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HD Patrick's next port of call: China

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Patrick Ports is best known to many Australians as the former Chris Corrigan-run entity that was at the centre of the bitter 1998 waterfront dispute in Melbourne.

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A lot has happened since then. Patrick was swallowed up by logistics giant Toll Holdings and was later spun off as part of the ports and rail outfit now known as Asciano.

Patrick is now on course for another ownership change, which is expected to put a significant **stake** of the stevedoring giant in foreign hands. Asciano has been in long-running talks with its suitor, state-owned conglomerate **China** Merchants, about selling off part of the business.

The cynics suggest the talks have gone on for too long without results and the two cannot agree on price because the **Chinese firm** prefers majority control, something Asciano is not willing to give up.

But Asciano remains confident a deal will be secured by the end of the year, giving it a powerful new ally in the increasingly competitive global shipping business and a potential entry point to expand offshore.

A **sale** also heralds another new entrant into an increasingly crowded stevedoring market, as Australia's ports sector heads for a major shake-up.

Governments are rushing to privatise the port infrastructure itself, generating **billions** of dollars in revenue, but the stevedores are under growing pressure to forge new alliances and deal with fresh competition for the first time in decades.

When containers were introduced more than four decades ago, the number of stevedores in Australia dropped off dramatically because the business was suddenly so capital-intensive.

A cosy duopoly has dominated the Australian waterfront since the late 1990s – Asciano-owned Patrick and DP World Australia. A new entrant, Hutchison Whampoa-owned Hutchison Ports, has the incumbents on the defensive, although its Australian plans have got off to a slow start.Mullen's strategy

There are two ways of looking at the potential transaction. Some see the desire to sell Patrick as chief executive John Mullen distancing the **company** from the port **operations**, or exiting the business altogether.

The obvious upside is a healthy injection to the balance sheet. Analysts have pegged Patrick's value at $2 **billion** to $2.5 **billion**.

But it should also be viewed as a step in the opposite direction, as Asciano is looking at whether forming a powerful alliance in Asia will bring global expansion opportunities.

Mullen knows Asia well, having run DHL Express Asia Pacific's operations there for several years. Finding a partner like China Merchants would have been tough under Asciano's former management, which took a more entrepreneurial approach to the business compared to Mullen, who has corporatised the company.

Mullen has not spoken much about it publicly, but Asciano management see international growth and expansion in stevedoring as a potential upside of a deal.

This could play out in a number of ways. The most likely scenario is a partial sale, which would give China Merchant a direct equity investment in Patrick below 50 per cent, allowing Asciano to retain control. Mullen is not ruling out a full sale for the right price – although this is seen as unlikely.

Interestingly, when Mullen first started in the job, investors were pushing for a sale or demerger of Patrick, which did not have obvious synergies with the rail business.

Asciano and China Merchants could also look at forming an alliance without any equity changing hands, but this is also seen as unlikely. The fourth scenario is that the two are unable to strike a deal and nothing happens. Asciano says it is also talking to several other parties.

The main attraction in a tie-up with China Merchants, which has other port joint ventures in Asia and Africa, is access to the customer relationships it has with global shipping lines. Ports and trade flows are increasingly becoming global businesses and Patrick's biggest competitors are international players.

Mullen has talked about making the container ports business part of a "global network". Patrick has long-standing relationships with customers in Australia, but not offshore. There are also cost-saving opportunities around suppliers and equipment like cranes and saddles.Consolidation trend

Longer-term, though, Asciano wants to look at growth in containers and other parts of the group, and international expansion is a possibility, particularly if it has a platform to go offshore. On home soil, competition is stiff and some analysts say the Australian market is not big enough to support three or four global players. Volume growth has slipped and port operators are moving towards automation, which allows them to move bigger loads than before.

The good news for Asciano is that Hutchison has been battling delays but is now working on hurrying the development of new terminals in Sydney and Melbourne.

Part of Hutchison's problem has been trying to run the business out of Hong Kong, which it is seeking to fix by sending its south-east Asia boss, Mark Jack, to Australia.

Hutchison has less than 3 per cent of the container ports market, while both Asciano and DP World claim market share leadership. Asciano said at its full-year results in August that its market share over the financial year was 48.5 per cent, compared to 47.5 per cent previously. But DP World claims a 50.4 per cent market share for the year to date.

Another new entrant, Filipino-owned International Container Terminal Services (ICTSI), has also arrived on the scene, while Corrigan-chaired Qube Logistics is also a player – although it is worried about rising cargo charges and over-capacity, which has diluted its appetite for terminal investments.

The potential Patrick-China Merchants tie-up is reflective of the consolidation and partnering going on elsewhere in the sector. Hutchison and ICTSI are expected to explore a tie-up on the east coast, which will further pressure the incumbents.

There is also some strategic sense in DP World tying up with Qube, but neither side is doing any work on that idea at the moment. Both sides are unlikely to agree on whose asset is the most valuable.DP World's push

DP World has been upping the ante since new chief executive Paul Scurrah was recruited last year to give the operator a local focus, after years of being run out of the Middle East, with mixed results.

Scurrah has capitalised on a period of ownership uncertainty at Patrick to poach a number of key staff – including former Freemantle operations manager Bruce Guy and national landside logistics manager Greg Winstanley.

DP World Australia earlier this month announced an agreement to acquire a 50 per cent stake in AWH Pty Ltd from Elders.

What Patrick is trying to do with China Merchants is partly a response to the powerful partnerships DP World and Hutchison already have.

DP World has an Australian management team running the business locally while leveraging its international partnership. This is a different approach to running the business like a branch office, which is what happened previously.

Dubai-based DP World owns 25 per cent of the Australian ports business after selling a 75 per cent **stake** in the business to Citi Infrastructure Investors in 2010.

Port automation has been a significant factor in the consolidation story. The ability to move containers faster has made Hutchison's entry more problematic and means the industry needs fewer players rather than more.

Analysts have valued the Patrick assets at around nine to 11 times earnings. Asciano argues it doesn't need the capital and that is not what is driving the decision to partner with **China** Merchants.

Asciano is exiting a large capital investment phase as Mullen turns around the **coal** haulage and **coal operations**. UBS analysts except the container ports business to grow at 2 per cent to 3 per cent over market growth in the 2015 financial year. Still, a cash injection would be handy and could be used to pay down debt, be reinvested back into the business to make it more efficient, or look at international expansion opportunities.

Mullen does not want to rock the boat, though, now that a tough couple of years of restructuring and cost-cutting are starting to reap rewards. He and the board will not want to do a deal that does anything to increase debt or affect the current strategy of increasing dividends and cash flow.

Goldman Sachs and JPMorgan are advising on the deal.

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RE china : China | austr : Australia | apacz : Asia Pacific | asiaz : Asia | ausnz : Australia/Oceania | bric : BRIC Countries | chinaz : Greater China | devgcoz : Emerging Market Countries | dvpcoz : Developing Economies | easiaz : Eastern Asia

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