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ATCO Ltd.

Third Quarter 2022 Results

Conference Call Transcript

Date: **Thursday, October 27, 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:

Linda Ezergailis TD Securities – Managing Director

Maurice Choy RBC Capital Markets – Research Analyst

Mark Jarvi CIBC Capital Markets – Executive Director

Operator:

Welcome to the ATCO Ltd. Third Quarter 2022 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.

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 Third Quarter 2022 Conference Call.

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

Before we move into our formal agenda, I'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 Treaty 7 Region. This is the ancestral territory of the Blackfoot Confederacy, comprised of the Siksika, Kainai and Pikani Nations, and 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 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 with 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 Third Quarter 2022 Conference Call.

ATCO achieved adjusted earnings of $87 million, or $0.76 per share, in the third quarter of this year. This is $18 million, or $0.16 per share, higher than the third quarter last year. This $18 million of year-over-year growth came primarily from the strong performance of our utilities, combined with great performance across our broader portfolio of investments.

Our Canadian Utilities investment saw its adjusted earnings grow $32 million, from $88 million in the third quarter of last year to $120 million this year. The Alberta-based distribution utilities continued to deliver exceptional results in the final year of their second PBR cycle. Also, the international natural gas distribution business continued to benefit from CPI indexing, which pushed their earnings higher in the period.

I want to briefly touch on a couple of points that Brian covered during this morning's CU call, which have important impacts to ATCO, as well.

First, I want to congratulate the entire team at CU on their transformational acquisition of Suncor's renewable generation portfolio. These assets provide immediate scale with renewables generation, along with a strong development pipeline. This is exactly aligned with the strategy we've outlined to be a leader in energy transition. This provides a pathway to both achieving our 2030 ESG targets and is expected to be accretive to earnings and cash flow in its first year of operations.

Also, as you heard from Brian, our utilities continue to perform very well. A meaningful portion of their earnings in the period came from the international natural gas distribution business, which has benefited from CPI indexing in the face of a rapidly rising Australian CPI. Australian CPI remains elevated, though some forecasts suggest that this figure will trend downward to more normal levels in 2023. This movement has the potential to materially impact the earnings for this business.

Similarly, our Alberta distribution utilities have delivered exceptional earnings in 2022, the final year of their current performance-based regulation, or PBR, cycle. Consistent with the cyclical nature of the PBR framework, we expect to see earnings for the distribution utilities reset downwards as we rebase in 2023, and the efficiencies developed are shared with ratepayers. Despite the expectations that earnings from Alberta distribution utilities will reset downward in 2023, we still believe our utilities will deliver outperformance above approved ROEs in 2023, based on the drivers Brian outlined earlier today.

I also want to take moment to commend the LUMA team for the exceptional work that they've done in Puerto Rico as the territory works to recover from the damage done by Hurricane Fiona. The LUMA teams have worked tirelessly to restore service to customers impacted by the hurricane and ensure the safety of all citizens during the aftermath of this tragedy. While significant work remains, power has been restored for more than 99% of the customers, and the importance of LUMA in Puerto Rico's journey towards a stable, resilient and modern energy system has again been highlighted. I truly can't thank the LUMA team enough for their exceptional work.

Turning to ATCO Structures, we delivered adjusted earnings of $15 million in the quarter, approximately $2 million higher than the same quarter last year. In line with our strategy of expanding the base business, growth in the period was driven by strong performance from the space rental segment globally. The Structures business continues to focus on diversifying its customer base across both market segments and geographies. This quarter, in particular, saw expansion in the US market, with significant growth in the space rentals fleet. The US is an important market for us and we expect its contribution to earnings to increase going forward.

Beyond the base business of space rentals and workforce housing, which typically accounts for two-thirds to three-quarters of our segment earnings, strong project activity further supplemented our earnings growth. We continue to advance our Pluto II LNG expansion project with Bechtel, a long-time partner, in the third quarter. This project will see us provide accommodation for 2,500 workers and displays our ability to execute large-scale, multi-faceted workforce housing projects. Given the scale of this project, it will continue to be a significant driver of earnings for us throughout the next year.

At ATCO Frontec, we delivered stable earnings of $3 million, which were comparable to the prior year, and supported by strong occupancy levels at our Trans Mountain and other camps.

As discussed on the second quarter call, Frontec, through its Nasittuq partnership, won a seven-year contract from the Government of Canada to operate and maintain the North Warning System. The transition period for this contract commenced April 1, 2022 and was successfully completed on September 30 of this year. On October 1, our team assumed operations under the agreement.

