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ATCO

ATCO Ltd.

First Quarter 2022 Results

Conference Call Transcript

Date:	**Thursday, April 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
	Adam Beattie - President, ATCO Structures

Conference Call Participants:

Ben Pham BMO Capital Markets – Managing Director

Maurice Choy RBC Capital Markets – Research Analyst

Linda Ezergailis TD Securities, Inc. – Managing Director

Mark Jarvi CIBC Capital Markets – Research Analyst

Andrew Kuske Credit Suisse – Managing Director

Operator:

Welcome to the ATCO Ltd. First 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. 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 First Quarter 2022 Conference Call.

With me today is Executive Vice President and Chief Financial and Investment Officer Katie Patrick and President of ATCO Structures, Adam Beattie.

The call today will begin with some opening comments from Katie on recent Company developments and financial results, followed by an update from Adam on our Global Structures business. After 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 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 Patrick for her opening remarks.

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

ATCO achieved adjusted earnings of $134 million, or $1.17 per share, in the first quarter of 2022. This is $15 million, or $0.13 per share, higher than the first quarter of 2021. This $15 million of growth came primarily from the strong performance of our Canadian Utilities investment, and also higher space rentals and workforce housing activity within ATCO Structures. CU saw its adjusted earnings grow $28 million from $191 million in the first quarter of last year to $219 million in the first quarter of this year. At the ATCO level, this translated into year-over-year earnings growth from CU of $15 million. This strong performance was primarily driven by growth from our Alberta-based distribution utilities, which entered the final year of their second PBR cycle. LUMA Energy also supported CU's year-over-year earnings growth, contributing a full quarter of operations to earnings in 2022.

Before we go any further, I would like to comment on the AUC proceeding and settlement proposal, which Brian spoke about earlier on the CUL call. We acknowledge that we made administrative and regulatory errors and recognize that these serious missteps that have impacted customer trust. Our priority is rebuilding this trust as we bring this matter to a close and delivering exceptional service for the customers we have the honour of serving. For absolute clarity, none of the original costs in question, nor any penalties related to these, have or will be in the future impacting customer rates.

Moving back to our results, our Structures investment delivered $3 million of year-over-year earnings growth and a total adjusted earnings contribution of $16 million in this past quarter. In line with our strategy, the growth was driven by strong performance in space rentals across many geographies.

I'm very happy to have another voice for you to hear on our call today. Adam Beattie, our President of ATCO Structures, is here with me and will give an update on his business, recent contract wins, and his long-term strategy.

I'll turn the call over to Adam.

Adam Beattie:
Thank you, Katie, and good morning, everyone.

As Katie alluded to, our Structures business carried the momentum it built in 2021 into a great first quarter of 2022. Beyond the exceptional sustained performance of our space rentals fleet in the period, we also had a few key project successes.

Notably, we secured a contract in Karratha, Australia, for the construction of a workforce housing facility related to the Pluto LNG expansion being undertaken by Woodside Energy. On this project, ATCO Structures will work with Bechtel, a long-term repeat customer, to provide accommodations for the

2,500 workers involved in the construction of the Pluto LNG expansion. This brownfield expansion will see the construction of a second natural gas processing train, increasing capacity for the facility, and will be a significant driver of earnings for us in 2022 and 2023.

The first quarter of 2022 also saw us complete an additional 550-person camp expansion for the Trans Mountain Expansion Project in Blue River, British Columbia. Announced in the fourth quarter of 2021, the camp was successfully completed in the first quarter of 2022 and will remain rented into 2023.

The advancement of these projects help signal the restarting of major projects that were largely delayed or postponed due to COVID-19 pandemic, and indicate strengthening economic activity levels in major infrastructure projects.

Major projects like the Pluto II expansion project in Australia are an important business line, and we excel at executing these large-scale, multifaceted workforce housing projects on behalf of our industrial clients. ATCO continues to be the prominent modular accommodation provider to LNG projects globally, executing seven major projects within the last decade. However, our business is more than just major projects. A key strategic focus of the ATCO Structures business in recent years has been the growth and expansion of our core business. Tied to our space rentals and workforce housing product categories, these business lines deliver stable and less cyclical earnings contributions for the business.

