

Brookfield Business Partners L.P.
Q1 2020 Conference Call Transcript
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Corporate Speakers:

- Jaspreet Dehl; Brookfield Business Partners L.P.; CFO
- Cyrus Madon; Brookfield Business Partners L.P.; CEO
- Denis Turcotte; Brookfield Business Partners L.P.; COO

Participants:

- Devin Dodge; BMO Capital Markets Equity Research; Analyst
- Rupert Merer; National Bank Financial, Inc.; Research Division, MD and Research Analyst
- Andrew Kuske; Credit Suisse AG; Research Division, MD, Head of Canadian Equity Research, and Global Co-ordinator for Infrastructure Research

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Brookfield Business Partners Q1 2020 Results Conference Call and Webcast.

(Operator Instructions)

Please be advised that today's conference is being recorded.

(Operator Instructions)

I would now like to hand the conference over to your speaker today, Jaspreet Dehl. Thank you. Please go ahead, ma'am.

Jaspreet Dehl

Thank you, Operator. Good morning, everyone. Welcome to Brookfield Business Partners' 2020 First Quarter Conference Call.

Before we begin, I'd like to remind you that in responding to questions and in 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 would encourage you to review our filings with the securities regulators in Canada and the U.S., which are available on our website.

On the call with me today is Cyrus Madon, Chief Executive Officer, and Denis Turcotte, our Chief Operating Officer. I will pass the call over to Cyrus to provide you with an

update on our business and how we are responding to the challenges from the global COVID-19 pandemic.

Denis will then provide additional insight on the actions we're taking to position our companies in the current environment. And finally, I will review our first quarter financial results. We will then be available to take your questions. I'll now pass the call over to Cyrus.

Cyrus Madon

Thanks, Jaspreet. Good morning, everyone, and thank you for joining us today. Our world has changed considerably since our last call, and I'd like to start the call by saying that we are grateful to all those on the front lines responding to this global health crisis, including many of our own employees providing essential services and products around the world.

Our focus at BBU over the last several weeks has been to protect the health and safety of our people and partners. Across our offices and portfolio companies, we're supporting relief efforts in our communities with donations of funds, time and essential equipment and supplies to people and causes that need it most. We're also working closely with management teams across our businesses to reposition operations and protect liquidity in these challenging times.

Although we are planning for an uncertain business environment this year and a slow economic recovery, BBU is well positioned to face these challenges. We have strong liquidity and businesses of exceptional quality. Over the last few years, we sold many of our smaller, more cyclical operations to fund the acquisition of larger businesses with more durable cash flows. Many of our businesses provide products and services that are essential to their customers, which means our operations should recover quickly as global activity levels resume.

That said, all our businesses, like most around the world, are being impacted by the pandemic and related economic downturn.

We can segment the impacts to our businesses into three categories, first, essential service providers experiencing limited impact to operations today, second, essential service providers experiencing manageable near-term impact, and finally, businesses experiencing more material impacts that will require additional capital support to manage through the current environment.

Starting with our essential service providers experiencing limited impact to operations, there are three significant businesses in this category. Westinghouse, an essential service provider to the nuclear power industry, has been relatively unaffected by the pandemic.

Altera Infrastructure provides essential services to the offshore oil and gas sector. Most of Altera's revenues are secured under fixed price take-or-pay contracts, and the company has been largely unaffected by the short-term drop in oil prices.

BRK Ambiental is our provider of water distribution and sewage treatment services to over 15 million residents. Residential demand for water treatment services has been very resilient. And while we're experiencing higher near-term delinquencies, we're confident we will be paid over time for the essential service / social infrastructure services we provide.

Moving on to the next group of companies, essential service providers experiencing near-term slowdowns in their operations. We expect each of these businesses to have adequate liquidity to manage through the current environment.

Starting with Clarios, our global manufacturer of advanced automotive batteries. Demand has declined sharply with reductions in global auto production and people around the world driving with their cars less. With the spread of the pandemic across the world, Clarios shut down facilities and idled production capacity as required. In Asia, our operations are back up and running, and we're already seeing a strong rebound in aftermarket battery demand. We expect the same to happen in other regions as global economies begin to recover.

At Healthscope, which is our private hospital operator in Australia, operations are being directly impacted by the government's decision to suspend all noncritical elective surgeries to preserve capacity for COVID-19 patients. Healthscope has been finalizing arrangements with Australian government authorities to make its hospital network available to the public relief effort at cost. This will impact profit for 2020, but we are confident in the critical role of the private hospital system in Australia and the long-term viability of Healthscope.

