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ATCO

ATCO Ltd.

Fourth Quarter and Year End 2021 Results

Conference Call Transcript

Date: **Thursday, February 24, 2022**

Time: **10:00 AM MT**

Speakers: **Colin Jackson -** Senior Vice President, Finance, Treasury, Risk & Sustainability

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

Conference Call Participants:

Maurice Choy RBC Capital Markets – Research Analyst

Linda Ezergailis TD Securities, Inc. – Managing Director

Andrew Kuske Credit Suisse – Managing Director

Mark Jarvi CIBC Capital Markets – Research Analyst

Operator:

Thank you for standing by. This is the conference operator. Welcome to the ATCO, Ltd. Fourth Quarter and Year End 2021 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. To join the question queue, you may press star, then one, on your telephone keypad. Should you need assistance during the conference call, you may signal an operator by pressing star and zero.

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

Colin Jackson:

Thank you. Good morning, everyone. We're pleased you could join us for ATCO's Fourth Quarter 2021 Conference Call.

With me today is Executive Vice President and Chief Financial and Investment Officer Katie Patrick. 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 Investor's 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 or segment measures such as 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'll 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 Fourth Quarter 2021 Conference Call.

As it has been a few years since we have hosted a quarterly conference call for ATCO, I'd like to provide a quick overview of ATCO's strategy and also introduce myself and the role that I hold at ATCO. Specifically, I think it would be helpful for the audience here to touch on ATCO's core strategy and how this differs from the strategy of our largest investment, Canadian Utilities, Ltd. Just for clarity, when I'm talking about Canadian Utilities, I'll often refer to it as CU.

ATCO is a globally diversified holding company with a multigenerational investment horizon and a focus on investments in the essential services space. More specifically, we target investments across six essential service categories: energy, shelter, real estate, water, agriculture, and logistics and transportation. The maturity and scale of our investments in each of these categories varies, with energy, shelter, and transportation and logistics being the most advanced, and water, agriculture, and real estate being longer term strategies for us. Collectively, investments across these categories provide economic resilience and stability through business cycles and allow us to demonstrate our corporate values in the market.

Investments in these categories are also well in line with our core capabilities and provide a pathway to the returns and growth profiles that we demand from our investments. While we continue to explore new investments in support of this strategy, it's worth talking through the current composition of our portfolio and how these investments are aligned with this strategy. Currently, ATCO's core investments include a controlling interest in CU, a 40% interest in Neltume Ports, and a 100% interest in ATCO Structures & Logistics. These investments provide our portfolio with direct exposure to the energy, shelter, real estate, and transportation and logistics segments. Basically, these investments also place our business adjacent to activity and key players in other segments of our strategy where we see further growth opportunities.

As most here are aware, our largest investment is our controlling interest in CU. This investment serves as our portfolio's primary energy investment vehicle and provides exposure to the Alberta, Australia and Puerto Rican utilities, along with energy transition investments in the renewable generation, clean fuels, and energy storage segments. This investment provides a stream of stable and reliable earnings and cash flow for ATCO, which supports new investment at the ATCO level and the funding of our dividends.

With that overview, I wanted to quickly touch on the joint role I hold as ATCO's Executive Vice President and Chief Financial and Investment Officer. This role is a nod to the diversified holding company strategy of ATCO. In this role, I have traditional financial oversight responsibilities, but I also oversee ATCO's portfolio composition and help drive its growth strategy.

Moving on to the 2021 year, I wanted to touch briefly on a few of our recent achievements. 2021 was a busy year and our business delivered year-over-year earnings growth, despite lingering market pressure related to the COVID-19 pandemic; completed work across our businesses, which spanned multiple years and allowed for the issuance of formal ESG targets in January of this year; participated in the competitive bidding process for the Government of Canada's North Warning System operations and maintenance contract; secured key Australian contracts in our ATCO Structures business for the construction of workforce housing; and saw our CU investment make significant strides in both energy transition strategy and delivery of electricity transmission and distribution services for the people of Puerto Rico through its LUMA Energy business, which Brian spoke more fully about during the CU call.

We're truly proud of these results and of our people who live the values of our Company to deliver service excellence across the portfolio in 2021.

Taking this discussion back to our financial performance, and as alluded to previously, 2021 was a great year for ATCO. We achieved adjusted earnings of $382 million, or $3.35 per share, for 2021. This is

$30 million and $0.27 per share higher than 2020. This growth in year-over-year earnings was primarily driven by our CU investment, though many of our other businesses had significant project wins, and we made continued progress in our strategic diversification within the Structures business.

