

Brookfield Business Partners – Q3 2022 Results Conference Call & Webcast

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Corporate Speakers:

- Alan Fleming; Brookfield Business Partners L.P.; SVP of Investor Relations
- Cyrus Madon; Brookfield Business Partners L.P.; CEO
- Denis Turcotte; Brookfield Business Partners L.P.; COO
- Jaspreet Dehl; Brookfield Business Partners L.P.; CFO

Participants:

- Gary Ho; Desjardins Securities Inc., Research Division; Analyst
- Jaeme Gloyn; National Bank Financial, Inc., Research Division; Analyst

PRESENTATION

Operator^ Welcome to the Brookfield Business Partners Third Quarter 2022 Results Conference Call and Webcast. (Operator Instructions) Now I'd like to turn the conference over to Alan Fleming, Senior Vice President of Investor Relations. Please go ahead, Mr. Fleming.

Alan Fleming^ Thank you, operator, and good morning. Before we begin, I'd like to remind you that in responding to questions and talking about our growth initiatives and our financial and operating performance, we may make forward-looking statements. These statements are subject to known and unknown risks, and future results may differ materially. For further information on known risk factors, I encourage you to review our filings with the securities regulators in Canada and the U.S., which are available on our website.

Joining me on the call today is Cyrus Madon, Chief Executive Officer; Denis Turcotte, Chief Operating Officer; and Jaspreet Dehl, Chief Financial Officer. Cyrus will start with an update on our strategic initiatives and Denis will then provide some perspective on what we're seeing in the current operating environment. Jaspreet will finish with a discussion of our financial results, and we'll then be available to take your questions. And with that, I'll pass it over to Cyrus.

Cyrus Madon^ Thanks, Alan. Good morning, everyone. Thanks very much for joining us today. While we're operating in a challenging environment, we had a strong third quarter. We generated record Adjusted EBITDA of about \$630 million, up more than 40% over the prior year. We're really pleased with our results.

As many of you know, in October, we reached an agreement to sell Westinghouse to a strategic consortium led by Cameco Corporation and Brookfield Renewable Partners for \$8 billion. This is a major milestone for our business that meaningfully advances our capital recycling and supports our growth. We expect to generate about \$1.8 billion of net proceeds to BBU and crystalize a six times multiple on our investment when combined with all the distributions that we have received to date. We're very pleased with this outcome. And over the last few weeks, unitholders who hold more than half of the votes eligible to be cast have provided us their support in favor of the transaction. We hope to close the sale in the second half of next year.

Looking forward, we have other large-scale businesses that will reach a mature state and eventually be sold. The timing will of course depend on how far along we are in our business

plans and broader market conditions. We've invested a significant amount of capital over the last few years to acquire super high-quality, large-scale businesses which should generate very substantial proceeds for BBU when it comes time to monetize them several years from now.

I want to turn to our growth initiatives. In October, alongside our partner, we completed the privatization of Nielsen. As many of you know, Nielsen is the market leader in third-party audience measurement. As the media landscape continues to evolve, the business' scale and customer relationships position it really well to provide a unified measure of audience viewership. We're excited about making this investment and look forward to supporting the business' growth strategy.

We've also continued to focus on opportunities to grow our existing businesses. Last month, our engineered components manufacturer completed the acquisition of a leading distributor of axles and other trailer components which provides us opportunities to continue growing and scaling our distribution operations. And our Brazilian fleet management operation completed the acquisition of Unidas, a leading full-service rent-a-car platform, which doubles the size of our existing fleet management business and provides meaningful opportunities to reduce costs and increase our scale.

As our business continues to grow, the cash flows our operations generate are also continuing to increase. To put this in context, in the last 12 months, our operations have generated about \$800 million of free cash flow. This is after interest, taxes, required maintenance capex and depletion, all at our share - which means our units today are trading at around a six times multiple of free cash flow.

As we approach the end of the year, our focus is on continuing to build value within our operations. Before wrapping up, I want to thank all of you that were able to join us in September at our annual Investor Day. For any of you that missed it, the webcast is available on our website.

And with that, I'm going to turn it over to Denis.

Denis Turcotte^ Thanks, Cyrus. Good morning, everyone. As most of you are aware, we're a global business today with operations that span across North America, Brazil, Europe and Asia Pacific. We own and operate large-scale businesses touching nearly every facet of the global economy which gives us a unique perspective in being able to monitor, anticipate and respond to changes in the global operating environment. With that context, I thought I'd spend a few minutes today to talk about several of the key themes we're seeing across the global operating environment and how we're responding to support our businesses.