Genworth Canada is the largest private residential mortgage insurer in Canada. Slowing housing activity is having an impact on the business and over the longer term, prolonged unemployment would increase mortgage delinquencies. Genworth is very well capitalized with 15% debt-to-capital and a \$4 billion investment portfolio. The business is positioned to manage through a prolonged recovery.

Few businesses within our portfolio have been meaningfully impacted by the global pandemic and require additional capital support. These situations are readily manageable given the substantial liquidity at BBU.

Multiplex, our construction services company, is facing significant challenges with work suspensions in the U.K. and material reductions in project-level productivity and increased costs. Although the business has no debt, we expect it will require additional cash to manage through the disruption.

The other business that will require capital is Cardone. Cardone is a U.S.-based remanufacturer of automotive aftermarket replacement. We recapitalized this company as a result of operational and liquidity challenges and had been effectively working to get it back on stable footing prior to the pandemic outbreak. The slowdown in auto-related demand brought on by the pandemic has severely impacted Cardone's operations, and the

business will require additional operational and capital support to navigate the current environment.

While we're confident in the resiliency of our overall portfolio, we're preparing for a challenging business environment through the course of the year. We expect our Q2 results will be the most severely impacted by the pandemic. Our estimate is that April revenue across our business was down about 40% compared to last year. Depending on how long government restrictions remain in place, we could begin to see a slow recovery in the second half of the year, but conditions today remain too uncertain for us to predict the pace of any recovery.

As we think about investment opportunities in this market environment where public markets have experienced extreme volatility and transaction activity in private markets has slowed in the face of heightened uncertainty, our focus has been in a couple of areas. First, pursuing new investments in the public securities of high-quality businesses that are trading at a significant discount to our view of intrinsic value.

Over the last several weeks, together with our institutional partners, we've invested approximately \$500 million in public securities. These public company stakes should lead to strong returns on our investment capital and may position us to privatize businesses as markets and activity normalize.

Second, we're pursuing investments at the portfolio company level, be they add-on acquisitions, customer acquisitions or the repurchase of debt in the event the debt of any of our businesses trades down to opportunistic levels. Like the equity trading prices of many companies, our unit prices traded at levels that are entirely disconnected from intrinsic value.

Our intrinsic value is best calculated as the present value of cash flows our operations will generate in the future. And while near-term cash flows will be impacted, longer-term cash flows should be robust.

We recently repurchased over 500,000 of our own units. And as the opportunity arises, we'll continue buying BBU units on your behalf. And with that, I'll hand it over to Denis to speak to our operational response to the challenges we're facing.

Denis Turcotte

Thanks, Cyrus. Good morning, everyone. One aspect of our culture at Brookfield is to approach our businesses with an owner-operator mentality, closely partnering with the management teams of our portfolio companies to balance focus on short-, medium- and long-term business success. This has never been more true than today.

Over the past several years, we've been growing BBU's in-house business ops team to bring operational excellence to our businesses wherever they exist and compete. We now have more than 30 dedicated professionals in the group located around the world with a broad range of backgrounds and domain knowledge, many of whom are senior executives

experienced in repositioning and running businesses in difficult times. Our presence in the regions in which we operate, combined with a systematic approach to monitoring and interacting with our portfolio company management teams, has been vital these past few months in allowing us to respond with speed to the evolving crisis in each region.

We've been working closely with management teams across our businesses to focus on the operational and financial implications of the pandemic, manage risk and identify opportunities.

The health and safety of our employees and the communities in which we operate, customers and suppliers has been and will remain paramount. We have restricted site access, adjusted shift work and, where possible, have rotated the workforce and encouraged employees to work remotely. We have also instituted protective equipment and screening requirements.

We're focused on preserving liquidity at our businesses and are working with them to actively develop and execute on plans to reduce discretionary operating and capital expenditures; manage receivables, payables and inventory levels; and consolidate fragmented supply chains. In select cases, the heightened urgency has allowed us to accelerate broader performance improvement initiatives that were already in progress. We are also actively managing lender relationships and facilities to preserve flexibility.

While we are predominantly focusing on managing risks, we are also continuing to be on the lookout for opportunities. These may include acquiring competitors or suppliers within the value chains of our operations and leveraging the stability and reliability of our businesses to grow market share.

To bring context to the actions we have been taking, I'll speak specifically to what we have been doing at Clarios, given it was one of the first of our businesses to be impacted by the outbreak of the virus in China. In response, we quickly assembled the business continuity team comprising senior members of both our team and Clarios' leadership. Their purpose was to ensure focus and a rapid response by coordinating and communicating across regions and functions with the information then cascading to employees and other parties as needed. This has been crucial in allowing Clarios operations across the world to benefit from best practices and lessons learned in each region as the virus spread.