Year over year, we have improved key performance metrics within our space rental segment, including high unit counts, utilization, and average rental rates. Similarly, we've worked to refine our workforce housing fleet size and configuration to drive high utilizations and average rental rates. This has included decentralizing our structure to better leverage our localized sales branches and manufacturing facilities to more effectively meet our customers' needs and access new markets.

While we often headline the exciting and large projects we are privileged to work on, the majority of our long-term, sustainable earnings stems from our stable core business segments. By continuing to build out these segments, we can deliver stronger and more stable Structures earnings that allows us to leverage our expertise to capitalize on more cyclical project activity as the economy picks up.

Finally, I'll briefly touch on inflationary and supply chain considerations that I know are at the front of mind for everyone.

As the world continues to emerge from the pandemic, we continue to manage these challenges and opportunities in our day-to-day business, like we did in 2021. To date, we're primarily seeing these factors result in project extensions as opposed to margin compression in our business. A by-product has been the increasing demand for rental and sale of our existing fleet products, 22,000 units that are instantaneously deployable and not subject to constraints. Our procurement, manufacturing, and project management teams have done a great job to mitigate these risks by negotiating favourable contracts with suppliers and clients.

Where we have seen input costs increase, we've generally been able to manage these through escalation clauses in contracts and shorter-term "validity" periods. Structures' priority to source locally and our vertically integrated production facilities have allowed us to directly manage supply chain reliability and pricing into our commercial positions. That being said, these are factors that that we'll be continuing to watch and manage closely.

I'll now pass it back over to Katie to provide an update on the other ATCO businesses.

Katie Patrick:
Thank you, Adam.

I'll now turn to the results from ATCO Frontec.

We continue to experience strong performance from this business. We signed new contracts and also drove additional earnings from existing contracts in the period. This quarter, ATCO Frontec delivered earnings of $4 million, which was an impressive $3 million of year-over-year earnings growth. This increase came from higher occupancy and short-term work requests at the Site C and Trans Mountain camps. These additional work requests tend to be short-term in nature but contribute additional earnings and show the further value we can provide customers outside of our core contract scopes.

As mentioned on the fourth quarter call, ATCO Frontec, through its Nasittuq joint venture, won a seven-year contract from the Government of Canada to operate and maintain the North Warning System. I'm happy to announce that the contract commenced on April 1st, with the transition well underway. Nasittuq expects to assume full custody and control of the system by August 1st.

Next, I'd like to touch on our Neltume Ports investment.

Neltume continues to provide a solid base of earnings for ATCO amidst unprecedented levels of global supply chain turmoil. Neltume had a strong first quarter that saw the business increase earnings by $1 million year over year. This increase in earnings was driven by higher volumes across the portfolio of ports resulting from favourable weather conditions compared to the prior year.

Overall, ATCO had a great first quarter. It saw us deliver strong, year-over-year earnings growth in all of our investments; this, while advancing numerous aspects of our corporate strategy. We're well positioned heading into the remainder of the year. I'm excited to leverage the work we've done to date as we continue advancing our portfolio strategy at ATCO.

Finally, we are pleased to announce that our 2021 sustainability report will also be released later today. This report demonstrates our continued focus on energy transition, climate change and environmental stewardship, operational reliability and resilience, people and communities, and Indigenous relations.

I would encourage everyone to take a look at the report on our website.

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

Colin Jackson:

Thank you, Katie, and thank you, Adam, for joining us.

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 the conference coordinator for questions.

Operator:

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 speaker phone, please pick up your handset before pressing any keys. To withdraw from the question queue, 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 Canadian Utilities investor relations team will follow up with you by e-mail after the call.

Once again, anyone on the conference call who wishes to ask a question may press star, one at this time.

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

Ben Pham:
Hi. Thanks.

I wanted to go back to the—some of your comments on ATCO Structures, and I'm wondering, you talked about the Pluto expansion, and it sounds like—are you—can you comment on your backlog at the moment, what you're seeing there; maybe more specific, how it compares to maybe last year or the year before? Are you bidding on a lot of opportunities? More to just get a sense of direction where the backlog is.

