Brookfield Infrastructure Partners L.P.

2014 Third Quarter Conference Call

Transcript

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Speakers:

Sam Pollock
Chief Executive Officer

Bahir Manios
Chief Financial Officer

Tracey Wise
Senior Vice President of Investor Relations

TRACEY WISE

Thank you, operator and good morning. Thank you all for joining us for Brookfield Infrastructure Partners' third quarter 2014 earnings conference call. On the call today is Bahir Manios, our Chief Financial Officer, and Sam Pollock, our Chief Executive Officer. Following their remarks we look forward to taking your questions and comments.

At this time, I would 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 annual report on form 20-F which is available on our website.

With that, I would like to turn the call over to Bahir Manios. Bahir?

BAHIR MANIOS

Thanks Tracey and good morning.

Our results for the quarter were solid. We reported total FFO of $178 million, or $0.85 per unit, translating to a 63% payout ratio, which sits comfortably at the lower end of our long-term target range. Our results increased by 6% on a per unit basis compared to the third quarter of 2013 as organic growth and incremental earnings on capital that we deployed over the past 12 months more than offset the impact of asset sales. On a comparable or 'same store' basis, our business continues to perform very well recording same store growth of 12% on a year to date, which exceeds our annual long term goal of 6% - 9%. This was driven by organic investments we have made over the last 12 months in our utilities business, inflation indexation across the various parts of our business, in addition to higher volumes in our transport operations. All of these positive impacts more than offset the lower contribution from our energy operations.

We were able to achieve these strong 'same store' results against a backdrop of a U.S. dollar that has appreciated on average by up to 10% compared to other countries where we invest. The U.S. dollar began to gain positive momentum in the second quarter of 2013, but fortunately, our results have been protected by foreign currency contracts entered into during prior periods that hedged approximately 70% of our cash flows that were generated in foreign currencies. Our FFO hedging program is designed to opportunistically lock in currency rates over a period of 12 – 24 months. Over time, these hedged rates will trend downwards should there be no rebound in exchange rates, as more favorable contracts roll-off and are replaced by contracts entered into at lower rates. In the near term, while we expect to see a drop off in our hedged rate profile, compared to previous periods, we are pleased to report that our average locked-in rate for the currencies where we have exposure exceeds current trading levels by a healthy margin.

I'll now discuss our results for our three operating segments.

First, our utilities business generated FFO of $93 million in the period compared to $97 million in the third quarter of 2013. Results were slightly lower, reflecting the impact of the sale of our Australasian regulated distribution operations in the fourth quarter of 2013.

However, on a comparable 'same store' basis, results were exceptional with growth of nearly 17% compared to the prior quarter. We benefited from higher connection activity in our UK regulated distribution business, the commissioning of projects at both our Australian terminal and electricity transmission businesses in addition to margin improvement programs that have been implemented across our operations.

Next is our transport business where we generated FFO of $102 million in the third quarter of 2014, compared to $82 million in the prior year period. This 24% increase in FFO was driven largely by the greater contribution from our Brazilian toll roads, where we doubled our ownership in September 2013, partial contribution from our new Brazilian rail business that closed during the period in mid-August, and higher overall volumes both at our Australian railroad operations and our South American toll road business.

And lastly, our energy business generated FFO of $10 million in the third quarter of 2014, compared to $14 million in the prior year period. Results were lower as our North American gas transmission business continues to be impacted by lower spreads and more temperate weather conditions. These results were partially offset by a higher contribution from our district energy business where we have brought a total of four systems on-line in a number of U.S. cities over the past 12 months.

And finally before turning the call over to Sam, I wanted to give an update on our various financing initiatives. This was a very busy quarter for us where we completed nearly $1 billion of financings at a number of our operations, at very attractive terms. Most significant of these financings included a 10-year, $200 million equivalent, non-amortizing bank financing done at our regulated distribution business in Colombia, at an all-in cost of 7.9%; two financings completed at our Brazilian toll road business that totaled R$700; and a $250 million private placement in our U.S. district energy business, that had an average maturity profile of over 10 years and was done at an average coupon of 3.9%. The proceeds from these financings will be used to fund various organic capital expansion projects and to refinance acquisition debt put in place at a number of our businesses

With that, I will turn the call over to Sam

SAM POLLOCK:

Thanks Bahir and good morning everyone.

In September, we held an investor day in New York where we highlighted that we have been increasingly focused on investing in Europe and that we are optimistic about our ability to deploy capital on a value basis in this region.

