Controller and Auditor-General
Tumuaki o te Mana Arotake

B.29[21e]

# Results of our 2019/20 audits of port companies

Photo acknowledgement:
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# Results of our 2019/20 audits of port companies

Presented to the House of Representatives under section 20 of the Public Audit Act 2001.

July 2021

# Contents

# Auditor-General's overview

E ngā mana, e ngā reo, e ngā karangarangatanga maha o te motu, tēnā koutou.

Ports are significant because of the part they play in New Zealand's economy and the capital invested in them. Ports are also significant because, for the most part, they are owned by councils on behalf of the public.

Port companies face some major challenges, including their need to:

- make major capital investments when the financial returns from those investments are uncertain;
- continue to respond to international trends in freight and logistics; and
- balance the potentially conflicting objectives of shareholders and other stakeholders.

Added to this are the challenges and uncertainty from Covid-19.

It is difficult to compare port companies' performance because of differences in their ownership, the size and scale of their operations, and the way they measure their assets.

I encourage port companies to consistently apply fair value in the valuation of property, plant, and equipment. This will help provide up-to-date relevant financial information to shareholders and enable better comparison and transparency of port company financial performance.

Some port companies' previous investment strategies have not delivered as expected. This is most notable for Lyttelton Port Company Limited, where $290 million of assets were written down over the last five years, in part because the expected revenue associated with the new investment did not eventuate.

As port companies look to the future, many are considering significant new investments. These might be to remain sustainable given international shipping trends or to cater for anticipated growth. There is considerable risk in these investments. Port companies need robust and realistic business cases to ensure that these investments deliver the benefits expected of them.

There is also a risk that, without a comprehensive supply chain strategy for the freight logistics sector, port companies will anticipate growth that competing port companies might have also factored into their business cases. Stranded assets, underperforming capital, and low returns or further asset write-downs are a likely consequence of this.

I encourage port company boards – and, where appropriate, their shareholders – to robustly assess the merits of significant capital investments before approving those investments. This is to ensure that the assumptions these investments are based on are realistic and are the best use of shareholder capital.

I thank staff and governors of port companies who worked hard to meet their customers' and shareholders' expectations and uphold their accountability responsibilities in an extremely challenging environment.

Nāku noa, nā

John Ryan
Controller and Auditor-General

15 June 2021

# Port company information for 2019/20

**Marsden Maritime Holdings Limited***

| | | |
|---|---|---|
| #12 | Revenue | $15.1m |
| #9 | Profits | $6.7m |
| #7 | Dividends | $6.6m |
| #10 | Total assets | $155.8m |
| #10 | Total equity | $137.3m |

**Ports of Auckland Limited**

| | | |
|---|---|---|
| #3 | Revenue | $234.5m |
| #4 | Profits | $23.1m |
| #12 | Dividends | $0.0m |
| #2 | Total assets | $1,451.5m |
| #2 | Total equity | $821.2m |

| Export | Import |
|---|---|
| $4.14b | $23.30b |

**Port of Tauranga Limited**

| | | |
|---|---|---|
| #1 | Revenue | $302.3m |
| #2 | Profits | $89.9m |
| #1 | Dividends | $124.5m |
| #1 | Total assets | $1,817.2m |
| #1 | Total equity | $1,163.6m |

| Export | Import |
|---|---|
| $26.72b | $10.13b |

**Port Taranaki Limited**

| | | |
|---|---|---|
| #8 | Revenue | $51.8m |
| #6 | Profits | $12.2m |
| #4 | Dividends | $8.0m |
| #9 | Total assets | $198.2m |
| #9 | Total equity | $148.9m |

| Export | Import |
|---|---|
| $2.31b | $0.60b |

**Port of Napier Limited**

| | | |
|---|---|---|
| #6 | Revenue | $101.4m |
| #5 | Profits | $21.6m |
| #2 | Dividends | $11.0m |
| #6 | Total assets | $375.8m |
| #7 | Total equity | $185.3m |

| Export | Import |
|---|---|
| $3.90b | $1.02b |

**CentrePort Limited**

| | | |
|---|---|---|
| #2 | Revenue | $262.7m |
| #1 | Profits | $158.4m |
| #9 | Dividends | $5.0m |
| #5 | Total assets | $506.4m |
| #4 | Total equity | $455.5m |

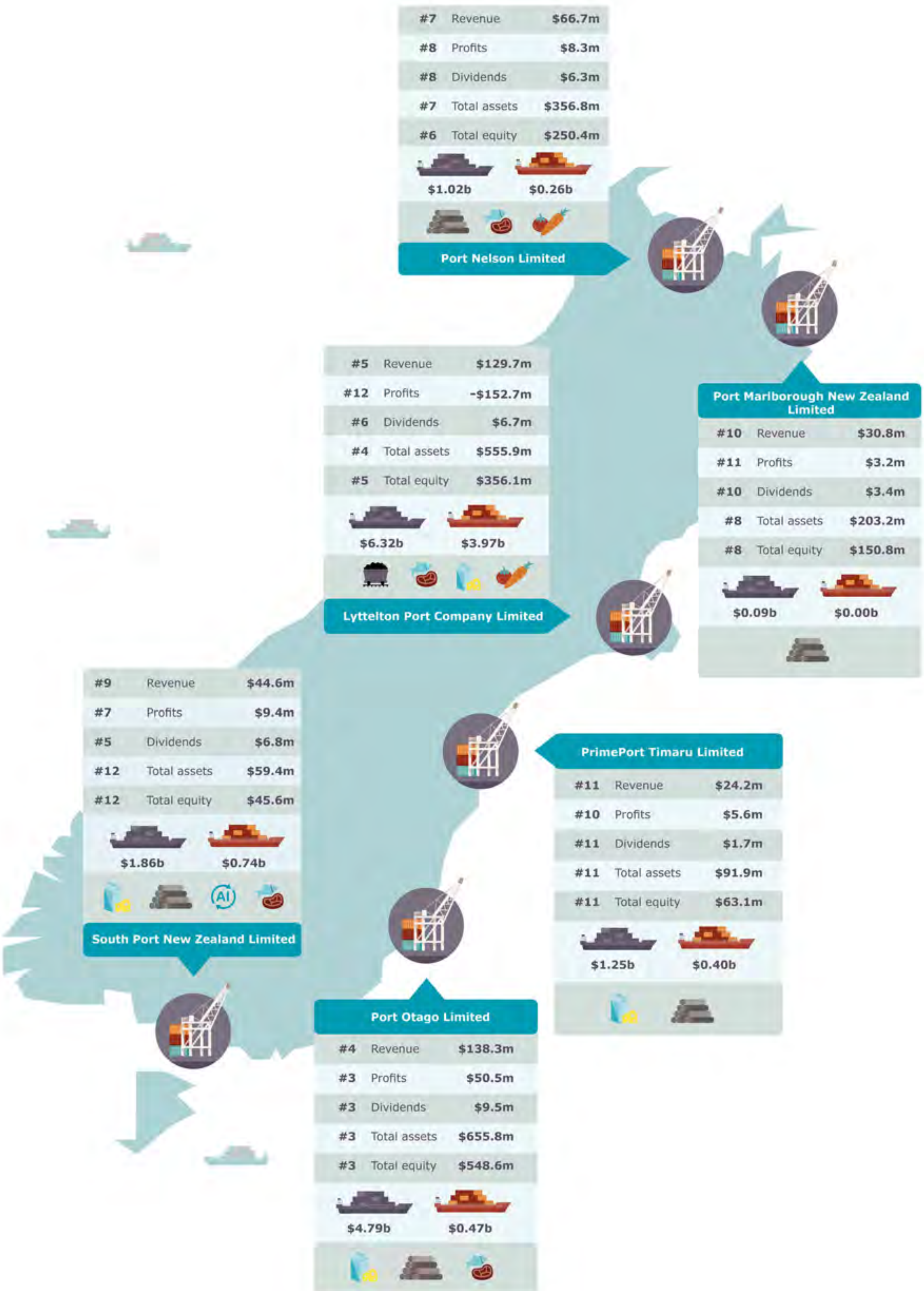
| Export | Import |
|---|---|
| $1.69b | $2.42b |

**Key**

Aluminium · Chemicals · Coal · Dairy · Logs including related wood products · Export

Meat & fish · Oil · Vegetables & foodstuffs · Vehicles including machinery · Import

* The port operations in Whangārei, where Marsden Maritime Holdings is based, are operated by three different organisations. Because of this structure, we have not included export, import, or bulk commodity information for Marsden Maritime Holdings.


