

Optimisation of Growth in a Challenging Economic Climate

Ladies & Gentlemen, Good morning and thank you for the opportunity to speak to you today.

My topic is the optimisation of growth in a challenging economic climate.

Globalisation and an opening up in world trade have seen growth in cargo volumes coming relatively easily to many ports over the last 20 years, including at Ports of Auckland.

However, I think it is fair to say that the last eighteen months have been very challenging globally, and probably, particularly for the industry that we all operate in.

Clearly, businesses cannot expect a speedy return to pre-recession spending levels.

So how do we grow our businesses in this new, leaner and rationalised world?

From our perspective, it is about identifying the most promising growth areas in New Zealand over the short to medium term, and even though we remain focused on what's happening in the world, our immediate growth opportunities all seem to be closer to our own shores.

The world has definitely changed, and we must now re-think how we achieve growth in volume, revenue, productivity, profits, dividends, organisational maturity and land utilisation

How we grow and re-tool our businesses to meet the challenges of a new and very different world.

Today I will give a two part presentation.

Firstly, the *Global / Regional Context* – I'll begin by touching on the wider economic and competitive scenario.

The new world requires a change in focus by everyone involved in the supply chain, and there are some particular challenges for our part of the world ahead.

Secondly, a *Case Study of Ports of Auckland as a "city port" eager to continue to grow*- I'll then move to some examples from Ports of Auckland, where we are at a very interesting point in the company's and city's development and growth - balancing pressures from different directions and stakeholders - the trend toward hobbing and larger ships, intense inter-regional competition, pressure to release waterfront land for other uses, and of course recovering cargo volumes.

Taking a look at the economic context, globally, GDP declined 2.2% in 2009, and just last week (20 Jan) the World Bank warned that recovery would slow this year, as the impact of fiscal stimulus wanes.

While the World Bank is predicting a 2.7% increase in 2010 and 3.2% in 2011, growth in 2011 could indeed slow to as low as 2.5% depending on consumer and business confidence in the next few quarters and the timing of fiscal and monetary stimulus withdrawal.

It's not all bleak though, the main engine of global growth remains China, which achieved 8.7% GDP growth over 2009 (calendar year), and is expected to be back close to double-digit growth in 2010.

Turning now to the competitive scenario, Alphaliner anticipate a net seven percent incremental growth in container shipping capacity year-on-year – but only a four percent growth in cargo and equipment traffic – this has been underpinned by one of the very large container lines who just a couple of weeks ago predicted a 3-5% market volume growth for 2010.

The overall situation could well compound the current tonnage supply surplus, putting additional pressure on lines and their service providers, including ports world-wide.

This new global dynamic will require a change in focus from everyone involved in the supply chain.

We must all do things differently in the future - there is no going back to where things once were, new standards have been set.

- Capital expenditure **must** be controlled
- Waste must be eliminated
- Customer service standards have been raised, with customers becoming even more demanding
- Competition will become even tougher in the future

Shareholders will need to adjust: port managements must necessarily generate continuous improvement in productivity and unit costs, but in the interim, some shareholders may well have to be patient and accept lower returns.

Ports are businesses with a very long-term horizon.

The new environment also requires a different approach to the management of ports' highly capital-intensive assets.

We are seeing an increased focus on optimising the use of existing assets and exploring ways of curtailing capex in the short term.

The longer the investment can be deferred and high fixed costs delayed, the better.

Looking forward I believe that many ports will only be prepared to make major investments on the back of very firm, long term customer commitments and contracts, not in a speculative fashion (which probably has been the case, to some extent, in the past).

Variable costs, including labour, will also come under increased and ongoing scrutiny, with new, more flexible labour models needed for ports to remain competitive.

The new dynamics also require fresh thinking and a focus on identifying new revenue streams that offer synergies with ports' core businesses.

This is about understanding how **we**, the ports, can add value to the whole supply chain, not just the operations on the wharf.

I'll move now to the second part of my presentation – a case study of Ports of Auckland.

Just briefly, for those of you who aren't familiar with us, we're New Zealand's largest container, cruise and vehicle import port.

We own the land we operate on, but are also terminal operators of our container business.

We handle cargo equivalent to \$27 B per annum, 15% of the country's total GDP - twice as much as any other New Zealand port.

And 38% of all of New Zealand's imports and 23% of her exports cross our wharves each year.

We handle around 840,000 TEU and 1,600 ships calls each year.

We've got three sites – the Port of Auckland on the east coast in the Waitemata Harbour, the Port of Onehunga on the west, and the Wiri Inland Port in South Auckland

I mentioned earlier the need to identify new revenue streams outside traditional stevedoring and seaport activities – we recently set up a subsidiary company CONLINXX Ltd, with long-established NZ logistics and freight company NZL Group, to run the Wiri Inland Port and increase our exposure to the wider freight sector, and get a stronger presence in the hinterland. It's about being innovative, curtail supply chain management costs and come up with new logistic solutions.

Ports of Auckland is 100% owned by Auckland Regional Holdings, the investment arm of the Auckland Regional Council; it's an inter-generational shareholder with a mandate to act in the best long-term interests of the Auckland region.

We are blessed in Auckland with a compatible shareholder who, while demanding adequate financial returns, also has a long-term view and mandate.

Our location in Auckland is advantageous; we are blessed with easy access to New Zealand's largest city and manufacturing and industrial heartland.

One major challenge for us is presented by our situation right on Auckland's CBD waterfront.

Since 1996 we have released around half our land for redevelopment but there is still pressure on our footprint from players in the tourism and hospitality sectors who would like to see further waterfront development take place.

