In Focus: Finance

Failing funds

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Barry Parker attempts to clear the financial fog shrouding port investment

Macquarie's assets in Vancouver (pictured) and Halifax could be at risk under a 'broken' fund model

Peering through the financial darkness, it's clear that the port industry is still stuck in an economic quagmire.

One leading bank closely involved with infrastructure investments, tells *Port Strategy* that "the financial markets can hardly be described as normal" - an understatement if ever there were one.

The actions of industry stalwart Macquarie, which owns port assets in British Columbia (Vancouver) and Nova Scotia (Halifax), demonstrates the desperation.

In late July, the Macquarie Group announced it would cease taking fees from a flagship airport fund with high profile investments including Copenhagen and Brussels. Several months after Macquarie booked large "impairment" charges on its fund investments, some observers were saying that the infrastructure fund model was "broken" given the private sector difficulties.

At investment manager Babcock & Brown (B&B), the fund model went to tatters earlier this year, with shareholders wiped out and debt providers now seeking to reap proceeds of asset sales. A European infrastructure fund went to a management-led group for €2.2bn ($3.1bn), while a large minority of B&B's investment in Euroports (with terminals around North Europe and the Mediterranean) was sold to the new entity, christened Arcus Investments, for roughly €140m ($200m). These figures imply an overall valuation at €353m ($503.5m) compared with €409m ($583.4m) in late 2008 - whichever way you cut it, B&B booked a large loss.

Still in the balance is B&B's investment in PD Ports, with locations at Teesport, the Humber River and at the Isle of Wight, acquired at the height of the boom in 2005.

With this context in place, we can be certain that the actions of three teams now seeking a role in operating three container terminals for the Virginia Port Authority at Norfolk, Hampton Roads and Portsmouth, and one inland terminal (at Front Royal, a rail and highway hub), will be closely followed.

In March, a Chicago-based developer of industrial parks, Center Point Properties Trust, submitted a proposal valued at $2.2bn over 60 years, to privatise these facilities. Then in late July, two other entrants submitted proposals: the Washington, DC-based Carlyle Group (also reportedly bidding for PD Ports in the UK), and a partnership composed of SSA-backer Carrix and partnerships tied to the $6.5bn (committed capital) Goldman Sachs Infrastructure Fund. Carrix has been 49% backed by the Goldman Sachs partnership since 2007. Goldman Sachs, through the infrastructure entity, owns 23.3% of Associated British Ports.

The politically-connected private equity specialist Carlyle Group, with $85.5bn under management (circa May, 2009), raised $1.15bn, in late 2007, for an infrastructure fund; its portfolio includes IMTT, a large terminal operator.

Port Strategy talked with Craig Fuehrer, managing director and head of Transportation and Infrastructure at Deutsche Bank, who offered his assessment of current market conditions. He says that many infrastructure funds were in positions of ample liquidity, having raised capital from investors during the boom over the past few years. But, he is quick to point out: "Many of the earlier port deals have not worked out; the business has fallen off dramatically.

"You need to have a viable business plan, and honestly, with throughputs down as much as 30% in some of the container trades, it's hard to get anyone with conviction."

In further assessing the market climate, he describes debt markets that have opened up, but not fully, telling *PS*: "The bank markets have opened up for existing credits, but not for new deals."

He says that with funds sitting in capital that has not been invested, "it's still very hard to pin down a base case that makes sense, with the flows correctly aligned with the leverage…there are a number of deals that are still not getting done."

Mr Fuehrer's remarks are borne out by financial analytics in the Carrix/Goldman Sachs proposal. On the equity side, a new euphemism, "multiple compression" is used to describe the valuation for a nine-company composite of share-listed port owning companies. Between January 1, 2008 and late July, 2009, the median multiple of enterprise value/operational cash flow dropped 40%, from 19.7x to 11.6x.

On the debt side, Carrix/Goldman reminds readers that leverage that fuelled the 2005/2007 boom is not available anymore, saying: "Credit is now scarce, what is available is more expensive, and banks will not allow the same amounts of leverage to be placed on assets."

Statistics on project finance (typically provided by banks in terms loans of around seven years) reveals that "…project finance global transaction volume was $312bn in 2007; with $168bn of that activity in the second half of the year".

But many of the biggest banks, which provided $4.3bn on five of the largest port deals of 2005/2007 (at ratios of debt to operational cash flow of between 9x and 17x), have exited the business.

According to Carrix/Goldman: "Those still operating have very little capacity to lend and/or more stringent credit standards. Global project finance volumes have declined to 2005 levels, with the first half of 2009 showing $80bn of transaction volume, a 52% decline."

For infrastructure equity holders, typically pension funds, endowments and trusts, port investments are sought after because of stable cash flows. A major investor backing CenterPoint is the California Public Employees Retirement System (Calpers), the largest public pension fund in the US, managing assets of $181bn as of end June, 2009. The investment experience of Calpers is instructive; the fund had lost $56bn (or 23.4%) from its value a year earlier.

The recent popularity of "alternative investments" has, of course, come to bite large institutional investors; real estate was a bad performer at Calpers, which reported an estimated 35.8% drop during the one year period, while private equity investments in the Calpers portfolio saw a 31.4% decline.

CenterPoint's original announcement of its proposal came, coincidentally, shortly after a privatisation deal on the US West Coast was announced, involving The Port of Oakland.

In March, Oakland announced that a 50-year concession would be awarded to a company owned jointly by Ports America (an entity owned by the private equity investor Highstar Capital - managing more than $4.5bn) and Mediterranean Shipping Company, for a handful of berths in its Outer Harbor.

Shortly after the official bids deadline, CenterPoint announced that it was seeking to team up with GCT Global Container Terminals. GCT itself is in the hands of another long term investor, the Ontario Teachers Pension Plan since its purchase from Orient Overseas several years ago.

An insight into the potential strategy of the entrant, also emerges, with a hint that "the partners will operate the only two deep-water ports on the East Coast," offering "a key marketing advantage to Virginia as it services the large ships expected to serve the East Coast" post-2014, when the widened Panama Canal opens up.

CenterPoint says that it might consider a non-competitive arrangement that restricts its investments to Virginia, after noting that, unlike other bidders, "CenterPoint/GCT does not operate or have investments in competing Mid-Atlantic maritime facilities". This can be construed as a reference to SSA Marine's stevedoring and terminal operations at facilities in nearby Charleston, South Carolina - a competitor with the Virginia terminals.

The CenterPoint letter also stresses the long term nature of returns sought by both Calpers and the Ontario Teachers funds, and talks about long term capital being available over the life of the proposed arrangement, 60 years.

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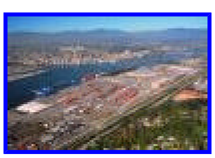

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