#7 Revenue $66.7m
#8 Profits $8.3m
#8 Dividends $6.3m
#7 Total assets $356.8m
#6 Total equity $250.4m
$1.02b
$0.26b
Port Nelson Limited
#5 Revenue $129.7m
#12 Profits -$152.7m
#6 Dividends $6.7m
#4 Total assets $555.9m
#5 Total equity $356.1m
$6.32b
$3.97b
Lyttelton Port Company Limited
Port Marlborough New Zealand Limited
#10 Revenue $30.8m
#11 Profits $3.2m
#10 Dividends $3.4m
#8 Total assets $203.2m
#8 Total equity $150.8m
$0.09b
$0.00b
#9 Revenue $44.6m
#7 Profits $9.4m
#5 Dividends $6.8m
#12 Total assets $59.4m
#12 Total equity $45.6m
$1.86b
$0.74b
South Port New Zealand Limited
PrimePort Timaru Limited
#11 Revenue $24.2m
#10 Profits $5.6m
#11 Dividends $1.7m
#11 Total assets $91.9m
#11 Total equity $63.1m
$1.25b
$0.40b
Port Otago Limited
#4 Revenue $138.3m
#3 Profits $50.5m
#3 Dividends $9.5m
#3 Total assets $655.8m
#3 Total equity $548.6m
$4.79b
$0.47b

# 1 Introduction

1.1 In this Part, we outline:

- why we prepared this report;
- the port companies covered in this report; and
- the structure of the report.

## Why we prepared this report

1.2 This is the first formal report we have prepared about port companies. In previous years, we reported our findings in other reports, such as our local government reports, or in letters to chief executives and chairpersons of port companies. However, we consider that the port sector had enough significant matters in 2019/20 for its own report.

1.3 We discuss several common trends that our audits of port companies identified. We hope this report will prompt Parliament, the port companies, and the port companies' shareholders and other stakeholders to further discuss these trends.

## The port companies covered in this report

### Port Companies Act 1988

1.4 This report covers port companies incorporated under the Port Companies Act 1988 (the Act). The purpose of the Act is to promote and improve efficiency, economy, and performance in the management and operation of the commercial aspects of ports.

1.5 Currently, 12 port companies are incorporated under the Act. We show their location and give an overview of each of them in "Port company information for 2019/20" (pages 6-7), and the Appendix provides a summary of their financial and other information for 2019/20.

1.6 Section 19 of the Act defines all port companies as "public entities". As public entities, they are audited by the Auditor-General.

1.7 Most coastal centres in New Zealand will have some port infrastructure (such as wharfs). This infrastructure will generally be regarded as community assets and is owned by a council or a community organisation.[1] This report does not cover these assets.

### Every port company needs to operate as a successful business

1.8 Section 5 of the Act states that the principal objective of every port company is to operate as a successful business. The Act does not define what a successful business is.

1 For example, Grey District Council owns the port assets based in Greymouth, and Trust Tairāwhiti owns Eastland Group Limited, which operates the Eastland port based in Gisborne.

1.9 In practice, port companies have worked with their owners to set out what it means to be a successful business. For some port companies, success depends on their ability to maximise returns for their shareholders. For others, their shareholders expect them to have a range of objectives instead of just maximising returns.

1.10 For example, Port Taranaki's mission is to "provide a safe harbour, services and facilities that [its] customers can rely on to **make trade easy** and enable [the] region to prosper" (emphasis in original quote).[2] Lyttelton Port Company's purpose is to "sustainably facilitate trade for Canterbury".[3]

## There are significant differences between the port companies

1.11 Although the 12 port companies all operate ports, they have some significant differences. This is partly because of their shareholders' views of what being a successful business means. There are also three important structural differences between port companies: ownership, size and scale, and operations.

1.12 All the port companies are either majority or wholly owned by councils. However, there are important ownership differences:

- Three port companies have publicly listed shares traded on New Zealand's Exchange (the NZX),[4] although they are majority-owned by a council.[5]
- One port company is owned by a listed company, which is majority-owned by a council.[6]
- One port company is partly owned by other port companies.[7]
- The other seven port companies are partly or wholly owned by one or two councils.

1.13 The port companies are also of different size and scale. The two largest port companies are Port of Tauranga and Ports of Auckland. Based on their results for 2019/20, these two companies own 51% of all of the assets (by value) that are owned by port companies in New Zealand and generate 38% of the revenue.

2 See Port Taranaki's website at porttaranaki.co.nz.

3 Lyttelton Port Company (2020), *Statement of intent: A sustainable port*, page 5.

4 Commonly, these types of organisations are referred to as "listed companies".

5 The listed port companies are Marsden Maritime Holdings Limited (majority-owned by Northland Regional Council), Port of Tauranga (majority-owned by Bay of Plenty Regional Council through its company Quayside Securities Limited), and South Port (majority-owned by Environment Southland). Ports of Auckland also owns 19.99% of Marsden Maritime Holdings.

6 Port of Napier is owned by Napier Port Holdings Limited, which was listed on the NZX in August 2019. Napier Port Holdings is majority-owned by Hawke's Bay Regional Council through its holding company Hawke's Bay Regional Investment Company Limited. Before listing, Port of Napier was 100% owned by Hawke's Bay Regional Investment Company Limited.

7 PrimePort is 50% owned by Port of Tauranga and 50% by Timaru District Council through its holding company Timaru District Holdings Limited.

1.14 Tauranga is New Zealand's largest export port (48% of total exports by value in 2020 went through that port). Auckland is the largest import port (receiving 51% of total imports by value). By comparison, the five smallest port companies own 11% of assets, generate 13% of revenue, and process less than 15% of the exports and imports that go through New Zealand ports.[8]

1.15 Some of the port companies have operations that are not part of their core port operations. Generally, these operations complement their core port operations. For example:

- Port of Tauranga and Ports of Auckland have investments in freight logistics businesses.
- Six ports[9] have invested in inland ports or freight hubs[10] that help transfer freight to or from the port.
- Many port companies own properties that are leased to third parties. Port Otago, in particular, has an investment property portfolio in Dunedin, Auckland, and Hamilton, with some commercial property development.

1.16 By comparison, Marsden Maritime Holdings Limited port operations are incorporated into a joint venture company, Northport Limited. Marsden Maritime Holdings also owns property in the area adjacent to the port operations and operates the Marsden Cove Marina complex. Port of Tauranga owns the remainder of Northport.