CU saw its own adjusted earnings grow $51 million, from $535 million in 2020 to $586 million in 2021. At the ATCO level, this translated to year-over-year earnings growth from our investment in CU of $30 million. The strong performance from CU was primarily driven by its LUMA Energy business and continued strong performance from its ATCO Gas Australia business, which benefitted from favourable inflation trends and low dynamics through 2021. I know Brian spoke in detail about LUMA's operations during CU's conference call earlier, but I would encourage anyone who isn't familiar with LUMA to take a look at both disclosures within our CU financial statement and MD&A, and also look at the LUMA Energy website for a better sense of the great work that the team in Puerto Rico is doing.

Moving on to our Structures & Logistics business, which comprises both ATCO Structures and ATCO Frontec. The team had a number of project successes in 2021. In the fourth quarter of 2021, ATCO Structures was awarded a contract for the construction of a workforce housing facility in Karratha, Australia. This project, with long-term partner Bechtel, will provide accommodations for 2,500 workers involved in the Pluto Train 2 LNG expansion. This brownfield expansion will see the construction of a second natural gas processing train, significantly increasing the capacity for this facility. While the business has done a great job of backfilling project earnings with more diversified and stable fleet and train sales earnings, major projects will continue to provide a strong supplement to the segment's earnings. The advancement of this project signals the restarting of major projects that were largely postponed due to the COVID-19 pandemic and suggests strengthening economic activity levels.

On the Frontec side of the business, the team actively participated in the Government of Canada's North Warning System RFP process through 2021. I'm happy to report that these efforts, executed through our Nasittuq joint venture with the Pan Arctic Inuit Logistics Corporation, was successful and we were awarded a seven-year contract to operate and maintain the North Warning System, beginning in April of 2022. The seven-year contract, which is valued at $592 million, includes four two-year extension options and represents an incredible opportunity for Frontec to demonstrate their technical expertise, both in the northern territory and as a trusted contractor to the Government of Canada. This contract also reinforces our commitment to Inuit and First Nations within Canada and demonstrates the importance we place on truth, reconciliation, and the creation of economic opportunities. This portfolio-wide commitment was a driving factor in our inclusion of an Indigenous economic benefits target within our recently announced ESG targets, and this project is a key steppingstone in advancing this objective.

Next, I'd like to touch on our Neltume Ports investment, which overall continues to provide a solid base of earnings to ATCO amid the challenging economic environment. Neltume had an active fourth quarter that saw the business acquire a 70% interest in Tidal Transport & Trading USA. It provided a full-scale marine operation services in the United States. This acquisition fits well within Neltume's overall strategy and highlights our desire to further strengthen our presence in the US. Significant dry powder remains in the Neltume business to support new investment and drive growth. While the pandemic slowed our deployment of capital in the business, we're optimistic about the investment opportunities we're seeing already for 2022 as global trade and economic activity continues to improve.

Overall, ATCO had a great 2021 that saw us deliver strong year-over-year earnings growth while also advancing numerous aspects of our corporate strategy, including the issuance of ESG targets. Our team has done a great deal of work, not only to weather the COVID-19 pandemic but to drive performance despite these factors and to prepare each of our businesses for growth as economic conditions improve. We are well positioned heading into 2022 and I'm excited to leverage the work we've done to date as we continue advancing our portfolio strategy at ATCO.

That concludes my prepared remarks and 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 rejoin the queue.

I will now turn it over to Claudia, the conference coordinator, for your questions.

Operator:

Thank you. To join the question queue you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. Webcast participants are welcome to click on the 'Submit Question' tab near the top of the webcast frame and type their question. The Investor Relations team will follow-up with you by email after the call. Once again, anyone on the conference call who wishes to ask a question may press star and one at this time.

Our first question is from Maurice Choy with RBC Capital Markets. Please go ahead.

Maurice Choy:

Thank you and good morning.

My first question is on the Structures & Logistics segment. Obviously, ATCO has had another year where earnings were above $50 million, a far cry from the single-digit earnings results in 2017. I recognize that contract earnings can be lumpy, but would you say that the business has reached a point where earnings are now sustainable at these levels? And if not, what portion do you think is a reliable run rate, particularly when you think about the rental business, or maybe your Frontec business, where the terms tend to be a little bit longer?

Katie Patrick:

Yes, hi, Maurice, and thanks very much for that question.

I think, you know, in short, the answer is I think we have reached that point where there's a relatively stable trajectory underlying our Structures business. As we know, we had a large contribution in 2020 from LNG Canada, and in 2021 we more than overcame that through the base business growth. I think that, yes, you know, that's been the focus to try and get some stability behind that earnings and have a predictable go-forward base business. That will be supplemented, though, just to be clear, from some of those large projects from time to time, such as the Pluto project that I mentioned. So I think, yes, in short, you know, I think we have reached a point of having a relatively stable base business and we'll continue to grow that through additional fleet within Structures.

