ATCO Ltd.

First Quarter 2023 Results Conference Call Transcript

Date: **Thursday, April 27, 2023**

Time: **10:00 AM MT**

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

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

Conference Call Participants:

Linda Ezergailis TD Securities, Inc. – Managing Director

Rob Hope Scotiabank – Research Analyst

Maurice Choy RBC Capital Markets – Research Analyst

Ben Pham BMO Capital Markets – Research Analyst

Mark Jarvi CIBC Capital Markets – Research Analyst

Andrew Kuske Credit Suisse – Research Analyst

Operator:

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

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

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

Colin Jackson:

Thank you. Good morning, everyone. We're pleased you could join us for ATCO's First Quarter 2023 Conference Call. With me today is Executive Vice President and Chief Financial and Investment Officer, Katie Patrick.

Before we move into our formal agenda, I would like to take a moment to acknowledge the numerous traditional territories and homelands on which our global facilities are located. Today, we're speaking to you from our ATCO Park head office in Calgary, which is located in the Treaty 7 Region. This is the ancestral territory of the Blackfoot Confederacy, comprised of the Siksika, Kainai and Pikani Nations, 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 people 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 that all our remarks today will include forward-looking statements that are subject to important risks and uncertainties. For more information on these risks and uncertainties, please see the reports filed by ATCO with the Canadian securities regulators.

Finally, I'd like to point out that during this presentation we may refer to certain non-GAAP and other financial measures, such as total of segment measures, 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 First Quarter 2023 Conference Call.

ATCO achieved adjusted earnings of $137 million, or $1.21 per share in the first quarter of this year. This is $3 million or $0.04 per share higher than the first quarter last year. This $3 million of growth came primarily from the strong performance of our structures business, combined with great performance across our broader portfolio of investments. Collectively, this more than offset the expected downwards earning pressure associated with the rebasing of our Alberta distribution utilities within the Canadian Utilities investment.

Having gone through PBR rebasing five years ago, we've been really focused on driving growth throughout other areas of our portfolio to help mitigate this pressure. You can see the results of this with the strong results in the quarter.

Jumping into ATCO Structures, we delivered adjusted earnings of $19 million in the quarter, $3 million higher than the same quarter last year. As you've heard Adam and I talk about many times now, a key strategic priority within our structures business is the expansion of our base business earnings. The successful execution of this strategy was a key driver of our earnings growth in the first quarter. Both our core space rentals business and our newly acquired Triple M housing division delivered exceptional results in the period. Compared to the first quarter of 2022, we grew our space rental fleet size by 14 per cent and our average rental rate by 19 per cent, all while achieving an average utilization rate of 75 per cent.

Moving on to Triple M, this business performed exceptionally well in the quarter, which helped offset the contribution last year from our LNG Canada project which is now complete. As Triple M is a newer business line for us, I thought it may be helpful to touch briefly on the seasonality of this business, and how this interacts with the profile of our overall structures business.

Generally speaking, Triple M sees its strongest earnings in the first and fourth quarters of the year, as it works with dealers to lock in orders and construct the units necessary to support dealer inventories. This quarter's results likely represent half or more of the full year expectations for this business.

In contrast, our broad structures business sees a stronger earnings correlation to periods of high construction and economic activity. In Canada, this tends to be in the warmer second and third quarters. This counter cyclicality is important to note when looking at the performance of our overall structures business and further reinforces the strategic alignment of this acquisition.

As I mentioned in the past, our base business typically accounts for two thirds to three quarters of our segment earnings. In addition to this, we saw strong project activity further supporting our earnings growth.

At ATCO Frontec, first quarter earnings declined normally from 2022 levels as the Trans Mountain Clearwater Camp contract was completed, and startup costs on the recently signed Pogo mines project created earnings pressure. Frontec has, however, been very active in signing new contracts that will support earnings moving forward. One notable example of these efforts was the signing of a camp services contract with BHP Jansen, a three-and-a-half year contract will see ATCO Frontec alongside our indigenous partner George Gordon Developments provide camp support services for the BHP Jansen

Discovery Lodge in Saskatchewan. The transition of camp services was completed on April 1st of this year.

As discussed previously, our Frontec business continues to see great opportunities in the defense and government spaces where deep indigenous relationships can be leveraged alongside our core remote services expertise.

Now touching on Neltume Ports, the business continued to deliver stable and dependable earnings with favourable foreign exchange impacts pushing first quarter adjusted earnings higher when compared to 2022. As you will see in our news release, Neltume just signed a significant contract two days ago at the Port of Vancouver in Washington State. This will see Neltume with our partner Nautilus operate Terminal 2 in this port for a 30-year period with two 10-year extension options. We are really excited about this opportunity as it is another milestone in Neltume's focus on expansion into North America.