1.17 These differences in ownership, size and scale, and operations make it more difficult to directly compare the performance of port companies.

## Structure of this report

1.18 Part 2 examines the recent financial results of port companies and the profitability trends apparent from their results.

1.19 Part 3 discusses the capital expenditure trends of port companies.

1.20 Part 4 summarises the impact of Covid-19 on port companies during 2019/20.

1.21 Part 5 sets out other matters that we have considered in our 2019/20 audits of port companies.

8 We note that a key driver of port company revenue is the volume of imports and exports going through a port. Port of Tauranga Limited processed 15.8 million tonnes of exports and 9.0 million tonnes of imports.

9 These ports are CentrePort, Lyttelton Port Company, Ports of Auckland, Port of Napier, Port of Tauranga, and South Port.

10 We discuss the differences between freight hubs and inland ports in paragraphs 5.12-5.15.

# Profitability trends

2

2.1 In this Part, we discuss:

- the consolidated profitability results of port companies;
- that port companies as a whole are profitable;
- that there were significant movements in dividends; and
- variability in port companies' return on equity.

2.2 As noted in paragraphs 1.11 to 1.17, the port companies vary significantly in their ownership, size and scale, and operations. This limits how much comparative analysis we can do.

## Consolidated profitability results of the port companies

2.3 We analysed the consolidated financial information of the port companies for 2015/16 to 2019/20. The consolidated financial information includes the port companies' wider business, not just the results for the core port operations.

2.4 Figure 1 shows the main profitability information the port companies reported.

**Figure 1**
**Main port company profitability results, 2015/16 to 2019/20**

| | 2019/20 | 2018/19 | 2017/18 | 2016/17 | 2015/16 |
|---|---|---|---|---|---|
| Revenue ($million) | 1,426.8 | 1,425.1 | 1,275.7 | 1,261.7 | 1,045.9 |
| Net profit after tax ($million) | 247.1 | 395.6 | 347.2 | 320.7 | 209.9 |
| Net profit as a percentage of revenue* | 17.3% | 27.8% | 27.2% | 25.4% | 20.1% |
| Net profit as a percentage of equity* | 5.8% | 9.5% | 8.8% | 9.0% | 6.2% |
| Dividends ($million) | 200.4 | 287.9 | 236.5 | 225.0 | 173.9 |
| Dividends as a percentage of equity* | 4.7% | 6.9% | 6.0% | 6.3% | 5.1% |

*The net profit and dividend percentages are calculated on total net profit and total dividends for all port companies compared with total revenue and total equity.

Note: Port companies use either a 30 June or a 30 September year-end for financial reporting purposes. We have made no adjustment for the different financial year-ends in Figure 1.

Source: We sourced the dollar amounts from the annual reports of the 12 port companies.

## Port companies as a whole are profitable

2.5 Figure 1 shows that port companies as a whole reported increasing revenue and profits from 2015/16 to 2018/19. The port companies also provided an increasing level of dividends (in dollar terms) to their shareholders.

2.6 However, this trend changed in 2019/20. Although revenue increased by less than $2 million compared to 2018/19 (0.1%), net profit after tax decreased by $148.5 million (37.5%) and dividends paid to shareholders decreased by $87.5 million (30.4%).

2.7 From our analysis of port companies' audited financial statements, the change in 2019/20 was not primarily caused by Covid-19 (we discuss the effects of Covid-19 on port companies in Part 4). Instead, significant one-off events affected individual port companies and, in turn, the port sector. We discuss them below.

### Lyttelton Port Company Limited

2.8 In 2015/16, Lyttelton Port Company recognised an impairment expense of $99.5 million, which led to it recording an after-tax loss of $59.8 million. The impairment expense arose because the return generated by replacing assets damaged by the Canterbury earthquakes, and some new capital expenditure to meet expected growth, did not meet the investment return established by the then directors of Lyttelton Port Company.[11]

2.9 In 2019/20, Lyttelton Port Company changed how it measured the value of its property, plant, and equipment. Accounting standards[12] allow companies to measure their assets at cost (reduced for accumulated depreciation and impairment) or fair value (in effect, the amount someone else would pay for the asset).

2.10 In previous years, Lyttelton Port Company had measured its property, plant, and equipment at cost. However, in 2019/20, it changed its approach to measuring property, plant, and equipment from cost to fair value.

2.11 As a consequence, Lyttelton Port Company recognised a fair value asset reduction of $190.5 million, which led to an after-tax loss of $152.7 million. We highlighted this reduction in our audit report and referred readers to the disclosures Lyttelton Port Company made in its audited financial statements, which provided more information about how the reduction was determined.

2.12 We discuss the reasons for these asset write-downs in paragraphs 3.18 to 3.27.

11 Our 2015/16 audit report referred readers to the disclosures Lyttelton Port Company made in its audited financial statements that provided more information about how the impairment was determined.

12 The relevant accounting standard is New Zealand Equivalent to International Accounting Standard 16: *Property, Plant and Equipment* (NZ IAS 16).

## CentrePort Limited

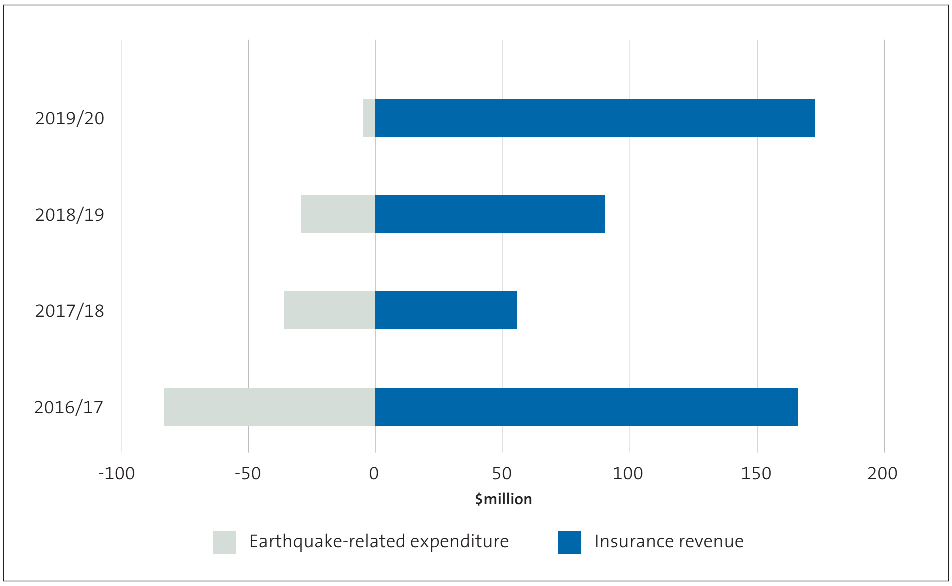
2.13 The Kaikōura earthquake of 14 November 2016 caused significant damage to CentrePort Limited's property and infrastructure assets and commercial properties. This had two main effects on CentrePort's financial results from 2016/17 to 2019/20.

2.14 First, CentrePort recognised revenue related to its insurance claims. At the time of the earthquake, CentrePort had cover for material damage and business interruption of up to $600 million for its port property and infrastructure assets. It also had cover of up to $276 million for its commercial property portfolio.

2.15 Between 2016/17 and 2019/20, CentrePort recognised insurance revenue of $484.5 million (see Figure 2).[13] CentrePort's insurance claim was finalised in 2019/20.