From the outset, Clarios set out to collaboratively engage with all the stakeholders, including local governments, employees, unions, customers and suppliers to ensure we could safely continue to operate as critical infrastructure. And when that was not possible, enable a swift, organized reopening of our operations at the appropriate time.

The company continues to follow global health guidelines on employee safety, including all of the health and safety measures I spoke of earlier. To date, there have been less than 15 confirmed cases of the virus across Clarios' global workforce of over 16,000 employees.

Clarios has worked to continue to service customers and be prepared to bring back production as governments allow and demand dictates. In the interim, the company has been servicing orders with inventory on hand where necessary. Clarios is also leveraging reduced production time to perform required maintenance, assess inventory obsolescence and prepare safe plant and office reopening plans.

Management is focused on mitigating financial impacts by adjusting production and scaling labor and other costs to demand. At the plants, this has included eliminating overtime, utilizing temporary staffing, reducing shifts and lines and temporarily idling production.

There is increased focus on cash management, and discretionary capital investment has been eliminated. We are continuing to respond to changing conditions within our businesses, looking to balance short-term financial impacts with longer-term opportunities aligned with strategy. And with that, I'll hand it back over to Jaspreet.

Jaspreet Dehl

Thank you, Denis. Brookfield Business Partners generated company EBITDA for the first quarter 2020 of \$294 million compared to \$266 million in 2019. Company FFO for the quarter was \$194 million or \$1.29 per unit. This compares to \$205 million or \$1.59 per unit in the first quarter of 2019.

We reported a net loss attributable to unitholders for the first quarter 2020 of \$126 million or a loss of \$0.84 per unit. This includes provisions, impairments and unrealized mark-to-market loss on financial assets that were recognized during the quarter. Net income attributable to unitholders for the first quarter last year was \$62 million or \$0.48 per unit.

On the operational front, company EBITDA increased in our industrial services segment, supported by acquisitions made over the last year, and this was partially offset by a decrease in our business services segment as a result of the impact of the pandemic. Our industrial segment generated company EBITDA of \$145 million for the first quarter.

Clarios, our global manufacturer of automotive batteries, contributed company EBITDA of \$89 million. Sales volumes in the quarter were impacted by mild winter weather in the U.S. and Europe, lower OEM production levels and lower aftermarket demand, primarily in the last few weeks of the quarter. Clarios has substantial liquidity available under its bank facilities to manage through the current environment, and its debt does not mature for over 6 years.

GrafTech generated company EBITDA of \$45 million with lower sales volumes in the quarter. Overall, the company's earnings and cash flows continue to benefit from long-term supply contracts, but given steel production disruptions as a result of the pandemic, the company expects a portion of contracted 2020 volume to be deferred to future years.

The business is planning for reduced profitability compared to last year, but GrafTech is well capitalized and generates free cash flow to appropriately manage through this downturn.

Moving on to our business services segment. This segment generated company EBITDA of \$19 million.

Multiplex, our construction business, reported a company EBITDA loss of \$47 million this quarter. Results reflect the impact of accounting for increased costs expected to be incurred on projects in the U.K., where construction works were substantially shut down as a response to the pandemic. The business is taking steps to actively mitigate losses, and we expect it to recover as project-related activity resumes to more normal levels.

Genworth Canada performed well in the quarter and reported company EBITDA of \$36 million. During the quarter, Genworth extended its debt maturities by issuing \$215 million of debentures, bringing its debt-to-capital ratio to approximately 15%. This is in line with the company's targeted capital structure. Proceeds from the issuance were used to pay down debt and fund dividends.

At Healthscope, our hospital chain in Australia, results in the quarter were marginally impacted by the pandemic with lower admission rates in March. The business is planning for materially lower profitability beginning the second quarter. Healthscope has implemented operational readiness initiatives to prepare facilities for public use and is managing the supply chain of key consumables.

In our infrastructure services segment, we generated company EBITDA of \$156 million.

Westinghouse reported company EBITDA of \$82 million and performed well in the quarter. The business benefits from the resiliency of its core fuel manufacturing and servicing operations. The business executed on all fuel reloads as planned during the quarter and progress continues on the new plant projects that Westinghouse is supporting. Westinghouse completed the acquisition of Rolls-Royce's Civil Nuclear Systems and Services business this quarter. This business will enhance the company's technological capability around plant automation, monitoring systems and providing digital engineering services to customers.