Maurice Choy:

Great, and my second question relates to Neltume Ports. Globally, there obviously has been supply chain issues, and some ports have seen record-setting volumes. I recognize that Neltume Ports has a wide range of ports with different contracts, volumes, products, and the diversity here should generally mean predictable results. That said, under what market conditions would we see this business do greater than, say, the $3 million to $4 million per quarter run rate?

Katie Patrick:

Yes, that's a great question. I think that, you know, it is a very diversified portfolio, which is great, because it gives us that stability of earnings that we have seen since making our investment. It's exposed to a number of different industry factors, geographies, economic cycles. But as you say, what would drive higher returns for that? There's a few things that I can quickly say.

Certainly, it still remains, it's predominantly based in Chile, which has strong exposure to the commodity cycles. Upswings in commodities would certainly help drive higher earnings. But the number one thing that we're going to see drive growth from within Neltume is the deployment of that capital that we provided as part of our equity investment. There's a healthy pipeline, and I think we should be seeing some of the efforts they have come to fruition shortly to help bolster and grow that earnings that we see come from the Neltume investment.

Maurice Choy:

This is a quick follow-up. How do you compare the returns that Neltume Ports sees for these capital deployment opportunities versus say the types of opportunities that ATCO as a whole has right now?

Katie Patrick:

Yes, I mean, I think, you know, our internal lingo we call Neltume one of our beta investments, which is that it's got a very good stability of earnings and cash flows coming from it. The returns are comparable to other, call it, infrastructure-type investments. You know, we also are seeking to add some faster earnings growth, and some of the energy transition projects would fall into that category. But I think the returns are relatively comparable to, say, our investment overall in the utility segment. It's, you know, obviously got some benefit from being exposed to potentially some higher growth geographies. So you know, should though start to grow faster, then we could see some better returns from the Neltume investment.

Maurice Choy:

Great. Thank you very much for the response and thank you for holding this call.

Katie Patrick:

Thanks, Maurice.

Operator:

Our next question is from Linda Ezergailis with TD Securities. Please go ahead.

Linda Ezergailis:

Thank you. I have a question about your Structures & Logistics approach to managing and mitigating risk. There was an unfortunate incident at another work camp, the Coastal GasLink site last week. I'm just wondering whether you view that as somewhat of a unique circumstance, or do you see that as potentially a datapoint suggesting that there might be more risk in terms of work, remote work locations? How might that effect your business way, and might that reflect—be reflected in maybe more resilient structure design or operations? Can you comment on what changes, if any, might be coming and what sort of cost might be associated with that?

Katie Patrick:

Yes, thanks for that. That was, you know, a very unfortunate incident that no one in Western Canada is super happy about. I think at ATCO, safety of our employees and our contractors and the people on our site is absolutely our number one priority. That is always in the forefront of our mind. We are, you know, we have a 75-year history, probably, of working in remote locations and dealing with the challenges that are faced there. I think it's a very unfortunate incident, and we will obviously continue to, you know, monitor our security protocols in any of the remote areas that we work. I think we have very good experience, as I said, in dealing with that and we will continue to prioritize the safety.

In terms of any specific modifications to the structures or our materials, I don't think there's anything necessarily there on the table at the moment. It's always going to be difficult when someone is trying in that specific situation like that to try and necessarily 100% protect your assets. The people are the most important part.

Linda Ezergailis:

Yes, agreed. Maybe moving back to Neltume. There have been some geopolitical developments and potential implications for a trade of goods globally. Obviously, that is influencing how you approach where you invest, and I think your South American focus serves you well in that regard. But I'm just wondering how that might influence the activity, your businesses that you have right now, and how you approach what sort of investments you make not just in South America but in the US, I guess, and potentially elsewhere over time in terms of goods flow of trade globally?

Katie Patrick:

Yes, I mean, I think we're all adjusting to the overnight news and what's that's going to mean for the world as a whole in terms of go-forward. Generally speaking, ATCO we are—the majority of our assets, as you know, are in very well developed and stable countries where we see the risk to be relatively low. That being said, we do have the Neltume Ports investment; but even then, you know, Chile is one of the leaders of South America in terms of its long-term stability.

I think we're very mindful of the current geopolitical environment and continue to focus on our core geographies, being Canada and Australia, and United States is well as one of our growth areas. But I don't—I think at the moment, you know, we don't have any plans for new endeavours in new geographies beyond what we've already talked about. Obviously, like the whole world, we're going to have to watch and monitor what the implications of the current geopolitical issues in Russia and Ukraine are for our business.