2.16 Secondly, CentrePort recognised earthquake-related expenditure. This expenditure related to the impairment of assets damaged in the earthquake, as well as temporary costs incurred to repair assets or demolish assets that it no longer needed. CentrePort recognised $154 million of these types of costs between 2016/17 and 2019/20 (see Figure 2).

**Figure 2**
**CentrePort's recognised insurance revenue and earthquake-related expenditure, 2016/17 to 2019/20**




Source: CentrePort's 2016/17 to 2019/20 annual reports.

13 CentrePort's associate property entities recognised $163 million in insurance revenue from their insurance claims. The claims were for damage to commercial property buildings that were owned by the associate property entities.

2.17 In our 2019/20 audit report, we referred readers to the disclosures CentrePort made in its audited financial statements that discussed the impact of the 2016 Kaikōura earthquake on the company, summarised the insurance claim settlement, and summarised the impacts on other parts of the financial statements, including income tax.[14]

## There were significant movements in dividends

2.18 Dividends that port companies pay have been subject to some significant changes:

- in 2016/17, dividends increased by 29% to $225.0 million;
- in 2018/19, dividends increased by 22% to $287.9 million; and
- in 2019/20, dividends decreased by 30% to $200.4 million.

2.19 The increase in 2016/17 was mainly from a special dividend that Port of Tauranga paid to its shareholders. This was done as part of a capital restructure that aimed to return funds to shareholders over four years.

2.20 The increase in 2018/19 was primarily because Port of Napier declared a special dividend to its then shareholder Hawke's Bay Regional Investment Company Limited. This occurred before Napier Port Holdings Limited listed and became the owner of Port of Napier.

2.21 The decrease in 2019/20 was primarily because:

- the previous year included the special dividend paid by Port of Napier; and
- Ports of Auckland did not pay a dividend in 2019/20, a decrease of $45.9 million compared with the previous year. Ports of Auckland had agreed with its shareholder to reduce its dividend while it invested significantly in changing its business operations. For 2019/20, the dividends were set at 20% of after-tax profits.

2.22 Ports of Auckland declared a $4.9 million dividend for 2019/20, which was paid in 2020/21.

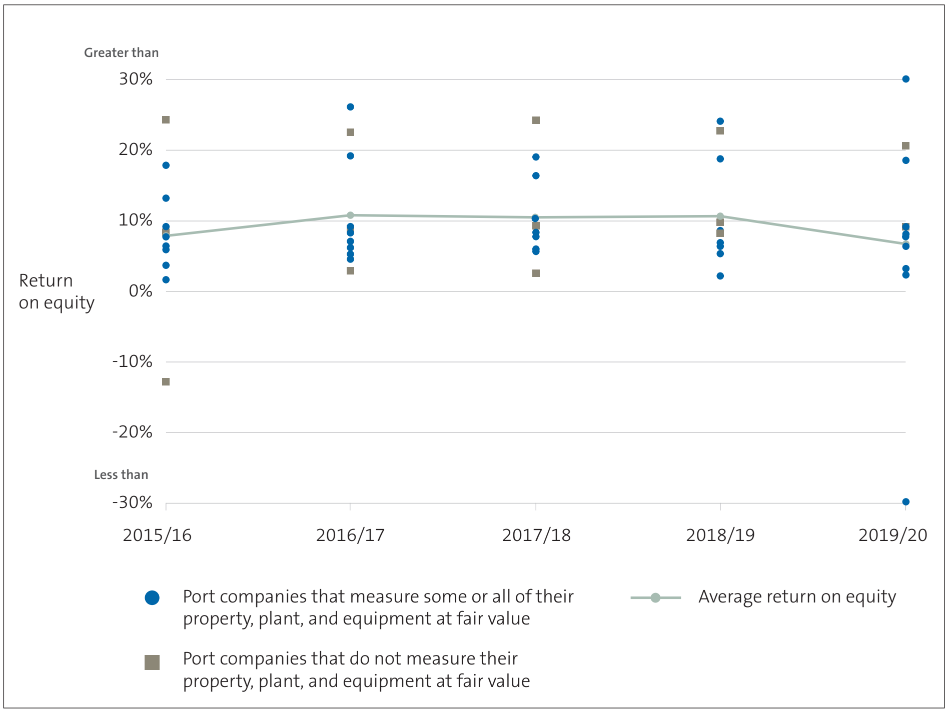
14 In our 2016/17, 2017/18, and 2018/19 audit reports, we referred readers to the disclosures the company made in its audited financial statements describing the impact of the 2016 Kaikōura earthquake on the company.

## Why there is variability in port companies' return on equity

2.23 We wrote a letter to all chief executives and chairpersons of port companies in 2018 about the results of our 2016/17 audits.[15] In that letter, we noted our concerns about the variability in how individual port companies report their returns. These concerns remain.

2.24 Figure 3 summarises the return on equity for all the port companies for 2015/16 to 2019/20. We have also included the average return on equity[16]. The average return on equity has ranged between 6.6% (in 2019/20) and 10.8% (for 2016/17), with the lower returns coinciding with the large financial losses recognised by Lyttelton Port Company. However, Figure 3 also shows considerable variability between port companies in any given year.

**Figure 3**
**Port companies' reported return on equity, 2015/16 to 2019/20**




Source: Analysis by the Office of the Auditor-General.

15 See *Port companies: Matters arising from our 2016/17 audits*, dated 19 June 2018, on our website, oag.parliament.nz.

16 In this paragraph and in Figure 3, "return on equity" has been calculated as the average of all the port companies' individual returns on equity.

2.25 There are three main reasons why there is variability in the returns made by port companies:

- Some port companies are more profitable.
- Some of the variability is because of one-off events, such as asset write-downs. These one-off events have affected only two port companies (see paragraphs 2.8-2.17).
- Some of the variability in the reported returns is because the port companies have different approaches to measuring the value of their property, plant, and equipment. These variations arise because accounting standards allow different approaches to be adopted in different circumstances. Paragraph 2.9 provides an example of this.

2.26 The first two reasons are because of how the port company operates. The third reason is because of the accounting policies the port company chooses.

2.27 Of the 12 port companies, 10 measure at least some asset classes at fair value. However, these 10 port companies do not consistently measure the same asset classes at fair value. In nine cases, the fair value is not based on the expected cash flows the assets can generate.

2.28 We remain concerned that these different approaches to measuring the value of property, plant, and equipment make the performance of port companies less transparent to stakeholders, Parliament, and the public. This means that it is difficult to assess the performance of the individual port companies and the port sector as a whole.

2.29 We consider that it is more appropriate to use fair value in operational asset valuations and to assess the fair value based on the expected cash flows to be generated. This will provide up-to-date financial information to stakeholders and make the port sector's performance more transparent.

2.30 In our 2018 letter to chief executives and chairpersons of port companies, we urged port companies to review how they measure the value of their property, plant, and equipment.[17] Lyttelton Port Company followed our suggestion and now measures its property, plant, and equipment at fair value, based on the expected cash flows the assets can generate. We are aware that another port company has been considering a similar change.

2.31 We continue to encourage port companies to review how they measure the value of their property, plant, and equipment.

17 See *Port companies: Matters arising from our 2016/17 audits*, dated 19 June 2018, on our website, oag.parliament.nz.

# 3

# Capital expenditure trends

3.1 In this Part, we discuss the capital expenditure trends in the 12 port companies. We cover:

- the amount of investment the port companies made in their assets;
- the importance of having a good business case to support decisions about capital expenditure;
- Lyttelton Port Company's investment story; and
- the risk of over-investment in port companies.

