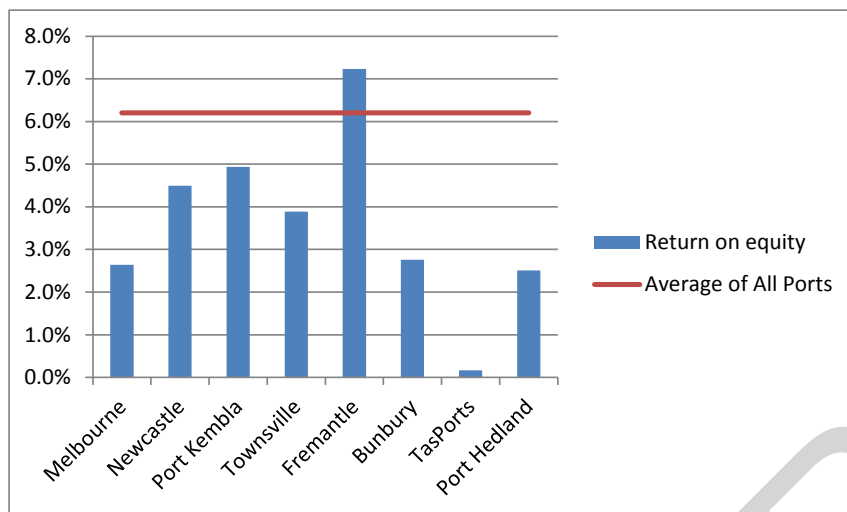


Revenue / Total Assets: In this chart a higher ratio represents greater revenue generation per dollar of assets and is a measure of how efficiently the asset is being used. Fremantle and TasPorts are above the average of all ports, while Bunbury and Port Hedland are in line with the average. The remaining ports are significantly below the average and should be investigated to ensure that appropriate fees are being charged and assets used efficiently.

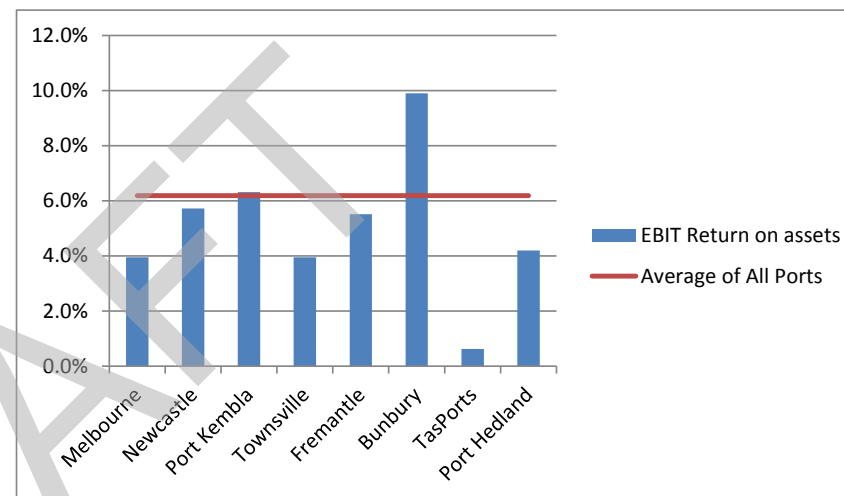


Return on Assets: In this chart a higher ratio represents greater profitability of the port and is a measure of how profitable the port is relative to its asset values. Port Kembla is in line with the average of all ports, however all other ports being analysed are below the average. The reasons behind this trend will need to be investigated further. TasPorts and Port Hedland have particularly low return on assets, in TasPorts' case this is due to falling volumes causing the port to generate a loss.

It should be noted that the current 10-year Australian Government bond rate is c3.89%, and so no port is currently generating a return on assets equivalent to the risk-free rate.



Return on Equity: In this chart a higher ratio represents greater profitability of the port and is a measure of how efficiently the asset is being used. Fremantle is in line with the average of all ports, however all other ports being analysed are below the average. The difference from the return on assets chart is mainly due to the levels of gearing employed by each port. For example Fremantle is highly geared, so while it does not generate a high return on assets, it is able to produce a high return on equity.