Many of you on the call have likely recently read reports in the press that we are very close to announcing an acquisition of a large French communications infrastructure business. Our policy is that we cannot comment on transactions until they are fully documented, irrespective of how advanced they may be. As a result, I won't be able to take any questions on that situation at this time.

At investor day we also highlighted that we have established a strong track record of internally generated growth – and I will talk a little more about that.

We believe that our organic growth engine acts as the main driver of cash flow growth in our business. Our business today benefits from inflation-linked revenues, a backlog of significant expansion opportunities that provide attractive risk adjusted returns, and revenue streams that provide linkage to GDP growth.

We have been increasingly focused on investing in businesses that have strong organic growth. A good example is the acquisition of a $350 million interest in VLI, which we closed during the third quarter. VLI is a large scale Brazilian rail operation that provides logistics services primarily to agricultural and industrial customers. We expect the business to deploy over R$6.0 billion, on a 100% basis, to upgrade and expand operations over the next seven years, allowing it to capture volume growth from increased activity in the country. The growth capex program has a number of components.

First is the expansion of a terminal in Santos which will provide agriculture customers with an integrated, rail and port solution for the export of their products. There is significant increasing demand for the import of fertilizers and for the export of grains and sugar. A critical part of this expansion is the integration of a highly modernized and efficient rail link at the port, which will enable the facility to handle over five times more volume from 2.5 mtpa to 15.4 mtpa; second is the development of inland terminals directly connected to the rail network to consolidate the number of loading points to a single depot, to reduce loading times and the number of idle wagons; and third, we are adding and replacing new rolling stock to handle additional volumes, as well as materially improving the age profile of the fleet. The new locomotives provide higher fuel efficiency, have lower maintenance costs and significantly improve the operational reliability and physical availability of the VLI integrated logistics system.

While VLI is just one example, it demonstrates our strategy to pursue investment opportunities with significant organic growth pipelines. We believe investments in organic growth generate the best risk-adjusted returns, and therefore we will continue to seek acquisitions of businesses with similar growth potential.

In addition to closing VLI during the quarter, in our energy business, we closed on the acquisition of a system in Chicago and in the next few weeks we will close on the acquisition of one in Seattle. With these acquisitions we are adding three systems that provide environmentally-efficient heating and cooling to large buildings in Chicago, Seattle and Las Vegas. We now own six district energy systems in North America, and have grown our overall heating and cooling capabilities by approximately 50% over the past year. Our acquisition of a California gas storage project is progressing as planned and we expect this transaction to close by the end of the first quarter of 2015, following completion of customary closing conditions.

I will conclude my remarks with an outlook for our business.

Looking ahead to 2015, Brookfield Infrastructure is positioned to generate sustainable growing cash flows, given our secure income streams and the solid pipeline of growth projects that are currently committed in our project backlog. We remain confident in our ability to deliver annual ‘same store’ growth of 6 – 9%, consistent with our long-term stated target.

Our primary focus for the balance of the year is to execute on advanced transactions in our pipeline, continue to integrate our Brazilian rail business into our operating platform and execute on our organic capital project backlog bringing them to completion on time, scope and budget. The contributions from our Brazilian rail operation, other new investments, once completed, and the embedded growth we expect to achieve from our existing business, will meaningfully add to our cash flows in 2015.

With that, I would like to turn the call back to the operator to open the line for questions.

OPERATOR:

Thank you, sir. We will now begin the question and answer session. If you would like to ask a question, please press star, and one on your touchtone phone. You will hear a tone to indicate you're in queue. For participants using a speakerphone, it may be necessary to pick up your handset before pressing any keys. If you wish to remove yourself from the question queue, you may press star, and two. There will be a brief moment while we poll for questions.

The first question today is from Cherilyn Radbourne with TD Securities. Please go ahead.

CHERILYN RADBOURNE:

Thanks very much, and good morning. I just wanted to ask you a couple of questions on VLI, since that's an interesting recent transaction for you. You did highlight that it generates revenue largely from agriculture and industrial customers, and with agriculture just being so politically sensitive around the world, I wonder if you could just describe the regulatory context in which that business generates revenue.