Linda Ezergailis:

Thank you.

Operator:

Our next question is from Andrew Kuske with Credit Suisse. Please go ahead.

Andrew Kuske:

Thanks. Good morning. I guess, the question, related to Katie, on the commodity cycle and how we think about that in relation to the Structures business. Historically, it's been beneficial when we see more robust market prices on a series of commodities for future development projects in that Structures business. But you also get this dynamic where some smaller, regional competitors that come on into that space, most of which ends badly for the competition, but, I guess, just where do you think we are at this point in the cycle, in particular in the Structures business?

Katie Patrick:

Yes, I mean, I think we have a very healthy pipeline of potential opportunities. You know, the rebound in the commodities, particularly in Western Canada and the more recent rebound though, I think, you know, people are still reluctant to invest significant capital into the commodities, or increasing the capacity of the commodities, as we know. I don't, you know, from a large project perspective, I don't expect there to be an absolute flurry of opportunities there. Really, the size of our pipeline growing is a lot—can be a lot attributed to our strategy to diversify into, you know, smaller workforce housing projects, as well as our base business in space rentals.

I think, you know, we may see, and we are seeing, obviously, a bit of a spike in the commodity cycle right here, but I don't think that necessarily will be, you know, we won't see the same capital investments that we may have seen, and it won't necessarily translate into a huge number of massive projects for Structures. But there's still a solid pipeline behind them right now.

Andrew Kuske:

Okay, that's helpful colour and context. Then related, albeit slightly different, when you think about just the permanent structures, in particular for affordable housing, how big is that market opportunity that you can see deploying capital into, maybe expanding that business into something that's more meaningful in the future?

Katie Patrick:

Yes, that's, you know, a bit of a niche business within that we've been focusing on within Structures. I certainly, you know, it's a great skill to have and we continue to look for opportunities for the permanent modular construction. But it does represent at the moment a relatively small portion of the overall Structures business. I think it will grow, you know, grow incrementally. I don't think you'll see, a significant, huge jump in growth in that, but there continues to be a push for looking for new opportunities within that business.

Andrew Kuske:

Thank you.

Operator:

Our next question is from Mark Jarvi with CIBC Capital Markets. Please go ahead.

Mark Jarvi:

Thanks. Just going back to Structures & Logistics, particularly the Q4 results, topline revenue was pretty good, but sort of EBITDA ran a little lower. Is there anything in particular, the contract mix, thinking about how close sort of the subsequent quarters in terms of margin profile?

Katie Patrick:

Yes, no. I think there's a few things that were going on in Q4. The biggest thing is that Q4 2020 we still had some of the impacts of LNG Canada. Even though overall the margin profile this year was better, it's hard to make up for the volumes that we had there. We have some, we have projects that, you know, had a little bit more difficulty with as well that may have contributed to a little bit lower on the earnings side of the equation. But I think, you know, going forward the big thing is trying to exclude the impact of LNG Canada in Q4 2020 on a year-over-year basis to try and get a normalized view of earnings.

Mark Jarvi:

When you mention the word difficulties, is that on cost, on like equipment side? Is it labour, and is it anything you're seeing to carry through into this year at this point?

Katie Patrick:

Yes, no. We're working, in some of our international projects we had a bit of difficulty on a few different areas within it. Overall, we're just—we are trying to make sure that we maintain our commitment to the client, but it probably will result in a bit of some losses related to challenges on costs, COVID-related challenges, just some overall logistical issues with one particular project that hampered the earnings that quarter.

Mark Jarvi:

Okay, and last question, just there is a negative outlook from S&P on the ATCO Ltd. credit rating. I'm wondering how important it is to preserve the A- rating that they gave? Does it hamper your ability to deploy capital or issue a lot of debt at the ATCO Ltd. level? Would you be comfortable going down to BBB+?

Katie Patrick:

Yes, no, and we've had that, you know, we've had that negative outlook on for a couple years. You know, we're aware of that, and I think, overall, the impact from move to—from A- to BBB+, if that were to transpire, would have limited impact on our overall business. We do have, for lack of a better term, ring sensing in place for CU Inc., which is our primary debt issuer. That will maintain its strong access to capital markets. But I think even then, I don't anticipate big concerns with accessing capital at either the CU level, or the ATCO level, should there be any change to the S&P outlook or rating for us.

Mark Jarvi:

Okay, thanks, Kate.

Operator:

There are no further questions registered at this time. I would like to turn the conference back over to Mr. Colin Jackson for any closing remarks.

Colin Jackson:

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

Operator:

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