Return on Assets (EBIT Basis): In this chart a higher ratio represents greater operating profit of the port relative to the value of the assets and is a measure of how efficiently the assets are being used. Port Kembla and Bunbury are above the average of all ports, however all other ports being analysed are below the average. The reasons behind this trend will need to be investigated further. TasPorts has a particularly low return on assets, due to falling volumes causing the port to generate a loss.

## 3 Discussion

### 3.1 Introductory comments

The ports being analysed vary markedly in their current financial performance and also in their potential ability to procure additional debt. On balance they tend to have a lower level of gearing and a lower return on assets than the more commercially driven comparison ports, however this may be due to special circumstances particular to these ports, as well as differing objectives (maximising profit vs enhancing trade for the whole economy, or providing social facilities).

### 3.2 Balance sheet capacity

#### 3.2.1 Port of Melbourne

##### Debt Ratios:

The Port of Melbourne has one of the highest gearing levels of the ports analysed, however it remains below the average of all ports. Total Debt to Shareholder's Equity is 50.9% and Total Debt to Total Assets is 20.9%, indicating that there is a moderate level of gearing. Interest cover at 2.4 times is at the lower end of the comparison ports, which suggests only a limited ability to undertake further fundraising. Together these indicate that there is a moderate capacity to take on additional debt to fund expansion.

The table below sets out the **additional debt** that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. The first two ratios are indicative of the port's capacity to obtain further debt based on the asset base of the port. The second two ratios are indicative of the port's capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
<b>Total Debt / Shareholder's Equity</b>	\$560m
<b>Total Debt / Total Assets</b>	\$55m
<b>Interest Coverage Ratio*</b>	\$0
<b>Debt Coverage*</b>	\$0

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

By way of comparison, the total assets of the port are \$2,343m.

##### Profitability Ratios:

Port of Melbourne's return on assets and return on equity is amongst the lowest of all the ports analysed, with a return on assets of 1.7%, return on equity of 2.6% and return on assets on an EBIT basis of 3.9%. These returns are well below what would be expected from a commercial organisation.

**Liquidity Ratios:**

Current ratio and quick ratio are both close to the lowest of the ports under analysis. This indicates that cashflow may be tight in the next 12 months and that there are not significant free funds immediately available to undertake major investment in the short term.

**Revenue Structure:**

Melbourne is a well-diversified port, with 72% of tonnage comprising shipping containers and 28% made up of motor vehicles, liquid and dry bulk goods.

China represents 21.7% of containerised export trade and 36.9% of containerised imports.

Revenue from wharfage charges totalled \$156m, Channel usage fees represented \$27.3m, property rentals were \$43.8m. Other income totalled \$15.1m.

The Port of Melbourne is the only port in Victoria subject to price monitoring by the Essential Services Commission.

**Asset Valuation:**

“All non-current physical assets are measured initially at cost and subsequently revalued at fair value less accumulated depreciation and impairment.

...

In 2010, a valuation of PoMC’s non-current physical assets were performed to determine fair value as follows:

<b>Class</b>	<b>Method</b>	<b>Valuer</b>
Channel Assets	Discounted cash flows	Valuer-General Victoria
Land	Market based evidence	Valuer-General Victoria
Buildings and improvements	Depreciated replacement cost	Valuer-General Victoria
Plant and equipment (except for office equipment and motor vehicles)	Depreciated replacement cost	Valuer-General Victoria
Office equipment and motor vehicles	Indexed depreciated replacement cost	Management Assessment <sup>1</sup>

**3.2.2 Newcastle****Debt Ratios:**

The Port of Newcastle has one of the highest gearing levels of the Australian ports analysed, however it remains below the average of all ports. Total Debt to Shareholder’s Equity is 54.3% and Total Debt to Total Assets is 20.4%, indicating that there is a moderate level of gearing. Interest cover at 3.5 times is in line with the more efficiently geared comparison ports, which suggests only a moderate ability to undertake further fundraising. Together these indicate that there is a moderate capacity to take on additional debt to fund expansion.

