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ATCO Ltd.

Second Quarter 2023 Results Conference Call and Webcast

Conference Call Transcript

Date: Thursday, July 27, 2023

Time: 10:00 AM MT

Speakers: **Katie Patrick** - Executive Vice President, Chief Financial & Investment Officer

Colin Jackson - Senior Vice President, Finance, Treasury, & Sustainability

Conference Call Participants:

Maurice Choy RBC Capital Markets – Research Analyst

Robert Hope Scotiabank – Equity Research Analyst

Mark Jarvi CIBC Capital Markets – Research Analyst

Linda Ezergailis TD Securities, Inc. – Managing Director

Ben Pham BMO Capital Markets – Equity Research Analyst



Operator:

Welcome to the ATCO Ltd. Second Quarter 2023 Results Conference Call and Webcast.

As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. (Operator Instructions)

I would now like to turn the conference over to Mr. Colin Jackson, Senior Vice President, Finance, Treasury, and Sustainability. Please go ahead, Mr. Jackson.

Colin Jackson:

Thank you. Good morning, everyone. We're pleased you could join us for ATCO's Second Quarter 2023 Conference Call.

With me today is Executive Vice President, and Chief Financial and Investment Officer, Katie Patrick.

Before we move into our formal agenda, we'd like to take a moment to acknowledge the numerous traditional territories and homelands on which our global facilities are located. Today, we're speaking to you from our ATCO Park head office in Calgary, which is located in the Treaty 7 Region. This is the ancestral territory of the Blackfoot Confederacy, comprised of the Siksika, Kainai and Pikani Nations, the Tsuut'ina Nation and the Stoney-Nakoda Nations, that include the Chiniki, Bearspaw and Goodstoney First Nations. The City of Calgary is also home to the Métis Nation of Alberta, Region 3. We honour and respect the diverse history, languages, ceremonies and culture of the indigenous peoples who call these areas home.

Katie will begin today with some opening comments on recent Company developments and our financial results. Following these prepared remarks, we will take questions from the investment community.

Please note that a replay of the conference call and a transcript will be available on our website at atco.com, and can be found in the Investors section under the heading Events and Presentations.

I'd like to remind you all that our remarks today will include forward-looking statements that are subject to important risks and uncertainties. For more information on these risks and uncertainties, please see the reports filed by ATCO with the Canadian securities regulators.

Finally, I'd like to point out that during this presentation we may refer to certain non-GAAP and other financial measures, such as total of statement measure, adjusted earnings, adjusted earnings per share and capital investment. These measures do not have any standardized meaning under IFRS and, as a result, they may not be comparable to similar measures presented in other entities.

Now, I'd like to turn the call over to Katie for her opening remarks.

Katie Patrick:

Thanks, Colin, and good morning, everyone. Thank you all very much for joining us today for our Second Quarter 2022 Conference Call.



ATCO achieved adjusted earnings of \$87 million or \$0.77 per share in the second quarter of this year. While this is slightly down on a year-over-year basis, these results really highlight the benefits of our diversified portfolio of investments. This diversification allowed us to partially offset the downwards earnings pressure associated with the Alberta distribution utilities rebasing, with a phenomenal outperformance in recent years, is being shared with our customers. When we look more specifically at where these offsetting earnings came from, we see that our results were driven by exceptional growth from our Structures and Logistics business combined with great performance across our broader portfolio of investments.

Collectively, the performance of our investments outside of Canadian utilities, serves to offset approximately \$15 million of earnings pressure for the quarter.

At ATCO Structures and Logistics, we delivered adjusted earnings of \$26 million in the quarter, \$7 million higher than the same period last year. Continuing the trends from previous quarters, a key driver of our earnings growth in the second quarter was the strong performance of our base businesses. Both our Space Rentals business and our newly acquired Triple M Housing division, delivered exceptional results in the period. Compared to the second quarter of 2022, we grew our Space Rentals fleet size by 13 per cent and our average rental rate by 14 per cent, all while achieving an average utilization rate of 75 per cent.

