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ATCO Ltd.

Second Quarter 2022 Results

Conference Call and Webcast Transcript

Date: Thursday, July 28, 2022

Time: 10:00 AM MT

Speakers: **Colin Jackson** – Senior Vice President, Finance, Treasury, Risk, and Sustainability
Katie Patrick – Executive Vice President, Chief Financial and Investment Officer

Conference Call Participants:

Mark Jarvi CIBC Capital Markets – Research Analyst

Maurice Choy RBC Capital Markets – Research Analyst

Ben Pham BMO Capital Markets – Managing Director

Andrew Kuske Credit Suisse – Managing Director



Operator:

Welcome to the ATCO Ltd. Second Quarter 2022 Results Conference Call and Webcast.

As a reminder, all participants are in listen-only mode and the conference is being recorded.

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 Second Quarter 2022 Conference Call.

With me today is Executive Vice President, Chief Financial & 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 Investors section under the heading Events & 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 also 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 very much for joining us today for our Second Quarter 2022 Conference Call.

ATCO achieved adjusted earnings of \$92 million or \$0.81 per share in the second quarter of 2022. This is \$12 million or \$0.11 higher than the second quarter last year. This \$12 million of year-over-year growth was driven by the strong performance of our Utilities, combined with great results across our broader portfolio.

Our Canadian Utilities investment saw its adjusted earnings grow \$21 million, from \$115 million in the second quarter of last year to \$136 million this year. This strong performance was driven by CU's



Alberta-based distribution utilities, which continued to deliver exceptional results in the final year of their second PBR cycle.

Our ATCO Gas Australia investment also benefited from CPI indexing, which pushed their earnings higher in the period. Speaking to CPI, and inflation more broadly, it's worth reiterating that we have to date, been well insulated against these pressures. Across our portfolio, we've been successful in leveraging our operating expertise and experience managing through challenging financial conditions to provide this insulation. As an example, we've been working with suppliers to fix costs and obtain Board forecasts on key input materials, and have also leveraged escalation mechanisms in our contracts to manage this exposure.

For our Utility investments, we have structural protections embedded within our respective regulatory regimes. All that said, we continue to closely monitor inflationary impacts to our businesses. We will utilize the expertise of our teams and long-held relationships to manage through this period.

Before we move on to the performance of our ATCO Structures business, it is worth circling back to a point that Brian covered during this morning's CU Call, which will also impact ATCO for 2023. As Brian mentioned, all of our utilities have performed well this year, but in particular, our Alberta-based distribution utility have delivered exceptional earnings growth in the year. This growth is due to efficiencies they have unlocked during the second generation of their performance-based regulation, or PBR2.

Looking ahead to 2023, however, we expect to see a reset of earnings for the Alberta distribution utilities as we exit the current PBR cycle. This resetting is normal within a PBR regulatory framework, which, at its heart, is designed to incent utilities to find efficiencies. The earnings benefit of these efficiencies are retained by the utility during the PBR term, before being passed on to customers in the form of long-term cost savings. Acknowledging the above, we still have expectations for outperformance across our utilities next year. The drive of our leaders to deliver top-tier performance, our operating expertise, and our historical track record all support a view that outperformance above allowed ROEs will be attainable for 2023. This is further reinforced by the regulatory mechanisms embedded in the PBR framework, aimed at improving earnings stability, including the efficiency carryover mechanism Brian touched on this morning.

Turning to ATCO Structures, we delivered adjusted earnings of \$16 million in the quarter, which was comparable to the prior year. This earnings stability is worth highlighting, as the second quarter of last year included significant earnings from the LNG Canada project. This project was substantially completed in the second quarter of this year, and despite lower earnings from the project, overall earnings of Structures remained consistent. As we've said before, this stability comes largely from our focus on the core fleet rental businesses, which performed well across all geographies.

The Structures team remained focus on growing and expanding this core business of space rentals and workforce housing. These product categories typically account for two-thirds to three-quarters of our segment earnings, and deliver stable and less cyclical earnings for the business. Year to date, we have improved key performance metrics here, including higher unit counts, utilization, and average rental rates.