3.2 Capital expenditure is generally defined as the money that an organisation spends to buy, update, or improve long-term or fixed assets, such as property, plant, buildings, technology, or equipment. This type of spending is intended to increase the capability or capacity of the organisation's operations or add some economic benefit to its operations beyond the current year.

3.3 For this Part, we have characterised purchases of property, plant, and equipment, investment property, and intangible assets as capital expenditure.

## Port companies continue to invest in their assets

3.4 In the last five years, port companies have invested about $2 billion in their assets. One of the main reasons that all port companies have invested in their assets is because the ships visiting New Zealand's ports are getting larger.

3.5 This is a trend that has gone on for many years. Since 2014, the percentage of ships visiting New Zealand that can carry between 4000 and 6000 containers[18] has increased from 34% to 62%. At the same time, the percentage of smaller ships (that is, ships carrying fewer than 4000 containers) visiting New Zealand ports has declined significantly.

3.6 Most of the capital expenditure of the port companies has been by a few companies (see Figure 4). Ports of Auckland and Lyttelton Port Company have spent more than half of the capital expenditure incurred by port companies in the last five years.

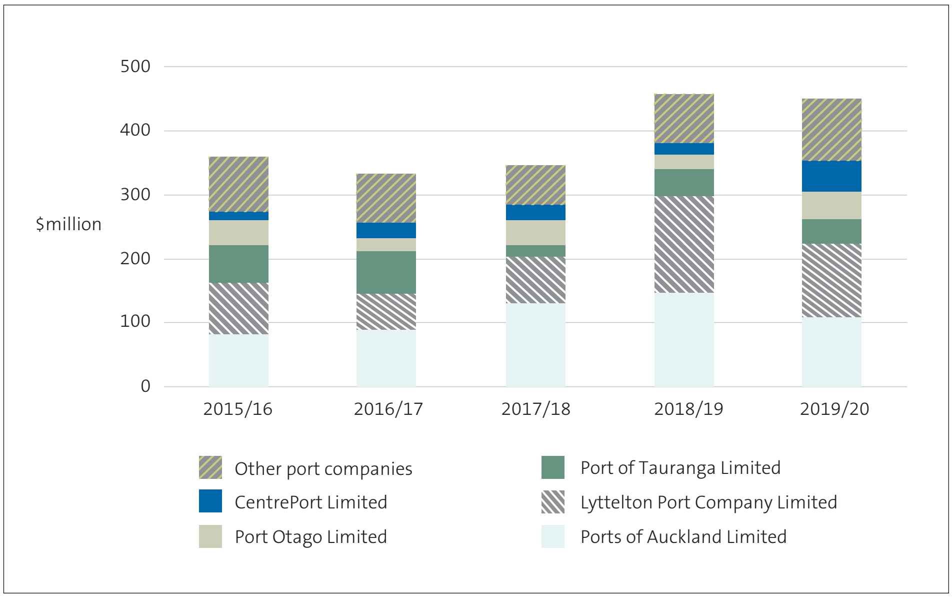
3.7 These port companies' capital expenditure has been for business transformation purposes and, for Lyttelton Port Company, to repair assets damaged by the 2010 and 2011 Canterbury earthquakes.

3.8 Lyttelton Port Company had to rebuild its port after the 2010 and 2011 Canterbury earthquakes. This rebuild led to a wider expansion project. We discuss Lyttelton Port Company in paragraphs 3.18-3.27.

18 The industry refers to a standard size for shipping containers as the "twenty-foot equivalent unit". This is based on the dimensions of a standard container – height 2.59 metres, width 2.44 metres, and length 6.10 metres.

3.9 Ports of Auckland has been working on improving its productivity by automating certain operations (for example, purchasing a fleet of new autonomous straddle carriers) and investing in its freight hubs.[19] Automating port operations is a trend we have seen in other port companies. However, they have also invested in complementary areas, such as inland ports and commercial property.

**Figure 4**
**Capital expenditure incurred by port companies, 2015/16 to 2019/20**




Source: The port companies' annual reports.

## We expect port companies' investment in their assets to remain significant

3.10 Port companies' investment in their assets is likely to remain significant during the next few years. Although Ports of Auckland and Lyttelton Port Company are coming to the end of their current investment programme, other port companies are starting theirs.

3.11 For example, CentrePort's port assets were significantly damaged by the 2016 Kaikōura earthquake. As described in paragraph 2.15, CentrePort finalised its insurance settlement in 2019/20. CentrePort has recently announced a port redevelopment and regeneration plan, which it plans to use the insurance money for. Completing this port redevelopment could take more than 10 years.

19 We describe "freight hubs" in paragraphs 5.13 and 5.15.

3.12 Port of Napier has begun constructing a new multi-purpose wharf. This is intended to increase capacity to meet additional shipping demand and improve supply chain efficiency. This investment is expected to cost Port of Napier between $173 million and $190 million and is expected to be completed in late 2022.[20]

3.13 As well as investing in new assets, all port companies will need to continue to reinvest in assets that are reaching the end of their useful lives.

## The importance of good business cases to support capital expenditure decisions

3.14 In the 2018 letter we wrote to chief executives and chairpersons of port companies, we noted that it was difficult to form a view about whether the capital expenditure of port companies was a good use of shareholders' funds.[21] This was because of the different approaches port companies used to measure the value of their property, plant, and equipment (we discussed this in paragraphs 2.26-2.31).

3.15 Our view has not changed. We expect port companies making significant investment decisions to prepare a robust business case that outlines the risks and opportunities of the investment decision. We also expect senior management, the board, and, as applicable, the shareholders to approve the business case before the investment goes ahead.

3.16 Given how the increased uncertainty from Covid-19 is affecting the wider freight logistics sector, business cases should actively consider and reflect that uncertainty.

3.17 Although reporting progress against their business cases might be considered commercially sensitive, port companies should look at ways to describe their progress so their shareholders can understand how their investments are being managed.

## Lyttelton Port Company Limited

3.18 As outlined in paragraph 2.11, Lyttelton Port Company wrote down the value of its assets by $190.5 million in 2019/20. This followed a write-down of its assets by about $100 million in 2015/16. Together, these asset write-downs represent a significant loss in shareholder value.

3.19 The 22 February 2011 earthquake was centred not far from the Lyttelton port. The earthquake caused extensive damage to the port's wharves and infrastructure. However, it remained open and processed record volumes of containers, coal, and log exports while carrying out repairs. Lyttelton Port Company was insured and received insurance revenue of $438.3 million from its insurance claim.

20 These values exclude interest costs and applicable overheads.

21 See *Port companies: Matters arising from our 2016/17 audits*, dated 19 June 2018, on our website, oag.parliament.nz .

3.20 Lyttelton Port Company's board and management identified that the completed repairs could not be permanent and that it would be necessary to rebuild a large amount of the port. This led to the board reviewing the future of the Lyttelton port.