Moving on Triple M, the business continued its strong positive earnings momentum from the first quarter into the second, and is integrating well into our existing Structures business. We continue to believe this integration will allow for opportunities to incorporate various manufacturing process efficiencies as well as unlocking potential customer synergies across our businesses.

During the quarter, we also reached substantial completion of the Bechtel Pluto Train II Project. This project was a significant driver of project-based earnings for us over the last year and highlights our continued ability to successfully execute large scale, multifaceted workforce housing projects globally.

I'm also very proud to say that this project was completed approximately four months ahead of schedule, an amazing feat given the current economic and supply chain environment.

Our plan to grow our base business globally continues to take form and we have had success securing new contracts as well as supplemental additions to existing contracts. This included the previously announced 116-unit project in Texas with TIC, where we were recently awarded a contract for an additional 31 units by the company. The US market represents a strong, repeatable growth platform and we look forward to increasing our presence in this jurisdiction.

As I've mentioned in the past, our base business typically accounts for two thirds to three quarters of our stake of our segment earnings. The strong performance from these base earnings at Structures offset the project-based earnings pressure we experienced at Frontec in the quarter. The team at Frontec continues to be active in pursuing new contracts to support earnings moving forward. Particularly, we see opportunities in the defense and government spaces where our deep Indigenous relationships can be leveraged alongside our core remote services expertise.

At Neltume Ports, the business continues to deliver stable and dependable earnings. During the quarter, the business increased its ownership at Puerto Angamos and Terminal Graneles del Norte from 40 per



cent to 50 per cent, helping to expand our earnings base moving forward. Favourable foreign exchange impacts also served for second quarter adjusted earnings higher when compared to 2022.

As expected, our Canadian Utilities investment saw adjusted earnings decline by approximately \$19 million when compared to the second quarter of 2022. This decline was primarily due to the impact of rebasing at our Alberta-based distribution utilities, which I previously had mentioned. This rebasing pressure was compounded by year-over-year earnings pressure in the Australia Natural Gas Distribution business as inflation levels began to recede from 2022 highs.

As Brian spoke about Canadian Utilities in detail on this morning's CU earnings call, I won't go into those details again here. I would, however, highlight how the expected performance for CU will impact the remainder of 2023 for ATCO.

Looking ahead to the second half of 2023, we still expect to see year-over-year earnings pressure at ATCO in the third quarter, driven by the same rebasing forces we are seeing this quarter. By the fourth quarter, however, we expect this pressure to ease for CU. Seasonal benefits and growth within our non-regulated businesses at CU, combined with growth at our remaining portfolio of investments, should provide opportunities for continued growth year-over-year.

Overall, ATCO delivered a second quarter that was in line with our expectations and highlighted the strength of our diversified portfolio. Our non-CU investments delivered strong results that helped soften the earnings impact of rebasing and a downward trending Australian inflation. Although these headwinds are expected to continue through the remainder of the year, we continue to be proactive across our portfolio to deliver long-term shareholder value during this key transition year at our largest investments, Canadian Utilities.

That concludes my prepared remarks. I will now turn the call back to Colin.

Colin Jackson:

Thank you Katie.

In the interest of time, we ask that you limit yourself to two questions. If you have additional questions, you are welcome to re-join the queue. I will turn it over to the conference coordinator now for questions.

Operator:

Thank you. We will now begin the question-and-answer session. (Operator Instructions)

The first question comes from Maurice Choy with RBC Capital Markets. Please go ahead.

Maurice Choy:

Thank you and good morning. My first question is just to follow up on the themes from a CU call, specifically the potential ATCO and EnPower separation, and a comment that was made that CU's open to selling assets and it sounds like that it doesn't preclude selling regulated utility assets. From ATCO's



portfolio standpoint and your position as a controlling shareholder of CU, how should we view your guardrails in regard to regulated utility and non-regulated earnings?