However, taking a "birds-eye" look at the 2000 – 2010 decade for Ports of Auckland – the period can be summarised as one of visionary planning, with substantial capital expenditure in infrastructure, dredging and reclamation, inland ports, new cranes, and straddles – with highlights including a major extension of our Fergusson container terminal and deepening of the Rangitoto shipping channel to accommodate the next generation of container vessels.

The trend to larger ships and hubbing is upon us all around the world.

The largest ships to visit New Zealand on a regular basis are currently 4,100 TEU class. What is happening is that the lines are keeping capacity tight on their existing schedules and bringing in extra-loaders when needed to cater for additional demand. The next step will likely be regular visits by 4,500 and 5,000 TEU ships before the next generation of 6,000 TEU vessels arrive.

Both the trend to larger ships and the extra loader phenomenon mean that not only seaports need to be equipped to deal with greater peaking factors and variability of demand, but the infrastructure beyond the port needs to be up to the job, too. NZ is faced with challenges in a number of areas, rail network and roads.

As a country highly dependent on exports and remote from global markets, New Zealand is prudently moving to understand long-term freight demand and the consequential implications for its supply chain, with a range of studies and research projects complete or underway.

There is undoubtedly considerable fat and inefficiency within the current supply chain and a lot of room to make gains.

In an attempt to generate further supply chain efficiencies we've also seen a series of attempts at port mergers in recent years, which however have as yet not been realised.

Some kind of New Zealand port rationalisation would appear logical, but how and when things will play out is as yet unknown.

New Zealand obviously has more ports and more geographically close ports than Australia.

For Ports of Auckland container cargo volumes held up fairly well in 08/09 – up 0.3%, and we saw encouraging signs of a further recovery in the last quarter of the 2009 calendar year.

But obviously even a 0.3% increase is well behind our historical annual growth rates of 6%-7%, and vehicle imports took a big hit.

We responded quickly with a major cost reduction exercise and a project to consolidate our two separate terminal operations into one – and we're on track to deliver a minimum \$5M of operational savings this financial year.

Looking back, the recession gave impetus to our decision-making and strengthened our spine when it came to pushing these changes through.

The temporary slow-down in cargo throughput has also provided us with the opportunity to change our focus slightly and put even more effort on getting the capex strategy right - deferring whatever can be deferred, in our case investment in Automatic Stacking Cranes.

We've also looked to put new revenue streams in place through the logistics subsidiary CONLINXX that I mentioned earlier, and other initiatives such as a brand new small 4,000 DWT tanker vessel, which we were able to secure at a competitive price during the downturn, and is proving very successful.

I would say that besides the confidence aspect we have also managed to grow the maturity of our organisation.

We've been able to focus more on what some people would probably consider the "softer" areas, such as organisational strength and maturity, corporate social responsibility and community relations

We've also been able to release some of our land, identifying a capacity window that enabled us to sell one of our old wharves, Queens, to the Government and the Auckland Regional Council, for redevelopment as an international cruise ship terminal and 'party central' for the 2011 Rugby World Cup, hosted by NZ.

Looking forward it's now a question of further optimisation / utilisation of assets including labour, and generating continual productivity and efficiency improvements.

We will not see a return to the days of big spending without full customer commitments to back it up.

So looking forward for Ports of Auckland and the wider sector – what next? How do we optimise growth in the current environment?

In the next decade and beyond I visualise Ports of Auckland, as a city port, increasing its focus on optimising land utilisation and footprint.

With a view to the long-term, and recognising fundamental changes in societal expectations and pressures upon port companies, we will also continue to work to grow and enhance our performance as a responsible corporate citizen and neighbour.

Examples of this include our ongoing commitment to dialogue with our neighbours and resolving issues of community concern, and to target-setting, measurement and reporting of our environmental and social performance (for example our annual externally audited greenhouse gas inventory).

We will look to new, cleaner technology and innovative ways of doing business to increase our efficiency and capacity.

There will be an increasing focus on e-commerce enabled customer service and information sharing across the supply chain.

We must also continue to grow the efficiency and maturity of the organisation through the training and grooming of talent.

Our focus on lifting productivity must and will intensify. Sure, we were doing this before the recession, but we have become more hard-nosed and will continue to raise the bar.

We must work smarter and faster, continue to control costs and get more done with less.

Critically, these days it's not just about efficiency within the port gate, but driving efficiencies and removing waste from the entire supply chain.

The key for Ports of Auckland is to take a leadership role in this, rather than leaving it to other parties. The vision is clearly defined: To be the best port company in this part of the world.

To briefly recap, the industry and the economic climate in which we operate has undergone, I believe, a fundamental change.

Everyone has become more efficient and cut their costs.

There will not be a return to the climate we were operating in before the global downturn.

Nor will there be a swift recovery from the recession.

Society is also changing in terms of its expectations of ports and other businesses – especially in regard to climate change, environmental impacts and social responsibility.

These changes require an equally fundamental re-thinking of how ports, especially city-ports such as Auckland, do business.

The days of extraordinary capital expenditure in advance of customer commitments are gone.

We have cut costs and achieved efficiency gains - the recession has had substantial positive impact.

In my opinion: Growth Anno 2010 is very different from how we defined growth prior to 2008.

Looking forward, it's about working together to achieve overall gains for the supply chain, and in doing that growing our own market share.

A partnership and whole-of-supply-chain approach will be required both at a regional and national level, if our industry is to thrive and New Zealand is to maintain its competitiveness in global markets.

Thank you for your attention.