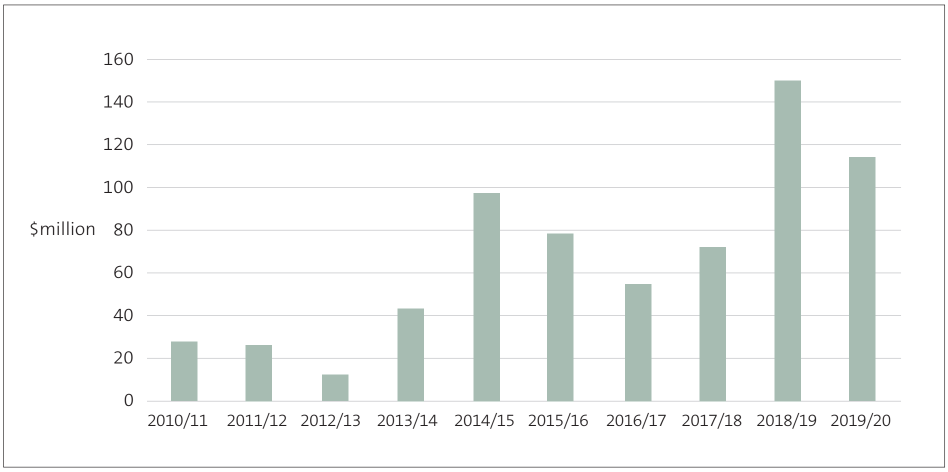
3.21 The outcome of that review was the Lyttelton Port Recovery Plan, which was published in November 2015. The recovery plan was intended to provide a "road map" for the port's redevelopment.

3.22 It was estimated that the plan would cost about $1 billion to implement. At its core, the plan was based on three objectives:

- replace damaged port assets with modern, fit-for-purpose infrastructure needed for the safe, effective, and efficient operation of the port;
- reconfigure the port to improve efficiency and enable it to meet current and predicted future shipping and logistical demand; and
- increase the resilience of the port and the greater Christchurch community more generally.

3.23 Figure 5 shows Lyttelton Port Company's capital expenditure since 2010/11. In total, it has spent $680 million to date, with the largest capital expenditure in 2018/19 and 2019/20. For context, in 2010/11, Lyttelton Port Company recorded a value for its property, plant, and equipment of $201 million. During the 10-year period to 2019/20, Lyttelton Port Company's revenue from its port operations increased by 41% (excluding insurance revenue received).

**Figure 5**
**Lyttelton Port Company Limited's capital expenditure, 2010/11 to 2019/20**




Source: Lyttelton Port Company's annual reports.

3.24 Financial reporting standards require Lyttelton Port Company to ensure that the carrying value of its assets does not exceed the value of the future cash flows the assets are expected to generate.[22]

3.25 If an organisation cannot generate the future cash flows to cover the cost of the assets constructed or purchased, NZ IAS 36: *Impairment of Assets* requires the organisation to reduce the value of the asset to what the asset's future cash flows can support.

3.26 The board wrote down the value of its assets by $290 million because:

- the expected growth in volumes did not occur;
- the company was unable to increase its prices enough to cover the cost of the new investment; and
- although some of the assets built by the port company are expected to provide wider community benefits, they will not provide the financial return it desired.

3.27 In discussing the asset write-down in its 2019/20 annual report, Lyttelton Port Company stated:

> *This readjustment recognises that our asset value and our ability to generate earnings in the current environment are out of line. It brings LPC's value back in line to reflect how much we can actually earn from our assets.*[23]

## The risk of over-investment by port companies

3.28 One risk that we see when looking at port companies and their plans to reinvest in their businesses is excess investment or "stranded or underperforming assets".

3.29 New Zealand is a small country with a proportionately large number of ports. It is not feasible for every port to cater for the larger ships that transport the country's imports and exports. Although not every port company is planning to do this, several are.

3.30 New Zealand's economy can generate only so many ship and freight movements, and expectations about the future rates of growth in freight are variable. Given this uncertainty, port companies planning to invest to meet that growth should be realistic about how much growth they assume. The example of Lyttelton Port Company illustrates the loss of shareholder value that can come from investing for growth that does not occur.

3.31 Because of the relative proximity of ports, there is considerable competition between them. The push to increase revenue streams and profits has led some port companies to invest outside of their traditional locations to obtain increased

22 The relevant accounting standard is New Zealand Equivalent to International Accounting Standard 36: *Impairment of Assets*.

23 Lyttelton Port Company Limited (2020), *Leading the way: Annual report 2020*, page 4.

cargo volumes. For example, Port of Tauranga set up inland ports[24] in Auckland and Canterbury, and Ports of Auckland set up freight hubs in the Bay of Plenty and Waikato regions.

3.32 Ports are public assets and are majority- owned by councils or community interests. Therefore, there is a significant risk that, without a level of national co-ordination, the collective investment of the port sector will not generate the returns anticipated.

3.33 In our view, the lack of a comprehensive supply chain strategy for the wider freight logistics sector heightens the risk of excess investment by port companies.

3.34 Our reference to a comprehensive supply chain strategy deliberately refers to the freight logistics sector instead of the port sector. Port companies are one part of the freight logistics sector and cannot be considered in isolation.

3.35 A comprehensive supply chain strategy could consider what level of investment port companies will need in the future to respond to the effects of climate change and new technologies for supply chains.

3.36 The Ministry of Transport indicated in its briefing to the incoming minister that it is considering preparing a supply chain strategy for New Zealand. The Ministry recently received approval from the Minister of Transport to initiate a freight and supply chain strategy in the second half of 2021, with the intention of delivering the strategy in the next 12-18 months. We support this initiative and encourage the Ministry to include the above elements in its strategy.



24 We describe "inland ports" in paragraphs 5.12 and 5.15.

# The effects of Covid-19 on port companies during 2019/20

4

4.1 In this Part, we summarise the main effects Covid-19 had on port companies during 2019/20. We set out how:

- Covid-19 affected port companies' revenue;
- port companies had to change how they operated;
- port companies received a minor benefit from a change in tax rules;
- port companies assessed the carrying value of property, plant, and equipment and investment property;
- port companies met their reporting deadlines;
- we emphasised the effect of Covid-19 in our audit reports; and
- Covid-19 is likely to affect port companies in the medium term.

## Covid-19 affected port companies' revenue

4.2 When the country entered a nationwide lockdown in response to Covid-19, the Government identified most port operations as "essential services". This meant they could continue operating during the lockdown. Port company staff were also considered essential workers, allowing them to participate in daily port operations.

4.3 In Part 2, we set out port companies' main financial results for 2019/20 (Figure 1). Excluding one-off effects relating to earthquakes, the total revenue of the port sector decreased by about $80 million (6%). When analysing port companies' annual reports, we were unable to determine how much of this decrease was directly related to Covid-19.

4.4 A port company generates revenue by facilitating the transfer of goods to or from ships. Therefore, a change in the quantity of imports or exports going through a port will generally affect revenue. Many port companies' annual reports described a decrease in the exports and imports they facilitated, and some of these decreases were because of Covid-19.

4.5 For example, exports of logs and related forestry commodities reduced by 10.3%, which affected almost all port companies. These exports were significantly affected by reduced international demand in the early days of Covid-19, as well as an increase in the number of logs exported from Europe. Forestry operations were not considered an essential service during the Alert Level 4 lockdown.

4.6 Some imports also decreased, especially vehicles (decreased by 23.2%) and minerals, such as fuel (by 25%). These decreases occurred because of a drop in demand as a result of lockdown.

4.7 Not all port companies were affected by the reductions in these imports to the same extent. For example, Ports of Auckland was most affected by the decrease in vehicles, because most vehicles imported into the country come through that port. Port of Tauranga was most affected by the reduction in imports of minerals.

4.8 A decrease in trade through New Zealand ports is broadly consistent with what is happening in other countries. The United Nations Conference on Trade and Development estimated that international trade decreased by 5% in the first quarter of 2020, with decreases also expected to occur in the subsequent quarters.[25]

4.9 Several port companies reported that the cruise ship season finishing early also caused them to lose revenue. Cruise ships could not enter New Zealand after the maritime border was closed.