SAM POLLOCK:

Sure. Hi, Cherilyn. The business largely operates similar to our rail business in Australia. It obviously has regulated tariffs, where the government establishes a ceiling price. We, in fact, price our product below the ceiling price and, in effect, try to shadow price the trucking charges that would be the alternative source of transportation for our customers, including the agricultural customers. Today, I'd say we probably haven't fully closed the gap between what we can charge and what the trucking charges currently are, so we see that as an opportunity to increase EBITDA in the business. But, probably the bigger value driver is the fact that there's just a huge growth in the agricultural sector in Brazil, obviously, even more competitive given currency rates at the moment, and we are debottlenecking our network, improving efficiency, and adding capacity, so that we can deal with the growth in the sector, but also allow a large amount of volumes that currently go by road and clog up the roads, now to go on our system, which would be more efficient, safer, and more cost-effective for that sector.

CHERILYN RADBOURNE:

Can you just give us some sort of picture of the average age of the power fleet and the rolling stock, and just, you know, what kind of quantum is possible as you modernize that?

SAM POLLOCK:

The quantum in what respect, Cherilyn?

CHERILYN RADBOURNE:

I'm just trying to get a sense of how old it is, and so how much improvement you could potentially see as you modernize it.

SAM POLLOCK:

Okay. I think the efficiency that we think we can improve by is around 20%. I'd say the fleet's relatively old, so I think there's a fair amount of investment that will go into modernizing it, but I think the target today is around 20%. To give you a sense of the business, it's a relatively large business, generates over R$3 billion of revenues and over R$1 billion of EBITDA, and we think that we can grow that meaningfully.

CHERILYN RADBOURNE:

All right, that's my two questions. Thank you.

SAM POLLOCK:

Okay, thank you, Cherilyn.

OPERATOR:

The next question is from Bert Powell with BMO Capital Markets. Please go ahead.

BERT POWELL:

Thanks. Sam, just staying on VLI, that backlog number's been out there for a while and now that you're closed on the transaction, when you look at that backlog, do you see a better way to deploy that relative to what were the initial plans for that capital?

SAM POLLOCK:

Hi, Bert. You know, I'd say it's still early days. We've only owned our interest in the business for barely two months and we do have a CAPEX sub-committee that is evaluating the timing of a lot of these deployments. Today, there is one project, in particular, the one I described in Santos on the call, that is fully underway and the one that we're most focused on, and that represents a significant portion of that CAPEX, probably about R$2 billion worth. So, that one, definitely, we are moving forward on. As for the rest of them, I think some of them have to be timed based off of the demand we see from our customers, as well.

BERT POWELL:

Okay, thanks, Sam. Then, the other question I had just related to NGPL. Kinder is gone to, you know, open season on some expansion in the Chicago market. I'm just wondering how that impacts Brookfield Infrastructure.

SAM POLLOCK:

Well, we have our interest in NGPL, which they're part of, and we have been looking to see what sort of interest there is regarding a reversal project which would be part of the NGPL system. We're still in the process of determining the level of interest, it has ebbed and flowed, and obviously there's lots of activity around gas coming from the Marcellus into the Chicago region, and ultimately probably finding a home down in the Gulf Coast. So, we're actively monitoring that, working with Kinder Morgan on developing some high-value projects for the system. Really all I can say at this stage, is we are very involved and working with them, and are very hopeful that we can attract shippers to projects that are on our system.

BERT POWELL:

What would that mean, just—I don't know if you can quantify it or kind of, you know, bigger than a breadbox, smaller than a house kind of thing, in terms of the capital that you'd have to put towards that for your interests.

SAM POLLOCK:

Look, I guess the short answer is it would probably not be overly material for us, just given our percentage of ownership of the business, but, nonetheless, it is the types of developments that while the initial volumes may not be material, over time we do expect there to be significant takeaway capacity from LNG terminals in that region, and the amount of projects that would be needed to meet that demand could become more material over time, but I think anything in the near term would not be overly material to Brookfield Infrastructure.

BERT POWELL:

Okay. Thanks Sam.

OPERATOR:

The next question is from Robert Kwan with RBC Capital Markets. Please go ahead.

ROBERT KWAN:

Good morning. Sam, maybe if I can actually then just start to follow up on your answer on NGPL. You talked about a reversal, I didn't know if you were talking about an actual physical reversal of flow, and the reason I'm asking is we've seen an adjacent system to yours at least start with a small capital project that was facilitating bidirectional flow and that resulted in a very significant increase, about a 50% increase in their EBITDA. So, I'm just wondering whether that might be a first step for NGPL, or if you think there's something structural that may not allow you to benefit either to that degree or that quickly on your system.