Katie Patrick:

Thanks, Maurice, and that's a great question. Thanks for that question. ATCO really values the stability of the earnings and the cash flows that we receive from our regulated utilities business, and going forward, that is something that will continue to be a very significant portion of our portfolio. So, as we think about, I think Brian mentioned sort of the consideration out of the CU level, we would expect maybe earnings to grow to 20 per cent from the non-regulated side. But, as I said, I think we continue to value the stability of those utilities and when we do talk about capital recycling alternatives, those would be probably more at the margin rather than a significant recycling opportunity within the utilities.

Maurice Choy:

Just to be clear, those recycling opportunities at the margin, does that include utility assets?

Katie Patrick:

Sorry, could you repeat the back part of that question, Maurice?

Maurice Choy:

You mentioned that any capital recycling that you do is on the margin. Just to be clear, does that include selling utility assets?

Katie Patrick:

Yes, no, as Brian mentioned, we're still—we're exploring all options at this point, but I would say, as I said before, ATCO as a shareholders really values the stability of the earnings and cash flows from the utilities. So, long term, I don't expect our portfolio to deviate meaningfully from that 80/20 split that Brian had mentioned.

Maurice Choy:

Got it. Just staying with the theme of funding, obviously, CU's seeking funding options to fund its energy transition growth, and intuitively, I would think that equity raise at the CU level remains on the table. Can you speak to ATCO's range of options to raise funds to support CU, including of these options, what is your pecking order?

Katie Patrick:

Sure. No, I mean, we will—we have been a long-term shareholder in CU. We intend to maintain a similar ownership stake as a meaningful owner of CU. ATCO has ample access to liquidity through the debt capital markets through various different financing alternatives at the ATCO level, so as we look forward we probably will look at the comparison between the cost of capital of all of our alternatives, but we



maintain a very strong balance sheet on a standalone basis at the ATCO level, including cash and access to the debt capital markets.

So I think we'll look to use a balance of those to fund initiatives as well as, we mentioned, to help finance some of these options for ATCO EnPower and ATCO Energy System. We look externally as well for those entities to be able to access capital.

Maurice Choy:

Thanks. If I could just do a quick cleanup question on the assets that—the stake sales, stakes that Neltume acquired. Can you just discuss how much is spent and how much cash does Neltume still have on its balance sheet?

Katie Patrick:

Oh, sorry, Neltume. Yes, there's still a significant amount of cash in the balance sheet. We still have over \$100 million on the balance sheet at Neltume, and that 10 per cent stake, we took out a minority partner that was in those investments. So, we actually financed that not with directly cash from the balance sheet at the corporate level, so there still remains a substantial amount of liquidity remaining at the corporate level at Neltume.

Maurice Choy:

Thank you very much.

Operator:

The next question comes from Robert Hope with Scotiabank. Please go ahead.

Robert Hope:

Good morning everyone. Just wanted to turn the attention to the base business of the Structures business. Just taking a look at the global space rental income this quarter, both on a quarter-over-quarter basis as more so on a year-over-year, we're seeing strong growth with an up 14 per cent the average rental rate. Can you maybe speak to what's driving this rental rate and do you see this stabilizing at this level or could we even see a softening depending on how mix works?

Katie Patrick:

Yes. Thanks for the question. Structures, as you saw, had an exceptional quarter, and there we've been able to benefit from overall rising demand in that sector, which you saw the rental rates increase. I would say I can't point to any one area. I would say that we are executing on our strategy to grow that business globally, you will see that particularly in the US, we've had some success in growing our fleet there. But also our core markets in Canada and Australia continue to perform very well.

Going forward, I think we've—there's been significant growth in our fleet size, and you can probably see the level of that growth tempering a bit because we probably have a significant—we have enough



capacity rate now in some of our existing fleet that we probably can continue to grow the business and our earnings through deploying some of those assets.

I hope that answers your question a bit.

Robert Hope:

Yes, that's helpful. So, I guess, continued strong results in the base business. As you take a look at the back half of the year, you have some larger contracts rolling off or have already rolled off. What have conversations been with for some of the larger projects out there to help backfill, we'll call it the large project backlog?