Leveraging our strong presence in the North, and experience gained through this contract, we expect the Government of Canada's recently announced NORAD modernization project to create additional opportunities for us in the future. Our teams will be actively marketing the expertise of both Frontec and our Nasittuq partnership to help meet the needs of this initiative, as they become more clearly defined.

Moving on to Neltume Ports, the business continued to delivery stability in the third quarter, with earnings of $4 million, which was in line with the prior period last year. Growth and the deployment of capital continues to be a key area of focus at Neltume. As global economic activity continues to improve, our pipelines of opportunities in the Neltume business grows, and we're confident that this will create meaningful opportunities for new investment.

Overall, ATCO had a great third 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 from our results today that we are well positioned to close out the remainder of 2022, with many exciting opportunities ahead in 2023 and beyond.

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

Operator:

Thank you. The first question comes from Linda Ezergailis with TD Securities. Please go ahead.

Linda Ezergailis:

Thank you. Looking at the next decade, there's a lot of initiatives underway, and I'm just wondering if you can help us understand how we might think of your business mix shifting as your company decarbonizes and pivots to an energy transition, and within that comment, maybe if you can talk about if you're considering any new discrete platforms, as well, in addition to the ones that you have?

Katie Patrick:

Yes, absolutely. Thanks, Linda. I think Brian, you know, roughly talked to the transition and what we expect from a proportion of earnings for CU going forward. I think the one thing I would add from an ATCO perspective, in addition to that, obviously, the energy transition business will become a growing portion of CU and, hence, flow up to be a more significant portion of ATCO's earnings, as well. The ATCO businesses, on a standalone basis, also generally have a higher growth expectation going forward, just based on their relative size, than CU, so, over the next decade, they should make up a more meaningful size of the overall portion of ATCO's earnings.

In terms of discrete new businesses, I would say that we do continue to look for platforms that are synergistic to the overall portfolio for ATCO, and we have in the past outlined the specific areas of essential services that we would look to make those investments. In the near term, we have, obviously, a very strong pipeline associated with the energy transition projects, so most likely, from a capital allocation perspective, we will be putting a lot of focus there, but in the back half of the decade, there may be other opportunities that present themselves.

Linda Ezergailis:

Thank you, and just as a follow-up, maybe, on your existing ATCO-level platforms, what is your outlook in terms of opportunities and achieving kind of an elevated growth profile at your Neltume business and Structures and Logistics? Can you comment on what roles any acquisitions might augment the organic growth, and which growth driver do you expect to be more significant over the next four years, let's say?

Katie Patrick:

Sure. Thanks, Linda. I think for both businesses, they have a very strong organic profile ahead of them. Now, when I say "organic" for Neltume, it's slightly different, in that there is some greenfield and some brownfield. They've made some acquisitions, which I think they will continue to do, that give them an entry into the new market. You will see we've made some acquisitions in the US in stevedoring, which just provides the foundation to look for the more concrete asset opportunities. So, I think there's a bit of a mix in the Neltume business, with a more heavy leaning, probably, towards the organic growth options there.

On Structures, I think we have done very well in the past with an organic strategy with—call it bolt-on acquisitions that help propel it forward a bit, but I think, for the most part, we'll be looking for an organic strategy there with the areas we've identified that we don't have a strong presence as yet, particularly the US, to make new headways.

Linda Ezergailis:

That's great, thank you. I'll jump in the queue.

Operator:

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

Maurice Choy:

Thank you, and good morning. My first question is about, you know, tying back to your relationship with CU. Obviously, there's a lot of capital requirements on the CU level related to the energy transition, and I acknowledge that Brian's got various non-equity funding options, that he's highlighted on his call, but what do you see ATCO's participation being in helping CU with its fundraising in the years ahead, if anything at all?

Katie Patrick:

Well, I mean, we work very closely on trying to map out what the overall funding strategy will be for CU, between ATCO and CU, obviously. I think there is access to various forms of capital for CU, including potential asset recycling opportunities, that Brian mentioned, great access to the debt capital markets, to other forms of financing, potentially the equity capital markets in the right situation. I think CU on its own does have the capacity to fund its own growth without necessarily support from ATCO, and I think that's been a historical trajectory and likely would be the path forward.

Did we lose you, Maurice? Do you have a follow-up on that one?