I'll start first with inflation. Most categories that form our cost of delivery, whether it be raw materials, transportation, logistics, labor or energy, remain elevated and above pre-COVID levels. The good news is we see many of these areas resetting back to trend line over time. Some of that has already happened – steel prices, a common material in a large number of our businesses as an example, are down 60% from levels this time last year and likely to drop further. We see this happening with other materials as well. Global container rates have also softened from previous highs, making international shipping options and costs, both land and sea, more favorable. However, we're still seeing shortages or constraints in certain supply chains and associated higher costs. We have been focused on diversifying our supplier networks, optimizing our inventory levels and mitigating both direct and indirect costs and risks

where we can. More broadly, we think the greater localization and re-shoring of key inputs will support continued easing on global supply chains.

Global labor markets continue to be tight and are not yet showing signs of easing and labor costs may very well be structurally higher for longer across both services and manufacturing sectors. Labor attrition rates in some of our operations have hit up to 30% or more in certain cases and like most, we're encountering similar challenges in the professional workforce. To compensate, we are putting more emphasis on ensuring we have strong management teams in place across all our operations with the right requisite organizational structure and associated compensation arrangements to both attract and retain key talent.

Similarly, energy availability and cost particularly in Europe have been an increasing focus of ours as the year has progressed. While the price of oil may present increased margin opportunities at some of our businesses, this is by exception and not sustainable. More broadly, the price and availability of natural gas as a major feedstock for many global production processes have significant implications on both production and cost levels, which may drive decisions to idle or cut back capacity to optimize cost structures in certain regions.

Within this inflationary context, we're determined to maintain our margin performance. So far, we have done a fairly good job of increasing prices which has been required in this type of environment simply to recover from inflationary cost pressure and to maintain margins. The nature of the larger businesses we own – providers of essential products and services in market-leading positions – are well positioned to pass through impacts of inflation with minimal impact to demand over time, though there are situations with time lags given broader macro forces. There have been pockets, where this has been an advantage for us, whether it's at Clarios or at some of our smaller operations like Greenergy, but it has been a continuous effort over the past year and in some cases, we're only now starting to see the benefit of pricing actions fully catch up to the pace of cost escalation.

We're also increasingly looking at opportunities that may emerge driven by both higher prices and rising interest rates. In particular, as the replacement cost of our asset intensive businesses increase, we should be in a strong position to participate in a repricing of contractual rates to enhance our cash flows. The buy versus rent equation for customers is also changing as capital becomes scarcer and more expensive. We're fortunate to have businesses, whether it's our returnable packaging business or our modular building leasing services operation in Europe, that are well positioned to align with evolving customer buying behavior that ultimately will strengthen our longer-term competitive position.

We look forward to taking any of your questions later and with that, I'll hand it over to Jaspreet.

Jaspreet Dehl^ Thanks, Denis and good morning, everyone. We reported strong financial results in the third quarter and continue to be pleased with the performance of our business. Adjusted EBITDA increased to \$627 million from \$443 million last year. Adjusted EFO increased to \$339 million from \$276 million last year. We saw improved contributions from each of our three operating segments.

Starting with our Business Services segment, Adjusted EBITDA increased by 40% to \$229 million and Adjusted EFO improved to \$152 million.

Our residential mortgage insurer generated \$69 million of Adjusted EBITDA, primarily driven by higher premiums earned following strong underwriting activity over the last few years. We continue to see low levels of mortgage default rates in the business as well. New underwriting activity is moderating as expected but the business remains very well positioned to manage through a period of normalizing housing activity.

In July, we closed the acquisition of our dealer software and technology services operation, which contributed \$49 million of Adjusted EBITDA during the quarter. The team is pleased with what we're seeing in the business so far. It's still early days but we have a high degree of confidence in achieving our value creation plans.

Healthcare services contributed \$16 million of Adjusted EBITDA during the quarter. Results continue to be impacted by higher rates of surgery cancellations and elevated operating costs. The labor environment is slowly improving as absenteeism, sick leave and overtime are all trending towards normal levels. We're working closely with the management team to support the business and expect performance to improve as the operating environment normalizes.

Moving to our Industrials segment. Adjusted EBITDA was \$228 million compared to \$171 million last year. Adjusted EFO increased to \$131 million and included a \$11 million after-tax net gain on the partial sale of our investment in public securities.