Adam Beattie:
Yes. Thank you, Ben, for the question.

Our backlog at the moment is different in each geography, but our primary geographies of Canada, the US, and Australia has quite a strong backlog of activity in both manufacturing and site construction, so I would say it would be certainly on par if not higher than last year's activity.

Ben Pham:
Okay, and are you finding maybe there's also in terms of sizing, you've got these more bigger ones like the Pluto and LNG Canada, you're seeing more of that come up in your queue?

Adam Beattie:
I would see on both scales, so certainly the larger infrastructure projects are continuing, so we're seeing the large project similar to the Pluto project, they've got continuation or they've recommenced activity, but with them come a lot of smaller activity that's driven around our core or base business there. We're seeing a lot of small infrastructure activity that's starting to become more active post COVID.

Ben Pham:
Okay. Maybe my follow-up, too, is really at what point do you need, or you're actually required to start spending CapEx and building out your fleet more? Do you still have a lot of room to take on more projects?

Adam Beattie:
We have a fairly aggressive capital plan already in place with our space rentals business that's being undertaken in the majority of our markets, and so we have good access to capital, and we have a good production backlog of committed capital that's being released to our business units so they can more instantaneously be deployed to the projects that we're actively working on or pursuing.

Ben Pham:
Okay, that's great. Okay. Thank you.

Operator:

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

Maurice Choy:
Thanks, and good morning

I'm going to just go back to a comment you made, Adam, about generating more sustainable earnings moving forward. Over the past two years, in 2020 and 2021, S&L recorded earnings that averaged around $55 million a year, which, obviously, is a stark contrast to 2017. As you look at your business, some parts of it are more predictable than others. How would you classify, I guess, the mix between what's sustainable within this $55 million and what is a little bit more one-offish that could surprise to the upside?

Adam Beattie:
Thank you for the question, Maurice.

I think, quite simply, we look at our core-based businesses built around that space rentals and rental workforce housing activity. That floats between about two-thirds and three-quarters of our earnings contribution, pretty consistently, and has done over the last three years.

Maurice Choy:
Great, and the follow-up to that is, obviously, you've had a lot of success related to diversifying your customer base, but you still have remained quite exposed to energy and resource-based sectors. As you see the stronger environment and greater focus towards energy security, unfortunately because of the war, have you seen a marked change in, I guess, the diversity of your customers and, I guess, even the geographies that you serve?

Adam Beattie:
Yes, Maurice. I think we're very well diversified against the resource and energy sector now. We've put considerable energy over the last five years about diversifying away from those markets, more driven off general infrastructure project activity, and a lot of that has been geographical dispersion, moving away from resource-based areas and more into metropolitan, urban-type environments, and we've seen a lot of positive activity from that strategic move.

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

Maurice Choy:
Well, I'm just trying to understand whether or not you're seeing more activity on the energy side—energy resource side, or are you still seeing better response from the other non-energy resource sector?

Adam Beattie:
Yes. We're seeing activity in both areas at the moment, I would say. We're certainly seeing commodity price performance drive some interest both in Australia and Canada, and to a lesser extent places like South America, Chile.

Maurice Choy:
Great, and my final question is a follow-up on a comment about Neltume performing well. Obviously, there is relatively strong amount of liquidity at the Neltume Ports level. Any comment about the ability to deploy that and expand the presence of the underlying company?

Katie Patrick:
Sure. Yes. Thanks, Maurice.

They continue to have a significant amount of capital on their balance sheet from our initial investment, and I would say that the project pipeline is probably the deepest that we've seen since we entered that investment, so we're working on a lot of opportunities both in South America, diversified outside of Chile, as well in the U.S. market, which we've identified as a place for expansion, so I think not in the very near term is there clear opportunities for deployment of that capital. Most of the things we're looking at have a little bit of a longer tenure to them, but there's definitely a strong pipeline of potential opportunities to grow that business.

Maurice Choy:
Great. Thank you very much.

Operator:

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

Linda Ezergailis:
Thank you.

