



Report 04.479
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Committee Policy, Finance and Strategy
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CentrePort - 2004/05 draft SCI

1. Purpose

To receive the draft Statement of Corporate Intent (SCI) of CentrePort for the 2004/05 year (refer **Attachment 1**).

2. Background

Section 10 of the Port Companies Act 1988 requires the Port Company Directors provide to shareholders a draft SCI before 31 July, to consider any comments from shareholders on the draft SCI before 31 August, and to deliver the completed SCI to shareholders by 30 September. However, this year we requested CentrePort to provide certain SCI information to us earlier than 31 July to enable completion of the WRC Holdings Group Statement of Intent (SOI) by 30 June. CentrePort agreed to do this and in late May we received from CentrePort a draft 2004/05 SCI covering the next three financial years (for the years ending 30 June 2005, 2006 and 2007).

In exercising their primary governance responsibility the Directors of Port Investments Ltd (PIL) have already considered the draft SCI and it is now brought before the Committee to seek any additional comment from Councillors, as the Council is the ultimate shareholder.

The delivery of the final SCI from CentrePort is expected during September.

3. PIL Directors views on the Draft SCI of CentrePort

As noted above, the draft SCI of CentrePort has already been considered by the Directors of PIL. At that meeting the Directors requested that a meeting be arranged with the CentrePort Board to enable PIL Directors to discuss issues directly with their CentrePort counterparts, prior to consideration by the Committee. It was felt that such a Board to Board meeting would give the PIL Directors a good opportunity to examine the issues more directly, and in more detail than a normal six monthly shareholders' briefing.

Following the PIL Board meeting in June a letter was sent to Nigel Gould, CentrePort Chairman (refer **Attachment 3**) requesting that the CentrePort and PIL Boards meet so that PIL (as shareholder) could receive an outline of the Port's strategic plan and receive assurance about other key matters identified in CentrePort's draft SCI.

In particular, the Directors raised concerns about:

- The implications of broadening the focus of the company from “port operations” to “transport logistics solutions”.
- The concept of a fixed \$ amount of dividend and the appropriateness of the level of \$3.6 million per annum, compared to the 55% of NPAT currently employed.
- The implications of CentrePort not establishing a separate property company.

4. Meeting between PIL Directors and CentrePort Directors on 18 August 2004

On 18 August the PIL Board, supported by officers, met with the CentrePort Board and the Chairman of Horizons Regional Council.

The meeting provided a good opportunity for the PIL Directors to explore the concerns raised above, within the context of a discussion on CentrePort's overall strategic direction.

4.1 Focus of the company moving to “transport logistics solutions”

The CentrePort Board explained that broadening the focus from “port operations” to “transport logistics solutions” reflected the changes being undertaken at CentrePort to allow the port to grow in an increasingly competitive environment. The CentrePort Directors explained that significant changes are taking place in the industry and that Port companies can no longer rely on a “captured” hinterland exporting through a local port. Moves to bigger container ships, hubbing of cargo, and changes to transport infrastructure in New Zealand and abroad, mean that new approaches are required. Shipping companies are increasingly looking to ensure that sufficient volumes of cargo are available in one place, at one point of time, and at one price. The change in wording to “transport logistics solutions” in the SCI is designed to capture this change in emphasis to a more proactive facilitator role rather than a reactive provider of infrastructure. This approach sounds sensible and should not significantly alter the risk profile of the company.

4.2 Dividends

The CentrePort Directors explained that the key driver behind the desire to move to a fixed \$ amount of dividend is to ensure that over time the Port Company can retain more money in order to fund what could prove to be potentially significant capital expenditure requirements over the medium to

long term. CentrePort's future capital expenditure requirements include maintaining and ongoing replacement of Port operational assets and further development of land in the business park, designed to both support current income streams and help grow revenue in the future.

In suggesting this approach CentrePort has assumed that calling on existing shareholders to advance further capital, or diluting existing shareholding by raising new capital would not be looked on favourably by the shareholders. Setting a fixed dividend amount would have the advantages of providing a more steady and predictable income stream to the shareholders and assist CentrePort in managing its debt levels. However, CentrePort indicated that for any significant future developments (e.g. large scale property developments or redevelopment of the ferry terminal), other funding options may also need to be considered.