4.10 Port Marlborough and Northport (the joint venture operation of Marsden Maritime Holdings and Port of Tauranga) were more affected by Covid-19 than other port companies, so claimed the Government wage subsidy.[26] Marsden Maritime Holdings (in its own right) and Port of Napier also claimed, but subsequently repaid, the wage subsidy.

## Port companies had to change how they operated, which led to additional costs

4.11 In 2019/20, port company expenditure increased by about $45 million (5.1%), excluding the one-off effects of earthquakes described in paragraph 2.16. When analysing port companies' annual reports, we could not determine how much of this increase was directly related to Covid-19.

4.12 Keeping ports operational during lockdown came at a cost for port companies. Given the increased health and safety risk, port companies had to adjust their operations and working practices. They also had to implement aspects of their business continuity plans (including new sanitary protocols and processes). These changes reduced productivity levels during the first weeks of lockdown and at least until the revised procedures and protocols became normalised.

4.13 Many port companies have kept these new protocols in place under all Covid-19 alert levels.[27]

4.14 Some of the biggest ports benefited from having well-established business continuity plans for emergencies. However, others had to prepare new plans to meet the lockdown's requirements.

25 United Nations Conference on Trade and Development (2021), *Covid-19 and maritime transport: Impact and responses*, page 12.

26 In response to Covid-19, the Government's economic priorities shifted to preserving jobs and protecting people's livelihoods. One of its responses was to introduce a wage subsidy scheme to support workers. The wage subsidy was paid to employers, who were required to pass it on to employees.

27 In response to Covid-19, the Government put in place a four-level alert system. Each alert level introduces more-stringent measures to protect people from contracting or spreading Covid-19.

4.15 Some port companies also put in place other measures to control their expenditure, although some of these will have a flow-on effect on 2020/21. These measures included:

- reducing director remuneration for a specific period of time;
- instituting wage or salary freezes or deferring salary increases; and
- deferring non-urgent maintenance.

## A change in tax rules had a minor benefit for port companies

4.16 In response to Covid-19, the Government changed the tax rules to allow certain taxpayers to deduct the depreciation on certain buildings from their taxable income. Taxpayers have been unable to do this since the 2011/12 tax year.

4.17 This change in tax rules benefited all port companies. In 2019/20, the estimated benefit of this change led to the port sector reducing its income tax expense (and the related deferred tax liability recognised by port companies) by $15 million.

## Assessing the carrying value of property, plant, and equipment and investment property

4.18 Port companies owned property, plant, and equipment valued at $4.8 billion as at 30 June 2020. Seven port companies also owned investment property (land and buildings) valued at $0.8 billion as at 30 June 2020. These two classes of assets make up most of port companies' assets, which are recorded at $6.4 billion in total.

4.19 Every year, port companies are required to assess whether the carrying value of their property, plant, and equipment needs to change. This usually involves considering whether an asset value needs to be reduced because the asset is impaired.

4.20 For assets measured at fair value, port companies also need to consider whether the asset value has changed.[28] Additionally, port companies are required to value investment property at the estimated fair value at each balance date.

4.21 These requirements meant that the port companies needed to consider whether their largest asset values had changed. By necessity, this consideration took into account the effects of Covid-19.

28 The applicable accounting standard, NZ IAS 16, requires that "revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period". When revaluing, an asset value can go up or down.

4.22 No port company directly decreased the value of its property, plant, and equipment or investment property because of Covid-19. However, Lyttelton Port Company noted that its consideration of Covid-19 in future years affected the growth forecasts it used to estimate the fair value reduction referred to in paragraph 2.11.

4.23 Covid-19's economic impact significantly affected the level of uncertainty in the assumptions port companies made when assessing the value of land and buildings included in their property, plant, and equipment, and investment property.

4.24 Valuers engaged by port companies identified that, although land and property prices had not changed significantly, there had been limited market information available since the lockdown. This made it difficult to predict what the short-term and long-term effects on values would be. Affected port companies appropriately disclosed the risks identified by their valuers in their 2019/20 financial statements.

## Port companies met their reporting deadlines

4.25 As a result of Covid-19, the Minister of Transport extended the statutory reporting deadline for when port companies needed to adopt their audited financial statements by two months. Listed companies have a different statutory reporting deadline, although the Financial Markets Authority also extended this by two months for companies with a balance date up to and including 31 July 2020.

4.26 All port companies met their revised statutory reporting deadlines, which is five months after their financial year-end.

## Emphasising the impact of Covid-19 in our audit reports

4.27 We issued unmodified audit opinions for the financial statements of all port companies. However, almost all of our audit reports on the port companies referred readers to the disclosures those port companies made about the impact of Covid-19 on their operations.[29]

4.28 We did this because we felt that the readers of port companies' financial statements would be interested in the how the port company was affected by, and responded to, Covid-19.

4.29 Our audit reports for listed companies (Marsden Maritime Holdings, Port of Tauranga, and South Port) included a description of the key audit matters in those audits. This was required because these port companies are listed entities.



29 We did not refer readers to Port of Napier's Covid-19-related disclosures in our audit report.

4.30 In describing the key audit matters, our auditors summarised how Covid-19 affected those matters. More often than not, our audit reports emphasised areas of uncertainty from Covid-19, such as the valuation uncertainty referred to in paragraph 4.24.

## The medium-term impact of Covid-19 on port companies

4.31 Looking to 2020/21 and beyond, it is unclear how Covid-19 will affect port companies. The nature of any economic recovery remains uncertain because it is unclear how Covid-19 will evolve and what capacity the world economy has to recover from lockdown measures other countries have used to slow the spread of the virus.

4.32 Currently, Covid-19 still affects international shipping, which is leading to delays in moving freight through ports in New Zealand and internationally. In New Zealand, this has particularly affected Ports of Auckland in 2020/21. However, there has been a subsequent flow-on effect to the other port companies.

4.33 Consequently, shipping companies are reconsidering what ports they visit and how often. Exporters are facing a shortage of shipping containers to transport some of New Zealand's exports.

4.34 No cruise ships will visit our ports while New Zealand's maritime border remains closed to passengers. This will result in a loss of revenue for most port companies.

4.35 These factors will continue to adversely affect port companies' profitability. The continuing effect of Covid-19 should remain a focus for port companies' boards, management, shareholders, and wider stakeholders.

# 5 Other matters arising from our audits

5.1 In this Part, we comment on other matters arising from our 2019/20 audits of port companies. We discuss:

- the port companies' disclosures about their environmental impact;
- the accounting for inland ports and freight hubs; and
- the disclosures of major customers by port companies listed on New Zealand's Exchange (the NZX).

## Environmental impact disclosures made by port companies

### Some disclosure is happening

5.2 Changes to the environment, such as larger and more intense storms and rising water levels, can significantly affect port companies. Port companies also need to consider the impact they are having on the environment.

5.3 We reviewed the information port companies provided in their annual reports about how they are managing their environmental impact. Most port companies included disclosures in their annual reports about a variety of matters. We summarise some of them below.

5.4 Three port companies[30] disclosed in their annual reports that they have prepared environmental strategies that are aligned with the United Nations Sustainable Development Goals.[31] This is helping them determine where to focus their efforts.

5.5 Port companies are increasingly mindful of their carbon footprint. Several port companies have disclosed their current carbon footprint in their annual reports and the mitigations they have put in place, or are putting in place, to reduce them.

5.6 Mitigations include decarbonising their vehicle fleets but this is more difficult for some vehicles (such as straddles). Some port companies have goals of producing zero emissions by 2040 or 2050.