Just to follow up on your Neltume opportunities, can you help us understand if any of those opportunities might be potentially accelerated through acquisition, and if you expect, over time, that your interest in Neltume to remain stable or potentially get diluted or dialled up, and at what point might you have the scale and the expertise to consider potentially port investments outside of Neltume?

Katie Patrick:
Yes. Thanks, Linda.

I would say to your first question of is there opportunities to move faster with M&A, we continue to look at M&A opportunities. As you know, those will be somewhat difficult to predict into the future, but there are some of those in the pipeline right now, and they could provide opportunity for quicker earnings advancement. In terms of our long-term position there and whether we intend to be diluted or go up in our ownership investment, I would say that, certainly, dilution is not our intention. We like that investment, and we are happy with our current stake, and any potential increase in ownership, obviously, would have to be a discussion amongst the partners and what opportunities lie in front of us.

I think your last question there was whether we have any intention to try and drive port investments outside of Neltume, and honestly, we're very happy with our partnership. They have clear operatorship skills, and I think most of the things that we would explore in that space would be in partnership with Ultramar and to the Neltume investment.

Linda Ezergailis:
Thank you, and just maybe as an even bigger question around your platforms, your company has added some platform around ports, you've got your core Structures and Logistics business. At what point might you consider becoming more active in real estate or potentially assessing the merits of other platforms, or is that more of a blue sky, lower-priority initiative right now with ATCO?

Katie Patrick:
Yes. No, absolutely not lower priority. We continue to look for opportunities to diversify both by

growing some of the other investments we have outside of CU, and potentially adding new platforms for growth. We have some smaller ones, of course, that we are, I would say, incubating and trying to continue to drive growth out of; but for a new platform, we look for opportunities to build on that core base of earnings, similar earnings to CU that provide dividends and cash flow, as well as some that might provide higher growth opportunities. So we're looking at both of those quite actively, and those are not low-priority initiatives for us right now.

Linda Ezergailis:
Thank you.

Operator:

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

Mark Jarvi:
Thanks.

First question's for Adam back on the Structures and Logistics business. In terms of the Frontec and in Structures, how would you say contracts compare in terms of the ability to pass through any inflation and pricing trends, and then follow-up, how do you see—overall do you see operating leverage right now for that business in terms of how much could you see margin expansion if you do grow the top line and the revenues?

Adam Beattie:
Thanks, Mark. I'll just confirm those questions.

Firstly, around how Structures and Logistics are passing though any inflationary cost to customer bases?

Mark Jarvi:
Yes, just whether or not there's any differences in the pass-through; the ability to pass through on the Frontec side versus the Structures side. Just maybe whether or not you're seeing—if they're equally strong in terms of passing through costs, or if one's better positioned right now?

Adam Beattie:
I think they're both fairly equally. I think there's—because the Logistics business or the Frontec business is more focused on man hours or labour imports, they have good mechanisms to control that pass-through under their contracts, and in Structures, I think because we have that large base business performance, a lot of it is the assets are already owned, so that's very easy to control that contractually, and also, otherwise in contracts, we have some very good escalation clauses. The majority of our contracts are actually short-term, not long-term, and the longer-term contracts where we have a longer cycle to deliver a project, we have good mechanisms built within those contracts, so they're very different businesses, but I think their ability to manage that through is consistent.

Mark Jarvi:
And then in terms of operating—yes?

Adam Beattie:
Just get you to repeat the second question again, Mark, please.

Mark Jarvi:
Just in terms of operating leverage, whether or not as you grow the business on the top line, how do you see that playing through in terms of margins, or do you think there's not really that much of an opportunity to expand margins if you can expand the top line?

Adam Beattie:
Well, I think it organically expands margins, because as the pricing in the market increases with inflation and new customer demands, our existing fleet, which is significantly large, actually rides that price increase, and there's no additional capital outlay, so we actually get a benefit through that mechanism of having our existing fleet ride the same market increase or margin increase, if not expanded or heightened, as that moves through in our core business.

Mark Jarvi:
Okay, and Katie, coming back to some of the other opportunities that was asked by Linda in her last question, now obviously, at the Canadian Utilities level, they're quite interested in exploring a lot of energy transition: RNG, hydrogen, and renewables. Are there any sort of projects along that area that maybe won't fit with Canadian Utilities that you're seeing that maybe could be a fit for ATCO, or is there anything sort of on the fringe there that you're seeing as potentially an opportunity?