Advanced energy storage operations during the quarter generated Adjusted EBITDA of \$122 million which was in line with last year. Higher selling prices and a favorable mix of higher margin advanced battery sales contributed to results during the quarter. We are seeing the impact of higher labor and input costs in this business. Increased overall battery volumes benefited from stronger original equipment manufacturer, or OEM, demand as auto production challenges are starting to ease during the quarter.

Our engineered components manufacturer generated \$32 million of Adjusted EBITDA. Performance benefited from the contribution of recent add-on acquisitions as well as pricing actions. The business is focused on cost saving opportunities to support margins and offset the impact of reduced volumes in the current environment.

And finally, in Infrastructure Services, we generated Adjusted EBITDA of \$205 million compared to \$140 million last year. Adjusted EFO was \$102 million.

Nuclear technology services performed well in the quarter, generating \$63 million of Adjusted EBITDA. Contribution from the recent BHI Energy acquisition was offset by reduced volumes in part due to disruptions caused by the conflict in Ukraine. The business remains on track to generate strong full year Adjusted EBITDA and cash flow.

Lottery services generated Adjusted EBITDA of \$39 million in the third quarter. Demand has remained resilient and we're helping the business on initiatives to mitigate the impact of higher input costs and supply chain challenges.

Modular building leasing services contributed Adjusted EBITDA of \$37 million as strong demand in Germany and Asia Pacific is helping support overall utilization levels. Performance also benefited from increased penetration of higher margin value added products and services as well as pricing actions. We're continuing to assist the business in reviewing potential add-on acquisition opportunities to enhance its offering and expand its geographic footprint.

We ended the quarter in a strong capital position with \$2.8 billion of pro forma corporate liquidity. This takes into account the planned syndication of our recently closed acquisitions as well as the expected proceeds from the sale of our investment in Westinghouse. This provides us with significant flexibility to manage our balance sheet.

With that, I'd like to close our comments and turn the call back over to the operator for questions.

QUESTIONS AND ANSWERS

Operator[^] (Operator Instructions) Our first question comes from the line of Gary Ho with Desjardins.

Gary Ho[^] Thanks and good morning. First one maybe for Cyrus. In your letter to shareholders, you hinted at further monetizations – how do you balance between the current choppy environment to monetize so maybe the lower end of your valuation versus investments in your pipeline that you can also buy at attractive valuations?

Cyrus Madon[^] Hi Gary. Cyrus here. In the letter, what we said is in the fullness of time, we expect to have large-scale monetizations and we are really giving some context to the fact that over the last couple of years, we've invested a lot of capital, many billions of dollars of capital, and that in the fullness of time, five to seven years from now, those acquisitions will likely generate in the order of \$12 billion of proceeds for us. That's the context we were trying to give. As for the environment today, I would say that strategics in general are well capitalized, certain industries are very well capitalized and they could be buyers generally, but we didn't have anything specific in mind in our letter.

Gary Ho[^] Okay and while I have you, I just wanted to go back to the Superior Plus investment. You had the preferred shares that generate 7.25% cash dividend yield and Brookfield also participated in the equity offering. Those returns are quite a bit off your 15% to 20% that you typically target for investments. So how should we look at this? Are you content with keeping the stake – adding to it or selling it off?

Cyrus Madon[^] We're very happy with our investment. We do get a 7.25% coupon on our preferred share investment. We participate in the upside of the share price. As far as we're concerned, the company is performing well. We're very pleased with it and we're happy with the position we have.

Gary Ho[^] Okay and then just last one maybe for Jaspreet. Your U.S. dollar reporting with global businesses, how does the stronger U.S. dollar impact your results? Was that a negative this quarter and how should we model that out?

Jaspreet Dehl[^] Hi Gary, thanks for the question. When you think about foreign currency exposure for the business, there are really two levels of exposure to think about. The first is in terms of our invested capital and the equity that we have in the businesses and stepping back, in all of the acquisitions that we've made over the last three to five years, the majority of them, about 65% of the capital we've deployed has been in U.S. dollars and the balance has been in developing countries, such as India and Brazil, which is a small piece of the book that we

always hedge. And then in other developed countries, the exposure is Canadian dollars, Australian dollars or Euros. On our invested capital, we have a hedging policy and we typically hedge our capital going in and it's an active program where we're constantly monitoring the hedges and rolling things or crystalizing where it makes sense. That's how we think about the equity that we put into the businesses.