The table below sets out the additional debt that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. The first two ratios are indicative of the port’s capacity to obtain further

<sup>1</sup> Port of Melbourne 2010-2011 Financial Report

debt based on the asset base of the port. The second two ratios are indicative of the port's capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
<b>Total Debt / Shareholder's Equity</b>	\$97m
<b>Total Debt / Total Assets</b>	\$14m
<b>Interest Coverage Ratio*</b>	\$0
<b>Debt Coverage*</b>	\$0

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

By way of comparison, the total assets of the port are \$472m.

#### **Profitability Ratios:**

Port of Newcastle's return on assets is the second highest of the ports being analysed, however it is still below the level of profitability achieved by the comparison group. Return on equity is lower than the comparison group, although it remains in line with the group of ports being analysed. Return on assets on an EBIT basis is almost in line with the average of all ports examined.

#### **Liquidity Ratios:**

Current ratio and quick ratio are both the lowest of the ports under analysis. This indicates that cashflow may be tight in the next 12 months and that there is not a significant amount of free funds available to undertake investment in the short term.

#### **Revenue Structure:**

The Port of Newcastle is highly dependent on the coal industry, making up 94% of tonnage processed by the port. This means the port's ability to obtain further funding will be strongly influenced by the fortunes of the global coal sector.

Port management makes up \$70.9m of revenue, while interest on deposits is \$0.3m. Other income is \$7.4m (Non-port related lease \$3.5m, Post employment benefits income \$0.9m, Other income \$3.0m)

#### **Asset Valuation:**

"Property, plant and equipment is measured at fair value less accumulated depreciation. Fair value is determined by reference to NSW Treasury policy and guidelines paper "Accounting Policy: Valuation of Physical Non-current Assets at Fair Value" (TPP07-1) April 2007. Land related to long term lease is valued by Director's based on the present value of future lease income and residual value. The value is tested against independent assessment."<sup>2</sup>

<sup>2</sup> Newcastle Port Corporation Annual Report 2010-2011

### 3.2.3 Port Kembla

#### Debt Ratios:

Port Kembla has one of the most conservative capital structures of all the ports analysed. Total Debt to Shareholder's Equity is 19.9% and Total Debt to Total Assets is 11.8%, indicating that there is a low level of gearing. Interest cover at 7 times is above the minimum requirement. Together these indicate that there is capacity to take on additional debt to fund expansion.

The table below sets out the additional debt that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. The first two ratios are indicative of the port's capacity to obtain further debt based on the asset base of the port. The second two ratios are indicative of the port's capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
<b>Total Debt / Shareholder's Equity</b>	\$238m
<b>Total Debt / Total Assets</b>	\$52m
<b>Interest Coverage Ratio*</b>	\$0
<b>Debt Coverage*</b>	\$0

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

In addition, Port Kembla's financial statements show \$130m of investment property, which could potentially be used to fund further expansion (if it is not required to hold the expanded facilities)

By way of comparison, the total assets of the port are \$452m.

#### Profitability Ratios:

Port Kembla's return on assets is the highest of the ports being analysed, and is in line with the comparison group. Due to the low level of gearing, the return on equity is lower than the comparison group, although it remains near the top of the group of ports being analysed. Return on assets on an EBIT basis is in line with the average of all ports.

#### Liquidity Ratios:

Both the current ratio and quick ratio are above the average for all ports, indicating that there is a level of funds available to undertake investment in the short term.

#### Revenue Structure:

42% of total import/export tonnage is made up of coal exports. 18% is made up of iron ore and 11% by passenger cars. There is some dependence on the coal industry for the port to remain sustainable, however in recent years the diversity of products has been increasing as part of the port's expansion strategy.