Beyond the core business, we continued to supplement our earnings with larger projects. This past quarter, we advanced our project with Bechtel, a long-time partner, to provide accommodations for the 2,500 workers involved in the construction of the Pluto II LNG expansion. This project, which is in Australia, displays our ability to execute large scale, multifaceted workforce housing projects, and will continue to be a significant driver of earnings for us in the next 18 months.

On the ATCO Frontec side of the business, we delivered earnings of \$3 million, approximately \$1 million higher than the same quarter last year. This increase was due to higher occupancy at our Trans Mountain camps, along with new project work for the Defense Threat Reduction Agency, an organization within the U.S. Department of Defense. This project utilized Frontec's expertise in rapid response scenarios to support the field accommodation requirements for this exercise in the United Kingdom. Our proven ability to execute these highly complex projects demonstrates our versatile skill set and creates future opportunities in this key market segment.

April 1st also marked the commencement of Frontec's North Warning System contract. As discussed last quarter, Frontec, through its Nasittuq joint venture, won a seven-year contract from the Government of Canada to operate and maintain the North Warning System. Nasittuq expects to assume full custody and control of the system by August 1st.

Moving on to Neltume Ports, the business continues to provide a solid base of earnings to ATCO, amidst the current economic environment and ongoing global supply chain turmoil. Neltume had a strong second quarter that saw the business increase earnings by \$1 million year over year. This increase in earnings was driven by higher activity across the portfolio of ports. Growth in the deployment of capital is a key area of focus for Neltume. Our pipeline of opportunities in the business is strong, and we're confident this will create meaningful opportunities for new investment in the future.

Overall, ATCO had a great second quarter. I'm excited to see the work that our businesses have been doing to secure new projects, execute on their long-term strategies, and drive earnings stability. You can see this in our results, and I believe we're well positioned heading into the remainder of the year.

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 rejoin the queue.

I will turn it over to the conference co-ordinator now for questions.

Operator:

Thank you.



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

Mark Jarvi:

Thanks. Hi, everyone.

First question is on Structures. It seems like you're expanding the fleet, there's some more invested capital going in, but utilization is down a little bit year over year and quarter over quarter. Can you help us sort of reconcile those two things? Is that just a lag on utilization, that you'll essentially see that tick higher as you roll out the expanded fleet?

Katie Patrick:

Yes, thanks, Mark.

Great question, and you've hit it quite clearly. We expanded our fleet, and we expect our utilization will take a little time just to catch up to that rapid expansion that we have. We're not concerned about the slight downtick in utilization, just because, as you say, we did have some expansion in the fleet side. As those units come on rent throughout the remainder of the year, we should see an improvement of that overall.

Mark Jarvi:

It'd be around year-end that we would start to see that sort of normalize out?

Katie Patrick:

It should start to normalize out over the next few quarters here, because we had—well, we're continuing to expand our fleet size, though, but you should see it over the next couple quarters, start to improve.

Mark Jarvi:

Okay. Then turning to Neltume, obviously lots of headline chatter around a recession, I think GDP growth's good, so, I don't know, technical recession, people talk about that, and underlying real growth is down. How would you see that playing out in terms of the outlook for Neltume? Just remind us again, I guess the volume sensitivity for that business, or the GDP sensitivity, if there is a bit of a softening in 2023?

Katie Patrick:

Yes, generally speaking, we have said in the past that Neltume's volumes kind of track with GDP growth in the region, which is obviously predominantly in South America. But that being said, throughout the pandemic, we've been very strong, even when there was a little softening overall of GDP growth. A lot of that is attributable to the diverse portfolio that we have within Neltume, of different types of cargo.



While there is some sensitivity, particularly you'll see containers and those type of ports more sensitive to the economic environment, there's a broad range of different cargoes that we are servicing, so you'll see some resiliency, and we have seen resiliency since we purchased into that investment, as we move forward through various economic cycles.

Mark Jarvi:

How would you characterize recent months in terms of activity, and how that business is performing?

Katie Patrick:

Neltume's been performing very well, to be honest. As I just mentioned, we have seen some strong results from some of our container ports picking up on excess volumes, because of the supply chain shortages. But across the whole portfolio, most of the ports are doing very well, with diverse commodities driving that. We obviously have a lot of exposure to some of the commodities in Chile, and those have all been doing quite well. The portfolio is doing well, as well as we've seen some benefit from the way that the exchange rates work in our favour from an operational perspective.

