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Report to the Policy and Finance Committee
from Greg Schollum, Chief Financial Officer

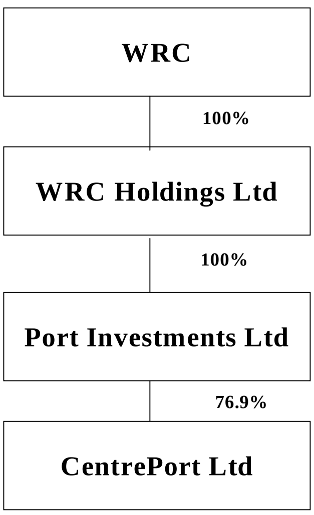
Port Investments Ltd – Retained Earnings

1. Purpose

To advise the Committee of the rationale behind the current level of retained earnings within Port Investments Ltd.

2. Background

As Councillors will recall, Port Investments Ltd is a 100% Council owned subsidiary company as follows:



Since November 1998 the Directors of Port Investments Ltd have been responsible for exercising the direct governance over Council’s 76.9% shareholding in CentrePort Ltd.

Port Investments Ltd is a company registered under the 1993 Companies Act.

At 30 June 1999 Port Investments Ltd had retained earnings of approximately $1.5 million.

3. Why does Port Investments Ltd need to hold any retained earnings?

There are a number of factors relevant to this issue as follows:

3.1 Directors’ responsibilities pursuant to the Companies Act 1993

Legally the responsibility for managing the financial performance and financial position of Port Investments Ltd rests with the Directors of the company. The Companies Act 1993 imposes significant responsibilities on Directors in terms of prudent financial management, both on an ongoing basis and particularly when a dividend is being declared by the Company. The satisfaction of the Companies Act solvency test (incorporating both trading and balance sheet solvency) is a prerequisite to any company declaring and paying a dividend. The solvency test essentially requires Directors to be satisfied that the Company can meet current and future liabilities from its assets. There can be substantial fines imposed if these conditions are not properly followed.

3.2 The capital structure of Port Investments Ltd

Port Investments Ltd purchase of Council’s interest in CentrePort was fully funded from debt (Port Investments Ltd borrowed the full purchase price from its holding company WRC Holdings Ltd).

This, coupled with the fact that Port Investments Ltd had no paid up capital (although $10 million of unpaid capital) at the time of the purchase, meant that the company had no equity. (i.e. its liabilities approximated its assets). Port Investments Ltd remains a company with a high debt level (debt:equity percentage 96% debt at 30/6/99) and with a balance sheet that contains principally one asset – its shareholding in CentrePort. As a result the Company’s balance sheet is also very dependent on its investment maintaining its value.

3.3 The banking covenants associated with the WRC Holdings Group

In order to fund the purchase by Port Investments Ltd of Council’s 76.9% interest in CentrePort, WRC Holdings Ltd needed to borrow from a bank. Such bank borrowing has certain general conditions attached in relation to Port Investments Ltd carrying on business in a proper and efficient manner (it is difficult to see that carrying on with no equity would have satisfied this condition).

3.4 The nature of Port Investments Ltd expenditure and revenue

Port Investments Ltd has expenditure which is relatively fixed (primarily relating to the interest on the debt to WRC Holdings Ltd) and yet history has shown that dividends from CentrePort (its prime revenue source) can be variable.

3.5 Summary

Given the above factors I advised the Directors of Port Investments Ltd that I considered a “buffer” of retained earnings needed to be built up as soon as possible so as to provide some flexibility within the company’s balance sheet.

While this could have been achieved by increasing paid up capital I felt that the 1998/99 net profit (excluding the CentrePort special dividend) would provide the best source of equity, as far as both the Council and the Company was concerned.

As it happened, the Directors of Port Investments Ltd were comfortable to pass up the chain a special dividend of $6.0 million even though a special dividend of less than $5.8 million had been received from CentrePort. (i.e. not all 1998/99 net profits excluding CentrePort special dividend were retained).

4. Where to from here?

Now that the buffer of retained earnings has been built up to approximately $1.5 million I believe it needs to be regularly monitored, depending on the circumstances facing the company in the future. If, for example, the value of its investment in CentrePort Ltd significantly reduced through, say loss of Port trade, this could result in a write down in the book value of the investment on the Port Investments Ltd balance sheet, which with minimal equity could threaten the solvency test and the payment of future dividends by Port Investments Ltd.

Therefore, the level of retained earnings needs to be a year by year assessment by the Directors taking into account all relevant factors (including those detailed within this report) as to what the appropriate level of retained earnings should be and the resulting level of dividend back to the Council.

The current budget approved by of the Directors of Port Investments Ltd provides for the company to pay at least 75% of net profit after tax in dividends.

5. Communications

Not applicable.

6. Recommendation

That the report be received and the contents noted.

GREG SCHOLLUM
Chief Financial Officer