29% of exports go to Japan, 21% to East Asian and 20% to South Asia. 51% of imports are sourced from within Australia and 19% are sourced from Japan. These reflect a reasonably well diversified customer base.

Revenue from operations is \$49.8m, interest revenue is \$2.5m and other income is \$0.7m

#### **Asset Valuation:**

“Property, Plant and Equipment is initially recognised at acquisition cost, including any costs directly attributable to the asset and any restoration costs associated with the asset. Cost is the amount of cash and cash equivalents paid or the fair value of the other consideration given to acquire the asset at the time of its acquisition or construction.

Assets acquired at no cost or for nominal consideration are initially recognised at their fair value at the date of acquisition.

Plant and Equipment is valued at fair value in accordance with Australian Accounting Standards and NSW Treasury Paper on Valuation of Physical Non Current Assets at Fair Value, TPP 07-01.

Specialised plant and infrastructure is measured at estimated written down replacement cost. Infrastructure assets include roads, wharves, jetties, breakwaters and rail.”<sup>3</sup>

### 3.2.4 Townsville

#### **Debt Ratios:**

The port of Townsville has the most conservative capital structure of all the ports analysed. Total Debt to Shareholder’s Equity is 7.7% and Total Debt to Total Assets is 1.5%, indicating that there is a minimal level of gearing. Interest cover at 23 times is well in excess of requirements. Together these indicate that there is significant capacity to take on additional debt to fund expansion.

The table below sets out the additional debt that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. The first two ratios are indicative of the port’s capacity to obtain further debt based on the asset base of the port. The second two ratios are indicative of the port’s capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
<b>Total Debt / Shareholder’s Equity</b>	\$103m
<b>Total Debt / Total Assets</b>	\$110m
<b>Interest Coverage Ratio*</b>	\$18m
<b>Debt Coverage*</b>	\$12m

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

By way of comparison, the total assets of the port are \$511m.

#### **Profitability Ratios:**

While return on assets, return on assets on an EBIT basis and revenue to total assets are below the average of all ports analysed, it is in line with most other government owned ports in the sample. The

<sup>3</sup> Port Kembla Financial Statements 2010-2011



lower returns could also reflect the lower gearing level of the port resulting in a less efficient financial structure.

#### **Liquidity Ratios:**

The current ratio and quick ratio are both above the average of all ports analysed, reflecting the low gearing level employed by the port. Any excess liquid funds could be used to fund expansion projects in the short term.

#### **Revenue Structure:**

35% of total import / export tonnage is made up of nickel ore imports, and 16% by mineral concentrates exports. All other products make up less than 10% of the total. This shows that the port is reasonably dependent on nickel ore imports but otherwise is well diversified.

22% of the port's trade is with New Caledonia, 13% with Australia and 10% with China. All other countries represent less than 10% of the total. This shows that the port has some dependence on nickel ore from New Caledonia, but otherwise is reasonably well diversified.

User charges make up \$48m of revenue, Grants and other contributions make up \$14m. Interest income is \$5m and other revenue is \$0.7m.

#### **Asset Valuation:**

“Actual cost is used for the initial recording of all acquisition of assets controlled and administered by the Corporation. Assets acquired at no cost or for nominal considerations are recognised at their fair value at date of acquisition.

...

Channels and swing basins, wharves, buildings, infrastructure, small boat harbours and facilities, breakwaters are shown at fair value. Fair value is estimated using an income approach based on discounted cash flows. The fair value of an asset or group of assets forming a cash generating unit is determined by the discounted cash flow methodology. The net present value of the cash flows of the asset group are allocated across the individual assets in the group. Valuations are undertaken annually to ensure that the carrying value of the assets does not differ materially from that which would be determined using fair value at the end of the reporting period.

...

Land is shown at fair value, based on period valuations by external independent valuers.

...

All property, plant and equipment is stated at historical cost less depreciation.

...