Mark Jarvi:

That's good to hear. Thanks for the time today, Katie.

Katie Patrick:

Okay.

Operator:

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

Maurice Choy:

Thank you, and good morning.

Maybe I'll just stick with a similar theme to the previous question. Maybe, your thoughts on the outlook of new contracts for the workforce housing and permanent modular construction? Obviously, if there is a recession, that some customers might want to hold back from committing to new projects. But on the other hand, the energy sector is doing well, given the high oil and gas prices, and this sector is a big portion of your customer base. Your thoughts on your contracts?

Katie Patrick:

Yes, I think we still have a very strong pipeline of new opportunities within Structures. As we've talked about before, we really have tried to transition that business to have the core stability of the smaller projects. But that being said, we do have some of the larger projects still in the mix, and, by design, they



are not as predictable in terms of when they will come into our earnings stream. They're obviously dependent on large capital expenditures, large projects around the world moving forward. But we have a good global footprint in that business, so to the extent—not even within Alberta, but other jurisdictions, there's large projects moving forward. We're obviously very well positioned to capitalize on those.

I think, overall, we have a good outlook, both, potentially for some large projects, and also for the core business to remain stable.

Maurice Choy:

Are you seeing this pipeline, whether by way of customer or size, or in the case of delivery, have you seen those change over the last three to four months?

Katie Patrick:

I think we're pretty consistent through this year, in terms of the pipeline and what we're seeing from an economic perspective. Obviously, inflation continues and the interest rate environment continues to be a challenge, but I don't think we've seen significant changes in the most recent period of that pipeline of potential activity.

Maurice Choy:

Got it. Just last question, sticking with Structures & Logistics, as you look at your contracts to help build new infrastructure for customers, what generally is your ability to pass through higher costs, due to inflation or supply chain issues, to your end customer? Take the Pluto contract in Australia as an example, where inflation—per Brian's comments this morning, Australia's CPI is running quite high. How exposed, how pertinent are those to ATCO?

Katie Patrick:

Yes, no, I mean, to date, actually, we've done a pretty good job of passing on some of those costs to our customers within the Structures business, and we've utilized quite a number of different tools, short validity periods for our contracts, our quotes. As I mentioned in my prepared remarks, we have line of sight with our suppliers in terms of the long-term costs, and we do have various mechanisms to increase the prices in some of our contracts as well.

To date, we have done a pretty good job. But obviously, inflation, and persistent inflation, is something we have to continue to monitor, and, inevitably, there will be—it will be compounded and we will have to work hard to maintain that ability to pass it on.

Maurice Choy:

Fantastic, thank you very much.



Katie Patrick:

Thanks, Maurice.

Operator:

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

Ben Pham:

Hi, thanks, good morning.

I'm wondering, my first question is, it sounds like—I mean, you mentioned the CU, the reset of earnings on the Utilities side. But it sounds like there's some good tailwinds in Structures, heading into 2023, the next 18 months. Do you have enough earnings increases throughout the back for some of the CU reset?

Katie Patrick:

I mean, I think, as we saw in the last reset of PBR, there is a pretty meaningful change in the ongoing rate for a distribution utility, so there is quite a bit of a reset there that we did manage last time to make up over time. But, at least in the outset, it's pretty hard to overcome some of that with the other businesses, just due to the magnitude of how much our distribution utilities do account for our overall earnings at ATCO. We are hopeful that the, obviously, that there are strong tailwinds, but I think it would be—we would have to have significantly stronger results within Structures to overcome that.

Ben Pham:

Maybe to stay on that point, when you think about PBR3 versus PBR2, do you anticipate the same trend on ROEs, it's more lower in the front end than the back end? And anything else to add on, really, the base O&M year, the regulators looking to the CapEx, is there a kicker in ROE? Is it similar to the second period, or is there some subtle differences you can comment on?