Katie Patrick:

Yes, no, I think we're still very optimistic for the back half of the year. I think we'll continue to see a lot of the same strong performance that we saw in the start of the year through the year. As you noted, there are some projects and the larger projects that have come off, not only the Bechtel Pluto project in Australia that has come to substantial completion, but we do have a strong pipeline of additional potential opportunities, as well as the resilience of that base business that I mentioned to carry us through the year.

Robert Hope:

All right. Thank you.

Operator:

The next question comes from Mark Jarvi with CIBC Capital Markets. Please go ahead.

Mark Jarvi:

Yes, thanks. I wanted to come back to the discussion of EnPower and the discussion on the CU call in terms of range of options. If they did spin it out as a standalone entity, any commentary in terms of what ATCO's ownership levels could be, I mean, obviously, relative to where you are now or willingness to even maybe increase your position around that business depending on the range, I guess, solutions, or financing options put out there?

Katie Patrick:

Yes, as Brian mentioned, we're still very early in exploring the options. As we noted in the press release, a spin out is one of many options under consideration, and it would be too early to speculate exactly where ATCO would see ourselves long term in that. Obviously, as opportunities arise in both ATCO Energy Systems and in EnPower, ATCO would consider its options for capital allocation between the two based on the best use of funds to maximize shareholder value at that time.



Mark Jarvi:

Okay. There's been a handful of, I guess, different M&A deals and things I've seen across different trade magazines and news articles on the port space. In prior calls you had indicated you'd look at a number of range of opportunities there. How would you say the deal flow looks right now in terms of, I guess, level of interest, competition, pricing, just in terms of, I guess, whether or not economic outlook and the impact of higher rates, how would you say asset values are trending right now?

Katie Patrick:

Yes, no, I mean, it's a very interesting space. Obviously, there's been a lot of actions, strikes in Canada and other events that highlight the benefit and the need for a diverse portfolio in terms of the ports, and we are seeing a very strong pipeline there in terms of the range of opportunities. Neltume, as I've discussed in the past, tends to target not necessarily the large, heavily sought after container type opportunities, as those continue to trade at the infrastructure premium type levels, and the Port of Vancouver in Washington State is a great example of kind of the type of opportunity that fits well within the Neltume sweet spot. That's a bulk port, and there's obviously some competition. But we did manage to get that with an attractive profile going forward.

So, there is definitely a lot of interest in that space but we continue to look for more of those niche opportunities where we can really add value at Neltume to the opportunity.

Mark Jarvi:

I guess, maybe just how you would say the competitive environment to find those opportunities? Has it moderated at all in terms of where you're seeing activity, or anything in terms of valuations and how you're seeing assets priced or evaluated?

Katie Patrick:

No, candidly not. I mean, it's the same themes across the sector, right. I don't think that in the private markets and the M&A environment there has been a significant moderation in the multiples that are being paid. So, we continue to see strong demand for most of those larger opportunities that I mentioned. But as I said, Neltume is looking at a slightly different field which tends to have not as much interest from some of those infrastructure type players and the opportunities we look at.

Mark Jarvi:

Got it. Okay. Thanks Katie.

Operator:

The next question comes from Linda Ezergailis with TD Securities. Please go ahead.



Linda Ezergailis:

Thank you. Recognizing it's still early days, but I just wanted to step back, big picture, and understand how ATCO balances complexity and the potential for subordination of cash flows and any sort of restructuring, either at the CU level, or can you confirm that this might not spill into any sort of optimization or initiatives at the ATCO level? Is that off the table or might that come subsequent to what you're doing at CU?

Katie Patrick:

I mean, as Brian mentioned, again, it's very early days in terms of EnPower specifically exploring its financing alternatives. At the moment, this does not—this doesn't impact ATCO in terms of how it's evaluating its current structure or its funding alternatives.