SAM POLLOCK:

Hi, Robert. You know it's difficult for me to say too much, just because we have partners and we haven't agreed on disclosure around various projects, but what I would say is we are examining a number of initiatives that are similar, but I guess what I can tell you is they just don't have that sort of impact on our business, where they're increasing EBITDA by 50%. Nothing's of that magnitude, and a lot of that is just due to the size of the overall NGPL system, and the fact that a lot of this stuff related to LNG terminals is for the latter half of this decade, it's not early on. Most of the projects today that are being done are to assist Cheniere. That's really the only one that's advanced. The capital is meaningful from an NGPL perspective. It's just not massive from a Brookfield Infrastructure perspective.

ROBERT KWAN:

Okay, thanks. I guess, just kind of on the macro environment, whether it's FX or just the global uncertainty with the economy, on one hand, some of the biggest wins you've had have been stepping in when others, or competitors couldn't. On the flip side, you had a more cautious approach, particularly in Europe, when there were concerns with the Euro breaking. So, just with the U.S. dollar strength and the global uncertainty, are you seeing the current environment more as an opportunity, or are there select regions that you're just taking a more cautious approach at this point with respect to deploying capital via M&A?

SAM POLLOCK:

We're pretty active in most regions where we have teams on the ground. South America is a market where we're seeing lots of interesting opportunities. I'd say it is more capital constrained than it has been for a number of years, and that's probably something that I've been saying for the last year or so, I guess. In Europe, we are seeing some good opportunities and, hopefully, we'll be able to announce a number of things in the near term. I'd say the two more competitive markets, but we're still executing on a number of interesting platform expansions, would be North America and Australia. I think both those markets today, where we're being mostly successful is where we have platforms that we can tack on various businesses, whether it be our gas storage business or our district energy business in North America, and similarly we've been successful in a number of smaller tuck-ins in our energy business in Australia, as well.

I'd say in those regions, where capital seems to be more plentiful and more aggressive, that's been our approach, but, nonetheless, we are still looking at some large transactions in those regions, and to the extent that we can acquire businesses that meet our return thresholds, we will definitely execute on them. So, I'd say we're not shying away from any region at all at this stage where we have people on the ground.

ROBERT KWAN:

Okay, that's great. Thanks a lot, Sam.

SAM POLLOCK:

Okay. Thanks, Robert.

OPERATOR:

As a reminder, if you would like to ask a question, please press star, and one on your touchtone phone.

The next question is from Paul Tan with Credit Suisse. Please go ahead.

PAUL TAN:

Hi, good morning. Just a question on the district energy business. How do you see that business—how big do you see that business to be with BIP in, say, five years' time; and the second part to that one is do you see that business to be an easier roll-up story due to the fragmented nature of the business, as well as maybe it's generally off the radar for most people?

SAM POLLOCK:

Hi, Paul. Let me deal with the second part of your question first and I'll come back to making a few guesstimates about how successful it'll be. One of the reasons why we are excited about the opportunity is the fact, as you pointed out, it's a very fragmented business and one that is not easily executable by a number of our, in particular, low-cost competitors, such as the pension plans. This is a business where you do need to roll up a number of smaller systems, have patience to go out and tie in new customers on an organic basis, and, frankly, the pension plans, who do have a lower return threshold, generally, than we do, don't have the resources to do that. They tend to like larger transactions where they can deploy capital on a meaningful basis in one shot.

So, we think that we have a unique situation here, where we can go ahead and approach the opportunity on a customer-by-customer basis, by visiting and reaching out to all the large municipalities and hospitals and educational institutions that have systems and see if we can build businesses around any place where we see scale and potential growth, and that's really what we're trying to accomplish, and we think we can do that at returns that meet our thresholds, but then with a business that we think has got very attractive investment attributes and very low risk.

As far as how quickly we can accomplish that is a little difficult to pinpoint at this stage. We do have a very large pipeline of opportunities. I think we've, in the past two years, built a business that, on a 100% basis, would have an EV over $1 billion, of which Brookfield Infrastructure is roughly 40% of that, plus or minus. Our hope now is that, given that we've put a lot of resources to it and have built a team focused solely on this initiative, that over the next five years we could, hopefully, triple the size. So, take that, on an EV basis, maybe up to $3 billion, and if we're even more successful, even a bit higher, and Brookfield Infrastructure would be roughly 40% of that size.

PAUL TAN:

No, that's helpful. Thank you very much.

SAM POLLOCK:

Okay. Thank you.

OPERATOR:

There are no more questions at this time. Should I hand it back over to Mr. Pollock for closing comments?

SAM POLLOCK:

Okay, thank you, Joe, and thank you everyone on the call for participating today. We look forward to speaking with you again in February for our year-end call. Have a nice day. Bye.

OPERATOR:

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