As expected, our Canadian Utilities investments saw adjusted earnings decline nominally in the first quarter of 2023 when compared to the first quarter last year. This decline was due to the sharing of efficiencies generated in the second PBR cycle with customers as the Alberta distribution utilities enter a single year cost of service period in 2023.

As Brian spoke about Canadian Utilities Q1 results on this mornings' CU earnings call, I won't go into these details again here. I would, however, like to reiterate that while the earnings pressure related to BP are rebasing was somewhat muted in the first quarter, we continue to expect more downward pressure throughout the year.

More specifically, first quarter CU results benefited from a few specific items: favourable timing of costs within the distribution utilities, the proactive advancement of work into 2022 that would have otherwise been completed in the first quarter of this year, strong performance of CU's non-regulated businesses, and continued outsized earnings from the Australian gas utility. Collectively, these factors muted the earnings decline related to rebasing for the first quarter of 2023.

Overall, ATCO had a great first quarter. The acquisitions that we've made contributed to short term earnings. These new investments, along with the proactive decisions we've made across our diverse portfolio will help to partially offset the cyclical earnings pressure that we expect in 2023 related to our PBR utilities.

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

Colin Jackson:

Thank you, Katie.

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

Operator:

Thank you. (Operator Instructions)

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

Linda Ezergailis:

Thank you. My first question is related to the Neltume opportunities in front of you. I see that you acquired an additional 5 per cent ownership in Sagres—I don't know if I pronounced that correctly—raising your ownership in that facility to 95 per cent. Are there more opportunities in the near-term to incrementally add to your ownership in facilities—or for Neltume to incrementally add ownership into facilities they already have a presence in? How significant might that be? Can you also comment on whether those incremental ownership acquisitions are expected to be potentially more accretive versus an outright new facility ownership?

Katie Patrick:

Sure, Linda. Thanks for the question. Yes, we did increment. That was part of an acquisition we made quite some time ago where the owner is still involved in the operations, and so we just took out an additional percentage of that in Sagres. But we do operate in 17 different ports where we have varying ownership interests and partners in almost all of them, so I think we're constantly evaluating whether there are opportunities for us to take a greater stake or even sell down our stake in some of those ports. There's nothing specific I can point to.

In terms of whether they would be more accretive than other opportunities, I think it really all depends on—obviously, it depends on the purchase price that we could negotiate. But I think the benefit of making moves like that, of course, is that we'd be pretty familiar with the operations. That does happen actually relatively frequently that we're able to change ownership. But really, the Neltume business development efforts are focused on growing our portfolio of ports into new areas. We've talked in the past, we're exploring opportunities in Brazil, and of course, the recently announced one in the US just shows our progress in trying to get a better footprint in North America.

Linda Ezergailis:

Thank you. Just as a follow-up, when you sign a contract such as in Washington State, do you see any opportunity to potentially parlay that into ownership or is that just an outright operating contract? When you look to grow in other regions, do the opportunities relate more to outright ownership or more operating contracts?

Katie Patrick:

Thanks, Linda. Yes, I think it's a bit of a mix of both. In the port of Vancouver, we're really excited about that because we have secured the operating contract for Terminal 2. But we do have line of sight to invest capital, as you note, to expand the capacity in that port in the near-term. I think that would be the model that we would take in many different locations as well, which is first entering through either a stevedoring or operating contract and looking to invest capital and take a bigger position.

There's also meaningful—it positions us well in Vancouver for additional ability to enter into some of the other terminals there. We do like that model. We can go in also just directly into an ownership/capital arrangement in any given port, that all depends on the circumstances of the port.

Linda Ezergailis:

Thank you. I'll jump back in the queue.

Operator:

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

Rob Hope:

Hello, everyone. Two questions on the ports as well. Sticking with Vancouver, maybe can you talk to how that opportunity came about? I know Tidal does have operations there. Does that help facilitate the conversations there? Can you clarify what quantum of earnings you're expecting or how much capital you think you could put towards there?

Katie Patrick:

Yes. Thanks, Rob. We have a very strong BD effort and presence both through our partner who operates the agency business around the world, and sometimes we see opportunities coming through that network, as you noted, potentially through our partnership network. Obviously, we're all constantly monitoring any public RFP or other ways that we may get it. We have a very strong ability to come across those opportunities and usually find unique opportunities that aren't necessarily broad auction processes. For that, I think in regards to that port.

Now, and I can't really—we're still working on signing some contracts for that port. We're very close, and we have a very strong—we believe strongly we will be able to sign those contracts shortly. We won't be able to give earnings guidance necessarily, but I can give you an order of magnitude that right now there's about 400,000 tonnes that moves through that terminal, but we can expect through some capital investments that we could basically triple that capacity for movement of product through that terminal. Right now, it's mostly copper concentrate and clay that's moving, so it is a bulk facility that could carry a number of different types of materials.