So, if anything, and as mentioned, that it becomes a separate entity, I think we'll continue to evaluate what's in the best—CU will continue to evaluate what's in the best interest of Canadian Utilities shareholders, of which ATCO is one of those, obviously. So, I don't see any potential spillover as you noted for ATCO at the moment.

Linda Ezergailis:

Okay. Just maybe looking back, I mean, at one point ATCO had streamlined, simplified its kind of ownership and platforms. I'm just wondering how both ATCO and CU consider, not just best access to financing at a given point in time, but also considering some of the potential implications around potentially introducing complexity of structures and also the potential for subordination in the debt capital markets.

Katie Patrick:

Yes. I mean, ATCO, as we look to structure our investments are going to take a look at each individual portfolio company and look for what's the best way to finance that vehicle. So the same would hold true for Structures, for Neltume, for any one of our particular investments. We would look to see the best way to maintain the ability for them to grow, combined with maximizing shareholder value for that, whatever that particular investment is.

So, in terms of—we understand that we do have a different structure, but I think that we continue to operate that well and it continues to serve us well in terms of accessing capital for the various entities.

Linda Ezergailis:

Thank you.

Operator:

(Operator Instructions)

The next question comes from Ben Pham with BMO. Please go ahead.



Ben Pham:

Thanks. I wanted to follow up. I know you talked about the ports opportunity and that could be M&A or debt. Can you talk about what else you're probably the most interested in terms of M&A, whether it's Triple M, Structures related businesses, or even any other verticals that you have looked at in the past?

Katie Patrick:

Yes. I mean, when we think about ATCO's group, and I think I've said this a few times in the past, we look at both growth within our existing portfolio of investments, which obviously would be the—considering that if we can find areas where we can have synergies or clear value proportion, that's probably our most preferred route of growth. So Triple M is a great example of how we're able to add on a very complementary business with synergies and a forward-looking pipeline to one of our existing businesses.

But we also do look at growth outside of our existing verticals. In our materials, we've mentioned interest in some of the other essential services, such as water and agriculture, and we'll continue to explore opportunities within those to add on a new portfolio for ATCO.

Ben Pham:

Okay. I think also in the past you mentioned one of the constraints for maybe more on the M&A side was valuations and what you're willing to pay for valuations. Has that changed now? I think that's in somewhat an earlier question that was framed. Can you also comment too, is this really a good environment for you to expand the opportunity of M&A given where valuations are, or there's really maybe no change in how you're looking at the lay of the land?

Katie Patrick:

Yes, I think it's obviously very sector specific. I mean, you'll hear from most people, I'm sure, that we probably haven't seen the valuations in the premiums for M&A transactions come down as much as you would expect considering the public markets at the moment. But that is pretty specific to the sectors that you're talking about. I think, for example, our Triple M, we got it at a very attractive valuation and I think in certain instances and in different opportunities we can still find areas where we can deploy capital and M&A at attractive valuations. But, I'm sure as everyone's aware, the general theme of—the current market is still a bit unstable and we're continuing to watch for opportunities that present themselves to deploy capital.

Ben Pham:

Maybe I'll ask you on your leverage. Is there room for you to take on leverage or even preferred shares. Just thinking the news on the credit rating agencies. Maybe just remind us on the balance sheet and where you're at.



Katie Patrick:

Yes, no, we still have a pretty—a very modest level of holding company leverage at the ATCO level. So I still think we do have capacity to take on additional debt there. We've kind of set ourselves an internal target that we wouldn't go above—around 30 per cent debt to total cap, but we're far below that. So there still is pretty good room on the standalone basis that is at the ATCO level, pretty good room to fuel growth if we see opportunities.

Ben Pham:

Okay, that's very helpful. Thank you.

Operator:

This concludes the question-and-answer session. I would like to turn the conference back over to Mr. Colin Jackson for any closing remarks.

Colin Jackson:

Thank you, Cherise. Thank you all for participating today. We appreciate your interest in ATCO and we look forward to speaking with you again soon.

Operator:

This concludes today's conference call. You may disconnect your lines. Thank you for participating, and have a pleasant day.