The second piece is around the underlying operations, and we've got operations in countries outside of the U.S., either where we've made investments like Modulaire or large global businesses like Clarios which has operations across the globe and currency exposure. In those cases, we've got active hedging programs within the companies and we'll typically look to hedge exposures – our cash flows from the operations within the businesses. Today, we've got a significant portion of that exposure hedged which is not to say that we haven't been impacted by some of the U.S. dollar strength. Specifically, in some of our larger businesses like Clarios, we've seen currency headwinds – a large portion of that is from the Euro. So, there is some foreign currency exposure and noise that is creates in the results. But if you step back overall at a BBU level, it hasn't been material. In summary, we've got our active hedging programs, most of our foreign currency exposure is hedged but there are some headwinds, specifically from the Euro that we are seeing, but it's not material to BBU.

Operator^ Our next question comes from the line of Jaeme Gloyn with National Bank.

Jaeme Gloyn^ Thanks. First question – thinking about organic growth and operating leverage on an organic basis, do you have any ability to provide some disclosures or additional color around how you're thinking about the organic growth rate in the underlying operating businesses and their operating leverage? Is that something you can give us a little bit of range around?

Jaspreet Dehl^ Hi, it's Jaspreet. I'll take a first crack and Denis and Cyrus can add to it. When we invest in our businesses, a large part of our investment thesis is around operational improvement of the businesses and improving EBITDA and usually the bulk of that comes through cost initiatives that we've got planned. Revenue growth is typically not a large part of the equation. There are some smaller investments that we've made which we think of as more platform investments where we are seeing very strong organic growth and that is the focus area as well as accretive M&A. We gave a little bit of color on this in our Investor Day at the end of September but on a same store basis, if you normalize or take out the acquisitions that we've been doing, so far, same store results have been pretty resilient. We've seen same store growth both in revenue and EBITDA across the portfolio on a year-over-year basis but as Denis alluded in his opening remarks, the operating environment in some areas is challenging and we're very focused on continuing to enhance and support underlying margins. Denis, is there anything you want to add to that?

Denis Turcotte^ Sure Jaspreet, I'd add to that by saying you're right and in environments like we're in where we're entering potentially recessionary environments at least in some sectors, as not by loss of market share but just simply a reduction in orders, whether it be products or services, we're working against operating leverage in that regard. But again, as Jaspreet mentioned, not only do we focus on costs very intensely, we also focus on applying the capacity we have in a smarter way. We do a lot of profitability analysis by product, by customer and geographically, and that three-dimensional analysis often puts us in a position where we see the old 80-20 rule apply, where 20% of our sales in effect are not as well placed as could be given fixed amounts of capacity. What translates then in those cases, you end up getting higher

revenue but more importantly, higher margin, which doesn't directly look like organic growth in unit count but it absolutely translates into higher revenue, higher EBITDA and higher free cash flow.

Jaeme Gloyn^ Okay great and to follow up to that, in terms of free cash flow and the growth in operating free cash flow, how are you thinking about the ability of the operating businesses to deleverage? Do you have any hints or forecast as to what you would expect from maybe an absolute dollar basis or a net debt-to-EBITDA basis? Any additional color that can walk us through deleveraging of the operating companies over the next several quarters?

Jaspreet Dehl^ Yes, I can take a shot at answering that and then Cyrus can add to it. When we think about leverage within the business, we really think about it from the perspective of each of our operating companies and every business is different. There are some businesses where we've always operated them with a very low level of leverage given the underlying profile of the business and there are others which are more stable contractual and in some cases, inflation linked businesses that have the ability to service a higher level of debt. We were obviously very closely monitoring the impact of higher interest rates on the serviceability of that in each of our portfolio companies and also just in terms of deleveraging or refinancing where it's appropriate.

The business is generating a lot of free cash flow today. So, it gives us a lot of flexibility to be able to manage that as it comes up and based on the current profile and the debt that we have in place, a 75-basis point impact has about a \$60 million to \$65 million impact on Adjusted EFO and considering the run rate, that's a very small percentage. We think the portfolio is very well set up to manage through it. There will be some businesses that come up for refinancing that we'll have to work through but nothing that concerns us at this point and that's not manageable.

Cyrus Madon^ Cyrus here. I'll just add one comment. If you look at what we've done consistently for years now, we've been able to increase free cash flow pretty well across the board – across all of our companies. What that really means is the businesses are deleveraging – earnings are going up and the level of debt stays the same. So, debt to EBITDA is actually coming down over time just through improved earnings.

Operator^ Thank you. That's all the time we have today for questions. I would now like to turn the call over to Cyrus Madon for closing remarks.

Cyrus Madon^ Thank you very much for joining us today. We look forward to speaking to you next quarter.

Operator^ This concludes today's conference call. Thank you for your participation. You may now disconnect.