The depreciable amount of all fixed assets including buildings and capitalised lease assets, but excluding freehold land, is depreciated on a straight line basis over their useful lives to the Corporation commencing from the time the asset is held ready for use.”<sup>4</sup>

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<sup>4</sup> Port of Townsville Annual Report 2010-2011

### 3.2.5 Fremantle

#### Debt Ratios:

The Port of Fremantle has one of the highest gearing levels of the ports analysed, and is within the range indicated by the larger, more diversified private port operators in the comparison group. Total Debt to Shareholder's Equity is 147.9% and Total Debt to Total Assets is 52.7%, indicating that there is a high level of gearing. Interest cover at 3 times is in line with the more efficiently geared comparison ports, however leaves little room for further fundraising for debt only. Together these indicate that there is not significant capacity to take on additional debt to fund expansion.

The table below sets out the additional debt that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. As the Port of Fremantle already has above average gearing, this calculation results in no additional debt being raised. The first two ratios are indicative of the port's capacity to obtain further debt based on the asset base of the port. The second two ratios are indicative of the port's capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
<b>Total Debt / Shareholder's Equity</b>	\$0
<b>Total Debt / Total Assets</b>	\$0
<b>Interest Coverage Ratio*</b>	\$0
<b>Debt Coverage*</b>	\$0

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

By way of comparison, the total assets of the port are \$457m.

#### Profitability Ratios:

Return on Assets and return on assets on an EBIT basis are in line with the returns generated by the other ports being analysed, however they are well below the levels seen in the comparison ports. Due to the higher gearing levels at Port of Fremantle, Return on Equity is significantly higher than the other ports under analysis and is in line with the rates of return seen on the comparison ports.

#### Liquidity Ratios:

Current ratio and quick ratio are both at acceptable levels, however at the lower end of these ranges. This indicates that there is not a significant amount of free funds available to undertake investment in the short term.

#### Revenue Structure:

33% of total export volume is made up of refined petroleum exports. Alumina exports make up 11% and wheat 10%. This demonstrates a reasonably diversified product base that limits the exposure of the port to any one industry.

57% of trade is with East, South East and Southern Asia, 17% with the Middle East and 15% other Australian ports. This is in line with the types of products being transferred through the port.

Revenue from port operations is \$134m, interest revenue is \$2m and other revenue is \$17m

#### **Asset Valuation:**

“Property, plant and equipment purchased or constructed for port operations is recorded at the cost of acquisition less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Any subsequent cost of replacing/upgrading an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to Fremantle Ports and its cost can be measured reliably.

Property, plant and equipment, excluding freehold land, are depreciated at rates based on the expected useful lives using the straight line method.”<sup>5</sup>

### 3.2.6 Bunbury

#### **Debt Ratios:**

The Port of Bunbury has the amongst the most conservative capital structures of all the ports analysed. Total Debt to Shareholder’s Equity is 11.8% and Total Debt to Total Assets is 10.3%, indicating that there is a low level of gearing. Interest cover at 16 times is well in excess of requirements. Together these indicate that there is significant capacity to take on additional debt to fund expansion.

The table below sets out the additional debt that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. The first two ratios are indicative of the port’s capacity to obtain further debt based on the asset base of the port. The second two ratios are indicative of the port’s capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
<b>Total Debt / Shareholder’s Equity</b>	\$91m
<b>Total Debt / Total Assets</b>	\$14m
<b>Interest Coverage Ratio*</b>	\$14m
<b>Debt Coverage*</b>	\$0

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

By way of comparison, the total assets of the port are \$107m.

#### **Profitability Ratios:**

Return on assets and revenue to total assets are at the lower end of all ports analysed. The lower returns could reflect the lower gearing level of the port resulting in a less efficient financial structure.

<sup>5</sup> Fremantle Ports Corporation Annual Report 2010-2011

Return on assets on an EBIT basis are well above the average of all ports, indicating that operating profits are reasonable given the asset base of the port.

#### **Liquidity Ratios:**

The current ratio and quick ratio are both well above the average of all ports analysed, reflecting the low gearing level employed by the port. These excess funds could be used to finance expansion projects in the short term.