Katie Patrick:

It is similar. We will go into one year of the cost of service, while we are still figuring out the final logistics of the next PBR3, so we don't have all those details yet. But I think you can expect a similar trajectory of ROEs, as you saw through PBR2, in that sort of glide path upwards, throughout the course of the next PBR term. But we don't have all the details yet, but those will be coming shortly.

Ben Pham:

Okay. Then maybe lastly, when you think about some of these trends, obviously, are to come off of a good year, you've got Australia helping out. How do you think about your payout ratio, your dividend at



ATCO? I know the payout's lower at ATCO than in CU. Maybe more of a reminder of your targets and thought process going forward on your dividend?

Katie Patrick:

Yes. We haven't set a public target on the payout ratio. We are relatively, at the ATCO level, we're relatively comfortable with our current payout ratio. Overall, we do aim to grow our dividend, consistent with the base sustainable earnings of our business.

Even if we have a significant outperformance year, we're not necessarily going to boost our dividend on a one-time basis, consistent with those earnings. We do look for the long-term sustainable growth in that dividend, which you've seen over the past, and that will continue to be our policy going forward.

Ben Pham:

Okay, got it. Okay, thank you.

Operator:

The next question comes from Andrew Kuske with Credit Suisse. Please go ahead.

Andrew Kuske:

Thanks, good morning.

Maybe just coming back to the Structures business, given some of the work you've done and continue to do with LNG-related customers, do you see an interesting business opportunity or a niche that you've built up for future potential, given just some of the global LNG dynamics that we're seeing?

Katie Patrick:

Yes, for sure. I mean, just generally—thanks, Andrew.

ATCO Structures is a global leader in workforce housing, if not the global leader, certainly amongst them. I think, to the extent, we have a lot of expertise, LNG Canada, and a lot of relationships with that community, so I think we do have a very strong advantage for future global LNG projects. They do tend to be, obviously, more remote, hence the need for the workforce housing. I think that's certainly an area that we would look to continue to capitalize on.

Andrew Kuske:

Have the conversations changed meaningfully with that clientele in the last few months or couple of quarters, just as the LNG market's really tightened up?



Katie Patrick:

I would say that we—obviously, these are long lead time projects, so we can't—you're not going to see an immediate jump to getting new projects there, but there is certainly, I guess tangentially, more chatter, more interest, more discussion around some of these projects, given the global dynamics and the need for the movement of gas. Yes. I think there is an increase, but it will take a while, obviously, before these come to fruition.

Andrew Kuske:

That's helpful context. Then, maybe just the top-of-the-house view for ATCO, when you think about the cash position and just the balance sheet that you've got, you've got a lot of flexibility. How do you think about capital deployment, as there's some market dislocations happening, just given the concerns on recession, rising interest rates, inflation? There's a whole cluster of things happening, and you sort of said they're very well positioned with capital to deploy, should you choose to do that. How do you think about market opportunities at this point?

Katie Patrick:

Yes, no, that's a great question. I think we have great pride in our historical—we've been conservative and we've been prudent with our balance sheet and maintain that strong cash balance. I think that mentality will hold true this current turbulence; but at the same time, as you say, it does position us well to look for specific opportunities where there could be a value accretive opportunity for ATCO in any one of our companies. We are looking, broadly, and there's lots of activity going on, to look for new growth, but we will be prudent in how we manage that capital and our balance sheet throughout these times.

We haven't necessarily seen yet, though it's pretty new still, a softening in the valuations of some of the growth opportunities we're looking at. But one would expect, with the rising interest rate environment, etc., that that will come, and we should remain well positioned to capitalize there.

Andrew Kuske:

If I can sneak it in, because you kind of opened the door, are there certain opportunities that are more interesting than others at this point in time?

Katie Patrick:

Sure. I mean, I think Brian touched on it. I mean, they're pretty consistent, that the energy transition and the opportunities we're seeing through clean fuels, renewables, obviously we've announced quite a few initiatives in that world, and energy storage, are probably high on our list. If we can get some policy clarity, those would be the areas, certainly, of key focus for the organization as a whole.



Andrew Kuske:

Okay. I won't sneak any more in. Thank you for that.

Katie Patrick:

Okay. Thanks very much.

Operator:

As there are no more questions from the phone lines, 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, Operator, and 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.