We closed the acquisition of BrandSafway at the end of January, and our results for the quarter include two months of operations. The business performed well in February and was impacted by reduced activities on customer facilities and the curtailment of customer spend in March as a result of the pandemic. We have actively been working with the management team to mitigate operational disruptions related to the current environment. A majority of BrandSafway's profitability is derived from essential maintenance activity that we expect will recover as economic conditions improve.

At Altera Infrastructure, contributions increased as a result of our increased ownership of the business. Shuttle tanker utilization was strong. As a part of the company's shuttle

tanker renewal program, Altera took delivery of two new vessels in the quarter, with the remaining five expected to be delivered over the next two-year period.

That's all of our remarks on operations. I'm going to quickly touch on our liquidity. We're in a very fortunate position to have a strong liquidity position. At the corporate level, we have approximately \$2 billion of cash, marketable securities and undrawn capacity on our credit facilities. The majority of these facilities are backed by large global banks that continue to be highly supportive of our business. We expect to utilize these bank facilities to bridge the funding of new investments or to support working capital needs within our operations.

At our portfolio companies, there's an additional approximately \$4 billion of liquidity, which is comprised of cash as well as available credit facilities. Cyrus mentioned this earlier, our larger businesses should have more than sufficient liquidity to fund themselves through this downturn.

Our approach to financial risk management is designed to protect our business during challenging times. Our companies are financed with debt that has no recourse back to BBU or across other businesses. Nearly all our large-scale businesses have long-dated maturities and no financial maintenance covenants. So we're not forced to repay debt even if these businesses experience a reduction in earnings.

At our companies that are more susceptible to volatility, we have chosen to keep leverage levels low and in certain cases like Multiplex, there's no debt at all.

This approach to financial risk management is serving us well to support our operations where needed and to continue funding our growth initiatives. That concludes our remarks, and I'll now turn the call back over to the operator to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Devin Dodge from BMO Capital Markets.

Cyrus Madon

Hey, Devin, we can't -- we can't hear you-- Devin.

Devin Dodge

Sorry about that. Maybe to start with a couple of questions on Multiplex. Just -- is it fair to assume that the revenue mix at Multiplex is weighted more towards private clients, just given the mix that we're seeing in the backlog, and maybe that the first strings from those private clients are pulled fairly tight in terms of compensating contractors for inefficiencies related to the stop and restart from COVID-19?

Cyrus Madon

Yes. That would be correct. Most of our clients, and especially in the U.K., would be private clients, yes.

Devin Dodge

Okay. And are there ongoing discussions to recover those extra costs? Just -- or is the contract language generally just not strong enough or favorable enough to support the claims from contractors like yourself?

Cyrus Madon

Look, I would say this is sort of unprecedented and uncharted territory. And obviously, Multiplex is going to push in every possible way to collect every penny that's due to it. But there is some uncertainty as to how this all plays out at this time. So we just can't give you a definitive answer today because we don't know yet.

Devin Dodge

Okay. Fair enough. I believe Multiplex and Cardone were identified as businesses that may need some capital injections. Just are you able to give us a sense as to the scale of the investment that BBU may need to kick in?

And maybe as you look out to Q2 and maybe even into the back half of the year, do you think there are other investments that may need some support?

Cyrus Madon

So look, at this stage, it's very hard to predict what happens in the back half of the year. But based on our planning, these are the only two. And that's based on a pretty conservative outlook for weak recovery in the back half of this year. So that answers your -- the back end of your question.

I'll speak to Cardone and maybe Jaspreet can speak to Multiplex. But Cardone probably needs in the range of \$150 million. We are in that investment with a couple of institutional partners. So we are in the midst of working through a recapitalization program. And it may be we put in half that money, and it may be we put in most of the money. We're still working through those details. But that gives you a sense of the scale of it. And Jaspreet, maybe on Multiplex, you could speak to that.

Jaspreet Dehl

Sure. Devin, so on Multiplex, as Cyrus said, the situation is quite fluid on the ground in the U.K., and the business does have cash available. But there are a number of projects that are in various stages of completion, and they may need support over the next little while from a working capital perspective to complete those projects before they can start collecting and recover from clients.

So we anticipate in the near term that we're going to provide about \$60 million, \$50 million to \$60 million to Multiplex over the next few months. And look, that number, as I

said, there's a lot of moving parts. It could be a little bit higher. It could be a little bit lower. But that's kind of what we're planning over the next couple of months or so.

Operator

Our next question comes from the line of Rupert Merer from National Bank.

Rupert Merer

So looking at the revenue that's been lost across your various businesses. Wondering if you can characterize how much of it is permanently lost versus deferred. And maybe looking at the three categories that you highlighted for your businesses. I mean is it fair to say that category 1, mostly, you're going to see deferred revenue, down to category 3 where you may see more lost opportunity? I was wondering if you could give a little bit of color.