Katie Patrick:
Yes. I would say that the majority of what we would be doing within the energy space, in general, we would keep within Canadian Utilities. I mean, that's really the core competency and where we have a lot of the key people and operating expertise to manage those type of products—projects. There may be some small, call them, venture or very small opportunities that could fit at the ATCO level that may not necessarily receive the adequate attention within CU or could be leveraged across different companies besides just CU that may make sense at ATCO, but that would be very small-scale stuff that I'm speaking about; but for the most part, any energy transition and those large projects, we would have within CU and driven out of that skill set.

Mark Jarvi:
Okay. Thanks. Thanks, everyone.

Operator:

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

Andrew Kuske:
Thanks. Good morning.

We don't talk a lot about Frontec, but it's been a nice niche business for you for many years, and obviously, from the Nasittuq announcement back in early Feb to now, a lot has changed. I guess maybe if you could give us a little bit of insights to conversations you've had or maybe developments out of the future for enhancing that contract and just capital that may be spent as part of NWS or other initiatives in the far north.

Katie Patrick:
Yes. I mean, I think, in general, we're very proud of our long history of partnering with governments and the military through the Frontec business in those type of projects. There was a bit of a quiet time, I would say, in that, and this—the North Warning System probably signals, hopefully, a return to seeing some more of those projects. That would be the hope, but they are—they're large projects, and they can be a little bit volatile in terms of when we see them.

Specifically, with the North Warning System, I think we are hopeful that we can drive some earnings, even outside of the contract. They've had early indication that there's some additional requests that will probably be needed there and could help boost the base earnings profile that we see off of that relatively large contract, so I think we're excited about that opportunity and to dig in and really understand more about the work we'll need to do there to continue the good work we've done in the past when we operated it.

Andrew Kuske:
That's helpful, and then maybe just as a point of clarity, the seven-year contract you have, does that wind up being exclusive to the operation and maintenance of NWS, and then you could potentially have exclusive rights or for add-ons to that, or it almost winds up being a foregone conclusion? Not that you want to be complacent about it, because I know you're not, but it's really your business to win should more activity be done in the far north.

Katie Patrick:
I think that's probably true. Again, we wouldn't want to be complacent. We lost the contract once, obviously, and then we did, obviously, re-earn it, and I think our intention would be to be there for the long term, as we have a strong commitment to the north and continuing to build that business and many other businesses with our Indigenous partners, so it is a seven-year contract with extensions available, and I think we—as you say, we'll probably be in a good position to capitalize on those extensions when they come.

Andrew Kuske:
That's helpful, and then maybe just focusing more on the Structures business, you've had a few

situations where you've done prefab construction for low-cost housing initiatives that have been led by government. How much has that resonated, and do you see that business niche expanding to a greater degree?

Adam Beattie:
It's resonated. It's a smaller portion of our business, but it's an emerging business, so I certainly think into the future it'll become market forces or macro forces are really driving off-site construction or manufacturing, which were very prevalent in most of our markets, as a real future opportunity, so I think the margins are tighter there, which you may allude to. They're certainly tighter because the construction industry margins are quite tight, but it's emerging business, and you can get scale and increase margin through volume and efficiency as you build that into certain projects, as you talked about there, with social or welfare housing contracts that have some repetition about them.

Andrew Kuske:
Maybe just a follow-up on that, you just characterized that business as you validated the concept, and there's some jurisdictions that are just farther ahead, but it's a very long cycle industry for you to scale it up to a greater degree.

Adam Beattie:
Yes. I think different markets that are a different level of maturity, certainly, and we have, in that permanent modular market, also a rental portion as well that is quite stable for us and quite high performing around schools and education facilities that are consistently in demand, so that's a portion of that market, and we've been very successful in that market, for example, in Australia.

Andrew Kuske:
Okay, that's great. Thank you very much.

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:

Great. Thank you so much, Charice, and thank you all for participating today. I'd also like to thank Katie and Adam for joining us. We appreciate your interest in ATCO and we're looking 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.