#### **Revenue Structure:**

70% of all trade is made up of alumina exports. A further 10% is woodchip exports and 8% caustic soda imports. This indicates that the port is strongly dependant on a narrow range of products, potentially exposing it to the risk that assets will be underutilised in the event of a downturn in demand for those products.

Operating revenue is \$18m, interest income is \$1m, rentals and leases is \$3m. Sale of electricity and water is \$3m and other revenue is \$1m.

#### **Asset Valuation:**

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

...

Property, plant and equipment, infrastructure and intangible assets are tested for any indication of impairment at each balance sheet date. Where there is an indication of impairment, the recoverable amount is estimated. Where the recoverable amount is less than the carrying amount, the asset is written down to the recoverable amount and an impairment loss is recognised. As the Authority is a not-for-profit entity, unless an asset has been identified as a surplus asset, the recoverable amount is the higher of an asset's fair value less costs to sell and depreciated replacement cost."<sup>6</sup>

### **3.2.7 Tasports**

#### **Debt Ratios:**

Tasports has the second most conservative capital structure of all the ports analysed. Total Debt to Shareholder's Equity is 10.4% and Total Debt to Total Assets is 8.0%, indicating that there is a low level of gearing. Interest cover at 1 times is a reflection of the current low level of profitability. Until profitability returns to more normal levels Tasports is unlikely to be able to raise additional debt finance, however once profitability returns, the low level of gearing would indicate there is scope for additional fundraising.

The table below sets out the additional debt that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. The first two ratios are indicative of the port's capacity to obtain further debt based on the asset base of the port. The second two ratios are indicative of the port's capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
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<sup>6</sup> Port of Bunbury Annual Report 2010

<b>Total Debt / Shareholder's Equity</b>	\$178m
<b>Total Debt / Total Assets</b>	\$36m
<b>Interest Coverage Ratio*</b>	\$0
<b>Debt Coverage*</b>	\$0

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

By way of comparison, the total assets of the port are \$234m.

#### **Profitability Ratios:**

Return on assets and return on equity are very low, reflective of the fact that in the previous year Tasports produced a minimal profit (excluding revaluation of assets).

#### **Liquidity Ratios:**

The current ratio and quick ratio are both below the average of all ports analysed, which indicates that there are limited resources available in the next year to fund expansion activities. Coupled with low levels of profitability, management will need to manage cashflow carefully in the next 12 months.

#### **Revenue Structure:**

The revenue streams to Tasport are well diversified, with a spread of geographic locations as well as a combination of containerised and bulk goods processed by the ports.

Operating revenue is \$75m, interest income is \$0.6m and other revenue is \$0.8m.

#### **Asset Valuation:**

“Plant and equipment, floating plant and dredging costs are stated at cost less accumulated depreciation and impairment losses. Subsequent costs are included in the asset’s carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the economic entity and the cost of the item can be measured reliably. All repairs and maintenance are charged to the Statement of Comprehensive Income during the financial period in which they are incurred.

Infrastructure assets which include land, land infrastructure, buildings, wharves and harbour improvements are stated at fair value. Infrastructure assets were revalued at 30 June 2011 and in future years will be reported at fair value less accumulated depreciation and impairment.”<sup>7</sup>

### **3.2.8 Port Hedland**

#### **Debt Ratios:**

The Port of Port Hedland has one of the highest gearing levels of the ports analysed, and is within the range indicated by the larger, more diversified private port operators in the comparison group. Total Debt to Shareholder’s Equity is 168%% and Total Debt to Total Assets is 43.9%%, indicating that there is a high level of gearing. Interest cover at 1.3 times is amongst the lowest of all the ports,

<sup>7</sup> TasPorts Annual Report 2010-2011

indicating that additional debt may place a strain on cashflows, leaving little room for further fundraising. Together these indicate that there is not significant capacity to take on additional debt to fund expansion.