Cyrus Madon

Yes. Look, I think some of these businesses have the potential to recover part of what's been lost. But I suspect if Q2 is going to be very difficult for the world, then there's revenue that is probably not going to be recovered. And what's -- the way we're looking at the business, what's more important is planning for this down cycle, doing everything we can to maximize liquidity, reduce expenses and then be in a position to recover quickly as the world recovers generally.

So to answer it slightly differently, we don't think our businesses are going to come out of this in the long term in a weaker position than they are today. Their revenues should recover fully as and when the world recovers fully. And if we are effective in what we're trying to do, hopefully, a number of our businesses can actually come out ahead as we look for add-on opportunities during this distressed period.

Rupert Merer

Okay. Well, great. And then looking at the liquidity, you mentioned you're going to, of course, have to recapitalize some businesses, you're looking at public markets, security opportunities and add-ons. How should we look at the liquidity? How should it evolve over the next couple of quarters? And should we expect to see the use of corporate credit tick up? I see it's at \$283 million, I think, in the quarter.

Jaspreet Dehl

It's Jaspreet. I'll take that. So you're right, we ended the quarter in a strong liquidity position. We had \$2 billion, which includes the availability on the lines as well as cash and some marketable securities at the corporate level and we were drawn \$283 million on the credit facilities.

I think in the near term you can expect to see us to continue to draw on the credit facilities where appropriate and where required and the size and scale of the business today kind of readily supports any servicing of bad debt.

As we're looking forward over the next few months and couple of quarters, the only firm kind of funding is around IndoStar, which was the Indian acquisition we announced earlier this year that we expect will close mid to late this year and so we will be funding for that plus whatever capital may be required by Multiplex and Cardone. But even taking those into account, we still have significant liquidity available to pursue new opportunities, like the public securities and other things that we're looking at, to expand and grow the business.

Rupert Merer

Okay. And in general, I suppose you'd say the public securities are not reducing liquidity because they are part of your liquidity.

Jaspreet Dehl

Yes, that's fair. And we've also got institutional partners alongside us in those investments.

Operator

Our next question comes from the line of Andrew Kuske from Credit Suisse.

Andrew Kuske

How do you think about just the economic returns of preserving capital for your core businesses, the opportunities that you see in the market -- as you mentioned, you were active in the market on effectively taking toeholds, and buying back the stock. That's sort of three questions wrapped into one. But how do you think about just the balancing act of those activities?

Cyrus Madon

Well, look, what we did is we sat back and thought about the four or five public companies that we could make investments and in reasonable size, if we wanted to, over the next, pick some extended time frame, let's say, a year and, what would be a meaningful position in each of those. We then thought about how much capital might we need to support our businesses and make sure that they can not only get through this, but perhaps even come out stronger at the end of this.

And we have ample liquidity at the BBU level to effectuate both of those and deal with both of those needs and more than ample liquidity, so much so that we can buy our units back as well.

So our approach so far has been to focus on all three. It may be at a point in time depending on where BBU is trading versus what the opportunity set is. We may tilt one way or another but at this point in time, we're looking at all three.

Andrew Kuske

Appreciate the color. And then just on the toehold or the investment positions, should we expect to see effectively other gains into the future or some M&A dialogue with the companies you've taken positions in?

Cyrus Madon

Look, it would be great if we could end up in an M&A situation, it would be fantastic because the companies that we've been spending time on are companies we followed for years. We admire them. We think they're great, high returns on capital, barriers to entry, etc. and if we can make that happen at a reasonable valuation, that would probably be our preference. And, if not, hopefully, the world will recover and those security values will recover, and we'll earn a great return on our capital.

Andrew Kuske

That's great. And one final question, if I may, just on Altera. Most of that is contracted positions. But to the extent that you have excess storage, to what degree did tanker rates go up? Or do you really act on your own book to play the contango in the market?

Cyrus Madon

I'm going to ask Denis, who's closest to Altera, to speak to that.

Denis Turcotte

Sure. We are looking at that and in effect, not only looking at repurposing some of the shuttles that we have available that are coming off contract, we're even looking at other creative sourcing of storage capacity.

And in parallel, we're simply taking the approach of looking at actually buying the physical and selling forward and then comparing what we would make in those cases with lease rates because we've been inundated with people asking us to lease incremental capacity. So trading off the risk, in effect, of actually holding versus leasing capacity, and we've executed with one vessel already.

Operator

Thank you. At this time, I'm showing no further questions. I would like to turn the call back 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. In the meantime, please stay safe and stay home and wash your hands and all that stuff, and we'll talk to you soon. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.