5.7 Some port companies' annual reports included a focus on improving the marine environment by monitoring water quality and their discharges into water. This focus will assist the port companies in determining future improvements to their stormwater management.

### Additional disclosures on climate risks might be needed

5.8 The Government has recently announced that certain organisations will be required to report on climate risks. These reporting requirements will be based on the Task Force on Climate-related Financial Disclosures framework, which is widely

30 These are CentrePort, Ports of Auckland, and Port of Napier.

31 For more information about the sustainable development goals, see www.un.org/sustainabledevelopment.

acknowledged as international best practice. Affected organisations will need to make annual disclosures about their governance arrangements, risk management, and strategies for mitigating any climate change impacts.

5.9 If Parliament approves these new requirements, they will affect several port companies.[32] The types of disclosures required will likely be more detailed than what port companies already disclose in their annual reports.

5.10 We encourage affected port companies to start considering what information they will need to disclose and what information they will need to collect to meet the reporting requirements.

## Accounting for inland ports and freight hubs

5.11 As noted in paragraph 1.15, several port companies operate inland ports and freight hubs. Because of concerns raised with us previously, we considered during 2019/20 how port companies should account for these types of operations in their financial statements.

5.12 **Inland ports** are a direct extension of a seaport and are considered integral to the port's operations. Inland ports offer cargo customers an alternative delivery point and thereby help to increase the volume of cargo moving through the seaport.

5.13 **Freight hubs** offer logistics services by providing facilities and services such as warehousing, cross docking, cold storage, and providing and storing empty containers. Third parties operate and lease these services and facilities. The third parties will not necessarily provide these services and facilities to a port company or its customers.

5.14 Although inland ports and freight hubs seem similar, they are different in substance and require different accounting treatments.

5.15 Inland ports are owner-occupied property and are accounted for in keeping with NZ IAS 16: *Property, Plant and Equipment*. Freight hubs, on the other hand, are not owner-occupied and are accounted for in keeping with NZ IAS 40: *Investment Property*.

5.16 We are satisfied that all port companies that currently operate inland ports and freight hubs are correctly accounting for them in their financial statements. Port companies that operated both inland ports and freight hubs had correctly applied the accounting rules. They had appropriate factors in place that management could use to determine how the different assets should be treated.

5.17 Accounting for inland ports and freight hubs can be a matter of significant judgement for port companies. We have asked our auditors to confirm that port

32 All issuers listed on the NZX will be required to comply with the new climate-reporting requirements. This will include the listed port companies and port companies that are owned by listed organisations.

companies that have subsequently set up these types of operations are also accounting for them correctly.

## Disclosures of major customers by port companies

5.18 Listed companies must comply with NZ IFRS 8: *Operating Segments* (NZ IFRS 8). The core principle of NZ IFRS 8 is that an organisation must disclose information to enable readers of its financial statements to evaluate the nature and financial effects of the business activities that it engages in and the economic environments it operates in.

5.19 This is important for listed companies. They are typically large companies that can operate in different industries and locations in New Zealand and internationally.

5.20 Paragraph 34 of NZ IFRS 8 requires an organisation to provide information about the extent to which it relies on major customers. Specifically, an organisation is required to disclose the total amount of revenue it receives from each single external customer that contributes to more than 10% of its revenue.

5.21 Of the listed port companies, South Port New Zealand disclosed this in its financial statements. Port of Tauranga did not include the disclosure. Marsden Maritime Holdings was not required to make this disclosure as it did not have any qualifying customers in 2019/20.

5.22 We consider that, although port companies should ordinarily make this disclosure, it provides limited information to the readers of the financial statements. This is because the user of the port decides which shipping company (which the port company receives revenue from) transports the freight through the port, rather than the port company. Therefore, the port company relies more on its major users than on its major customers.

5.23 We encourage port companies listed on the NZX to improve their disclosures by summarising their reliance on the major users of the port. In our view, including this information alongside the major customer information required by NZ IFRS 8 will provide more meaningful information to readers of their financial statements.

# Appendix
# Port companies' 2019/20 information

**Figure 6**
**Port companies' financial information for 2019/20**

| Port company | Revenue<br><br>$million | Net profit after tax $million | Dividends paid $million | Total assets $million | Total equity $million |
|---|---|---|---|---|---|
| CentrePort Limited | 262.7 | 158.4 | 5.0 | 506.4 | 455.5 |
| Lyttelton Port Company Limited | 129.7 | -152.7 | 6.7 | 555.9 | 356.1 |
| Marsden Maritime Holdings Limited | 15.1 | 6.7 | 6.6 | 155.8 | 137.3 |
| Port Marlborough New Zealand Limited | 30.8 | 3.2 | 3.4 | 203.2 | 150.8 |
| Port Nelson Limited | 66.7 | 8.3 | 6.3 | 356.8 | 250.4 |
| Ports of Auckland Limited | 234.5 | 23.1 | 0.0 | 1,451.5 | 821.2 |
| Port of Napier Limited | 101.4 | 21.6 | 11.0 | 375.8 | 185.3 |
| Port of Tauranga Limited | 302.3 | 89.9 | 124.5 | 1,817.2 | 1,163.6 |
| Port Otago Limited | 138.3 | 50.5 | 9.5 | 655.8 | 548.6 |
| PrimePort Timaru Limited | 24.2 | 5.6 | 1.7 | 91.9 | 61.3 |
| Port Taranaki Limited | 51.8 | 12.2 | 8.0 | 198.2 | 148.9 |
| South Port New Zealand Limited | 44.6 | 9.4 | 6.8 | 59.4 | 45.6 |

Source: Port companies' audited financial statements.

**Figure 7**
**Port companies' import and export information for 2019/20**

| Port company | Exports $billion | Imports $billion | Main bulk import and export commodities |
|---|---|---|---|
| CentrePort Limited | 1.69 | 2.42 | Meat and fish, dairy, and logs including related wood products. |
| Lyttelton Port Company Limited | 6.32 | 3.97 | Coal, meat and fish, dairy, and vegetables and foodstuffs. |
| Port Marlborough New Zealand Limited | 0.09 | 0.00 | Logs including related wood products. |
| Port Nelson Limited | 1.02 | 0.26 | Logs including related wood products, vegetables and foodstuffs, and meat and fish. |
| Ports of Auckland Limited | 4.14 | 23.30 | Vegetables and foodstuffs and vehicles, including machinery. |

| Port company | Exports $billion | Imports $billion | Main bulk import and export commodities |
|---|---|---|---|
| Port of Napier Limited | 3.90 | 1.02 | Vegetables and foodstuffs, logs including related wood products, and meat and fish. |
| Port of Tauranga Limited | 26.72 | 10.13 | Dairy, logs including related wood products, meat and fish, vegetables and foodstuffs, and vehicles including machinery. |
| Port Otago Limited | 4.79 | 0.47 | Dairy, logs including related wood products, and meat and fish. |
| PrimePort Timaru Limited | 1.25 | 0.40 | Dairy and logs, including related wood products. |
| Port Taranaki Limited | 2.31 | 0.60 | Oil, chemicals, and logs, including related wood products. |
| South Port New Zealand Limited | 1.86 | 0.74 | Dairy, logs including related wood products, aluminium, and meat and fish. |

Source: Statistics New Zealand.

Note: The port operations in Whangārei, where Marsden Maritime Holdings is based, are operated by three different organisations. Because of this structure, we have not included export, import, or bulk commodity information for Marsden Maritime Holdings .

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