Rob Hope:

All right. Thanks for that. Another port question, so ATCO/CU and Kansai have signed, are developing or potentially going to develop a clean hydrogen hub in Alberta with the expectation for export to Japan. There was talk about potential port facilities there as well. Can you maybe speak to how that could work for ATCO specifically? If there was going to be a port initiative, would that be a third-party? Or could Neltume be involved there as well?

Katie Patrick:

Yes. Great question, Rob. Thanks. Yes, absolutely. I think that there obviously will need to be some type of port logistics in that. We're early days in that Kansai arrangement, but we're very committed to try and find the right export value chain to make this happen for our partners. As you note, it could be any one of the above in terms of a third-party port. It could be an opportunity for Neltume/we are working and talking with them about that, and they have very strong operating expertise, obviously in terms of ports.

We're still working that through. But like any opportunity in ATCO, we're always going to try and look for ways that we can use our relationships and our internal businesses to bring it all to bear.

Rob Hope:

Thank you.

Operator:

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

Maurice Choy:

Thanks, and good morning. Maybe I'll just follow-up that and expand the discussion a little bit here. Neltume Ports was your last addition, and that was in 2018. I know that ATCO identifies six essential services categories. Maybe a broader question to ask here is, recognizing a world that's undergone quite a bit of change, be it COVID or war, which of these six essential services categories do you see the biggest opportunities that could be your next addition to that at the ATCO level?

Katie Patrick:

Sure. Thanks, Maurice. Yes, and I know Neltume was our last acquisition of a new business, but we did make the Triple M acquisition as well. I note that just because we're looking at both acquisitions that would be outside of our core, but we're always looking for opportunities to augment our existing business and grow those businesses, be it obviously CU, Structures, or Frontec with the Neltume opportunities to deploy more capital.

But in terms of new business areas, we have six, and we participate in many of them already. The two notable exceptions would be water and ag. But I think we see opportunities in both of those sectors, and we continue to monitor to see if there's an appropriate entry opportunity into either one.

Maurice Choy:

Sorry, just to recap, whilst you mentioned that water and ag are not there, which of the other four ones do you see the biggest opportunity?

Katie Patrick:

Well, on the other four we already are present. We do have a real estate portfolio, be it small in Alberta. Shelter, obviously most things that we do there would be through our structures business. Transportation and logistics, we do have the ports and as well as Frontec participates in that space. But any one of them could present opportunities. I think the one, probably, that's the highest that we're not yet involved in is probably water. Though, we do have a presence through CU. But for in a meaningful way, that could be an area of interest.

Maurice Choy:

Got it. Maybe my second question here, and just a quick question about your stock repurchases. You spent about $23 million in this quarter, and it looks like the average cost is about $40 to $42 per share. Thoughts on how you've gone about with that position, how you sized that up, or is it based purely and where the share price was and should we think about possibly you allocating some of your capital to buybacks this year?

Katie Patrick:

Yes. No, from time to time, we know that our share price may not reflect what we believe to be the true intrinsic value of our share so we may engage in buybacks, but we also generally will look to offset the dilutive impact of options issuance each year, and we are opportunistic in terms of the timing of when we execute on those purchases.

We saw a window to advance/fast forward a bit of our share buybacks in the early part of our NCIB timeframe, and I think we obviously weigh the decision of buybacks versus other opportunities that we see in the portfolio on a constant basis. I think I can't say whether there would be more or less, but at the moment we're happy with getting what we see is an attractive price in this early part of the year.

Maurice Choy:

Recognizing that there's obviously some balance sheet capacity at the Neltume Ports level, are you anticipating having to allocate some money into that that venture in the near-term?

Katie Patrick:

I think in the near term they have pretty decent capacity to fund some of the things, particularly the opportunity we already talked about in Vancouver. In the future, we hope that they are successful. We've been very happy with that investment. If they are and it requires more capital, I think it's something that we would very seriously consider and likely to continue to participate in that partnership.

Maurice Choy:

Great. Thank you.

Operator:

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

Ben Pham:

Hi. Thanks. Good morning. On ATCO Structures, would you characterize the stage of your strategic efforts there moving more towards execution from de-risking, and then can you maybe share context on what percent of earnings last year you would characterize as ratable or base?

Katie Patrick:

Yes, sure. Thanks, Ben. I said on my call this morning too that about two-thirds of three quarters of the earnings of Structures would be considered that base reliable earnings. I think that holds true and that continues to be where we are. In terms of whether we're in execution, I think we are going continue to try and grow in a consistent proportion the size of our space rentals, which comprises the majority of our base business.

We have significant opportunities, probably to grow in the US where we have a relatively small footprint. But we also see opportunities to continue to get market share in Canada and Australia, so I think we are always in execution mode in that business to be honest and always looking for new opportunities to expand.