A dividend of \$3.6 million per annum equates to a NPAT of \$6,545,000 at a 55% dividend payout and is consistent with what we have budgeted for in PIL. It also helps to provide certainty in any given year when profitability dips below SCI target levels, such as in 2003/04.

In my view, both the concept and level of dividends proposed in the draft 2004/05 SCI should be supported, as it is consistent with the Council's policy of:

"continuing to review CentrePort's policy for the payment of dividends (currently 55% of net profit after tax is paid out in dividends) to ensure the right balance between reinvestment and returns to shareholders"
[refer Council's Treasury Management Policy pg 23]

As a prudent and responsible shareholder this is hard to argue with as long as such capex is in fact required.

The level of proposed dividend should continue to be reviewed each year as part of the SCI process when it will be possible to further explore the nature of the capital expenditure programme.

In recommending acceptance of a fixed dividend amount of \$3.6 million p.a. I believe the shareholders should request that the dividend is paid in two instalments as follows:

- \$1.8 million February
- \$1.8 million June (3 months earlier than currently)

subject to CentrePort's solvency test.

4.3 Separation of property

The internal separation of Port land between operational, developed investment property and undeveloped investment property was discussed. Although it was recognised that from a return on assets and governance/management point of view, there may be advantages in taking the internal separation to the next

stage and forming a separate property company, there were also reasons put forward why this was undesirable. There are concerns that such an approach may compromise the ability of the company to generate synergies from port operations and property, there are possible negative taxation consequences from this approach and even possible issues related to ultimate ownership (if land assets were ever separated off from the operational port). On balance, CentrePort wanted to leave all future options open and felt that many of the benefits of a separate legal structure could be gained by improved internal reporting and monitoring without the downsides associated with running separate companies.

5. Comments on SCI document

As is normal, there are two broad issues to consider when reviewing the draft SCI document:

⇒ The words

⇒ The numbers

5.1 The words

I have compared the draft SCI for 2004/05 (refer **Attachment 1**) with the final SCI for 2003/04 (refer **Attachment 2**) to assess to what degree the Port Company has changed the wording.

Listed below are the changes that I have identified:

Para 1.1. (b)	rewording of old 1.1 (b)
Para 1.1 (c)	rewording of old 1.1 (b) with changed emphasis away from Port operations to a broader focus on transport logistics solutions
Para 1.4 (a)	new
Para 2.4	rewording, consistent with para 1.1 (c) above
Para 5.1 (c)	breakdown of return on assets to be provided between port, investment property and property development
Para 5.1 (f)	relocated from para 6.1
Para 5.3 (a)	rewording
Para 5.3 (c)	new [old 5.3 (d) deleted]
Para 5.4 (a)	rewording encompassing old 5.4 (a) and 5.4 (c)
Para 5.4 (b)	new
Para 5.4 (c)	new [old 5.4 (d) deleted]

Para 6.1 amended to reflect fixed \$ amount of dividends rather than a percentage

Para 11.4 date for governance review of 30 September 2005 rather than 30 September 2004

Overall, I believe that the changes to the words in the 2004/05 SCI are reasonable.

5.2 The numbers

As Councillors will note, the numbers in **Attachment 1** are not yet complete as CentrePort was awaiting the impact of the property revaluation at 30 June 2004 when the draft SCI was prepared.

However, the key numbers of interest to shareholders, are the projected dividends. As noted in section 3.1 above, the CentrePort is proposing to fix the level of dividends at \$3.6 million per annum.

6. Communications

Communication will be required with CentrePort once the Committee has considered the draft SCI.

7. Recommendations

That the Committee recommend the Council:

- (1) receive the report and note its contents.*
- (2) receive the draft Statement of Corporate Intent of CentrePort for 2004/05, and the immediately following two years and request that any comments or recommendations for change provided to the Chief Financial Officer for incorporation into the formal response from the Directors of Port Investments Ltd to CentrePort.*

Report prepared by:

Greg Schollum
Chief Financial Officer

Attachment 1: CentrePort draft SCI – 2004/05

Attachment 2: CentrePort final SCI – 2003/04

Attachment 3: Letter to the Chairman of CentrePort from the Chairperson of PIL dated 21 June 2004