The table below sets out the additional debt that could be raised assuming that ratios were brought in line with the average of all ports analysed. Note that these are indicative only, as the circumstances of each port will be different. The first two ratios are indicative of the port's capacity to obtain further debt based on the asset base of the port. The second two ratios are indicative of the port's capacity to obtain further debt based on the cashflows generated by the port. For all ports analysed there is greater capacity with regard to asset base than for cashflow, which may indicate that assets are not being worked as hard as the comparison ports.

Ratio Targeted	Potential Additional Debt
<b>Total Debt / Shareholder's Equity</b>	\$0
<b>Total Debt / Total Assets</b>	\$0
<b>Interest Coverage Ratio*</b>	\$0
<b>Debt Coverage*</b>	\$0

\* Note that if additional debt is raised and the port expanded then it is reasonable to assume the revenue and profitability of the port will increase, resulting in these ratios being higher than in this simple analysis

By way of comparison, the total assets of the port are \$476m.

#### **Profitability Ratios:**

Return on assets, return on assets on an EBIT basis and return on equity are all low, indicating that commercial rates of return are not being achieved on the assets.

#### **Liquidity Ratios:**

The current ratio and quick ratio are both below the average of all ports analysed, which indicates that there are limited resources available in the next year to fund expansion activities.

#### **Revenue Structure:**

Port Hedland's trade is dominated by iron ore with approximately 97% of total volumes. This means that its ability to sustain additional debt would be dependent on the worldwide demand for iron ore and the continued availability of sources of iron ore in the local area.

Operating revenue is \$97m, interest revenue is \$1m and other revenue is \$6m.

#### **Asset Valuation:**

"Land and buildings (note 13) are shown at cost less subsequent depreciation for buildings. All other property, plant and equipment are stated at cost less depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items.

...

Other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing

impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.”<sup>8</sup>

### 3.3 General comments and next Steps

There are substantial variations among the analysed ports on variables such as debt ratios. If these variables were used as the sole criteria for ability to fund expansion from debt, there would similarly be quite different results among the ports.

However, all show a low return on assets. All except for Port Kembla have a return on assets of less than the comparison ports – noting that most of the comparison ports themselves have returns which may be considered low by usual commercial standards. In part this reflects relatively low revenues and relatively high asset values. Since commercial investment decisions are made in relation to expected returns on assets created, the current low returns are not conducive to attracting further investment – rather better commercial use of existing assets would be first sought.

Reasons for low returns on assets could include legacy arrangements such as contracts and charges which do not fully reflect commercial principles, requirements to provide community services without adequate payment, and a lag between investment in capacity and the created assets generating adequate commercial revenue streams (possibly a lumpiness problem).

It is understood that there have been proposals for federal ‘equity’ investments into ports. The average return on equity in comparison ports at 9.2% is several percentage points above the ‘risk free’ (10 year) bond rate, and the official cash rate. None of the comparison ports has a return on equity of less than 5%. However, for the analysed ports return on equity averages 3.6%, which is less than the risk free rate, the official cash rate, and just over 1/3 of the rate of return achieved by comparison ports.

This is broadly consistent with earlier findings of the Productivity Commission in its former series Financial Performance of Government Trading Enterprises; which reported relatively low rates of return for ports up to the mid 2000s. However, the analysed ports show rates of return on assets well below those reported by the Commission for 2006-07.

From the perspective of an external passive investor into Australian ports, the above may suggest that some mechanism of pooling opportunities for equity investment in various ports may be attractive – this would be reinforced for those ports which rely heavily on particular trades. However, the issue of low returns on assets and equity would first need to be addressed.

The national ports strategy calls for 50 years plans for ports. While few Australian ports have long term plans, many ports have ambitious short term expansion plans. If the above patterns were repeated across government owned ports, implementation of such plans probably would require resort to taxpayer support explicitly through grants or ‘equity’ injections, or implicitly through acceptance of sub-commercial (and lower than cash rate) rates of return. This may be an issue for further discussion in the implementation of the national ports strategy.

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<sup>8</sup> Port Hedland Annual Report 2011

## 4 Limitation of our work

### General Use Restriction

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