Operator:

Maurice, your line is now open still.

Maurice Choy:

I had the mute on, sorry about that. Just a follow-up to that, I suppose. You mentioned that equity capital markets is something that he can consider, if the environment is suitable for that. I suppose, take that one step further, would ATCO be interested in maintaining the share that you have if he takes that route?

Katie Patrick:

Yes, I mean, CU is a very important part of ATCO's business, obviously, and I think has been a longstanding—it's a longstanding important part of our portfolio, so I can't foresee that we would significantly diminish our interest in CU. If there was an equity capital raise from CU, if that were to happen, I think ATCO would evaluate it based on the merits at the time, but it is an important portion of our business and I can't, as I said, foresee a significant dilution in that entity.

Maurice Choy:

Perfect, and my second final question, just coming back S&L. Obviously, the economic outlook seems to be ever-changing, not just in North America, but just globally. Anything, in your view, about the pace and interest of your customers wanting to continue their growth?

Katie Patrick:

Yes, I mean, I think, you know, for Structures, it's an industry tied to the economic activity globally, and so we are all watching to see the effects of inflation and what the economic growth going forward is. That being said, we've really, as we've mentioned in the past, tried to—we've mentioned many times—tried to improve the earnings stability of our base space rentals and workforce housing business and be less reliant on the large projects. We haven't seen the same number of large projects emerging in more recent times, but, that being said, the global infrastructure buildout and construction activity is still very robust. Therefore, the demand for our base business there, in the space rentals and smaller workforce housing, is still very strong. We're obviously still looking for those large projects and there are some that we continue to pursue, but we're really hopeful that there's continued growth in the economy, generally, supporting the space rentals and base workforce housing business.

Maurice Choy:

Thank you very much.

Operator:

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

Mark Jarvi:

Thanks, everyone. Katie, you talked about maybe trying to grow your presence a little bit more in the US market. Maybe you can touch—this is for Structures and Logistics, I'm talking about. Maybe you can talk a little bit about the competitive dynamic, both from an organic perspective, but also you did mention bolt-on acquisitions, so what are you seeing in that market, and sort of a competitive dynamic, in terms of trying to grow your presence there.

Katie Patrick:

So far, our growth to date has been on an organic basis, and I think that's served us well. We grew our fleet significantly in the US over the last year, so I think that will be the continued strategy going forward. When I say "bolt-on acquisition," I think there are sometimes essentially acquisitions of fleet or assets that become available at an attractive price, that we could use to bolster that. We have opened new branches and new locations in the US over the last year, and we've also, importantly, I think, significantly diversified our customer base. We were relatively reliant in the past on—or we had a large portion of our earnings, I should say, come from a major customer, and that has distributed to many more customers over the course of this year. So, I think there's definitely space in the market, I would say, first of all, for us, and a lot of opportunity to continue to grow organically.

Mark Jarvi:

Okay, and then my second question is just in terms of how you think about funding Structures and Logistics. You've been expanding the rental fleet, investing a bit more capital there. Is the idea there that as cash flows grow with the business, you can grow the fleet, or if you ever saw an opportunity to grow the fleet beyond what could be, I guess, self-financed by Structures and Logistics, would you start to sort of contribute more capital from, I guess, the top of the house. I just wonder about it in terms of, yes, sort of the outlook and sort of, I guess, will to be sort of internally sort of free cash neutral or positive at Structures and Logistics.

Katie Patrick:

Yes, I mean, obviously, at ATCO, we do look and hope for each one of our businesses to self-fund their growth, but, that being said, I think in certain instances, if there is a good growth opportunity behind our businesses, we will fund equity from an ATCO perspective, and particularly for Structures and Logistics. Should the right opportunity become available, ATCO also has good access to capital, that could be used to help augment their own sources of capital that they have to grow that business faster.

Mark Jarvi:

So, sitting here today and seeing the funnel and the opportunity in the US market, do you see that where, I guess, internally, generally, cash flows in Structures doesn't quite fund the ambitions there to expand the fleet?

Katie Patrick:

Honestly, over the medium-term period here, they do have a self-funded outlook, so I don't necessarily foresee that, but should—as I said, should there—as we move forward and see that there is significantly more demand, or, as you mentioned, an inorganic opportunity that presented itself, then we would look to participate from the ATCO level.

Mark Jarvi:

Okay, understood. Thanks, Katie.

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

Operator:

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