Ben Pham:

Okay. Great. Thank you. This might have been more a question for at the CU level, but there's some implications for you for ATCO. Is the marketable securities that's flowing through—can you provide us the rationale for that and what does that tell you about your balance sheet and maybe clarify how is that being booked in earnings? I'm assuming that's interest income.

Katie Patrick:

Yes, no, we did make a decision to allocate a portion of our cash balance, both at ATCO and CU, into marketable securities, which are very low risk portfolio of bonds and similar type high credit quality investments. Really that was just based on having some excess cash at the moment that we wanted to try and earn a bit of an outsized return. Yes, you will see that as a new line item. But from our perspective, it's a highly liquid investment that we could use for, if and when we need to deploy it for our growth activities within the business.

Ben Pham:

Okay. Got it. Thank you.

Operator:

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

Mark Jarvi:

Yes. Just one follow-up question on the Triple M business. Are you going to quantify what the revenue and earnings impact? Then maybe just expand on that business in terms of can you take the IP or that business model and apply it to anywhere else across your broader footprint in the structures and logistics business?

Katie Patrick:

Thanks. Sorry, can I just clarify, did you say IT or IP?

Mark Jarvi:

IP, just the business model, yes, strategy, all that kind of stuff. Yes.

Katie Patrick:

Okay. Thanks, Mark. Yes, if you look back when we made the acquisition, we did have fulsome disclosure of the retroactive one-year impact, so you can get a sense of magnitude of the size of that opportunity if you look back at our notes from last year. I think that's probably—it was a very strong year, the housing market has been strong, so that was probably reflective of a good year and we're still in that same territory this year.

In terms of leveraging their IP, I think right now we are focused on that business and how we can expand it in the Western Canadian and parts of the Northern US market in terms of selling some of their product into those areas. We already were in the past, have been many times in residential housing, but I think it does give us a strong opportunity to continue to grow in that area of the economy, which we see has very favourable tailwinds behind it and will continue to look for other opportunities to expand it in the North American market and then across our broader footprint.

Mark Jarvi:

Just a quick follow-up, are you implying then that for the foreseeable future what you acquired from Triple M is a flattish business with some modest growth before you can really start to leverage the existing platform and make it a more meaningful growth driver?

Katie Patrick:

Yes, I think that's probably fair. I think there is—as we can all read in the press right now, there is some pressure in the housing market that could see some modest growth beyond that. But I don't think it's exponential growth that's going to be coming out of that business in the near-term and it's just a very solid addition to our existing operations.

Mark Jarvi:

Got it. Okay. Thanks.

Operator:

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

Andrew Kuske:

Thanks. Good morning. You've managed to build a pretty interesting business in the structures world around LNG opportunities, whether it be Pluto, LNG Canada, the Plaquemines facility. Just how do you think about that LNG market opportunity on a go-forward basis?

Katie Patrick:

Yes. Thanks, Andrew. No, I think we have positioned ourselves as one of the leaders for building the camps around those big projects. But more broadly, I think just our history in that business, we have always been a leader in the workforce housing in remote areas. I think that extends not to just LNG projects, which we as Canadians, or Western Canadians, are all hopeful will continue to be built out. But also to the mining sector and some of those large projects, we continue to see the demand for key commodities in the mining sector be strong and projects beginning to pop back up. I think we're well-positioned for that entire natural resources space to be the choice in developing those camps.

Andrew Kuske:

Maybe just building upon that last point, are you seeing a trend of maybe smaller projects, but many more smaller projects as opposed to the mega projects, and in part just the effort towards near shoring, front shoring, whatever we want to call it, and the sort of dismantling of long supply chains. Does that change your origination efforts and really a bit of the sales function away from large RFPs with super majors to trying to originate with smaller mining groups?

Katie Patrick:

Yes. No, I think as we've talked about quite a few times, we're really trying to—and we would put some of those smaller workforce housing camps into our—what we call that, that base business that is a lot more repeatable and diversified in terms of client base and where we're targeting. We have put a focus on that, which you see in our results.

But I would say that that doesn't preclude us continuing to advance our relationships and our discussions for some of the larger projects, and we do continue to do those, but we've just really tried to balance at our earnings so that those large projects are not disproportionately contributing and then falling off shortly thereafter.

Andrew Kuske:

Maybe just coming back to large projects, when you think about LNG Canada, is there any colour you can provide on expiration of the contracts, a demobilization decision, or an extension of the contract?

Katie Patrick:

Yes. From the Structures perspective, we completed that contract. In terms of additional—the future of that, there's not much colour I can provide in terms of when. But so you won't see any more earnings coming from that particular project from the Structures side, but in terms of the long-term, that facility, there's not much more I can provide there.

Andrew Kuske:

Okay. Appreciate that. Thank you.

Operator:

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

Colin Jackson:

Thank you, Charice, 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.