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Aggreko plc

First Quarter Trading Statement

Thursday 27 April 2017

Chris Weston, Chief Executive Officer

Good morning, and welcome everyone to our first quarter trading update. I'll give an overview of trading for the first three months, and then update on the outlook for the year as a whole. Carole and I will then, as normal, take your questions. Unless otherwise stated, all numbers quoted will be on an underlying basis, i.e. adjusted for currency movements and pass-through fuel.

Overall performance in the first quarter was in line with our expectations. Underlying revenues were up 2%, and reported revenues up 18%. If you exclude the impact of Argentina, revenues grew 7% and 25% respectively.

Starting with our Rental Solutions' business where revenues were up 3% on the same period last year. We have seen an improvement in upstream oil and gas, with revenues in this first quarter up on Q4 2016. Year-on-year revenues are down, as expected, given that the oil price was lower in Q1 ’16. Activity in the shales had yet to pick up, and the downturn was still very much in progress at this stage last year. The remainder of the North American business performed well with revenues up 8%, excluding oil and gas. Outside of North America rental solutions also grew, with a particularly good performance in Europe.

Turning to the Power Solutions' Business Unit and first our Industrial business. Revenues here were 17% higher, with particularly good performances in Russia and the Middle East. Finally, Power Solutions Utility revenues were 7% lower than the prior year due to the price reductions and off-hires in Argentina. Excluding Argentina revenues grew 4%, reflecting the increased diesel utilisation rate across the business.

Year-to-date utility order intake remains lower than this time last year at 156 megawatts. The pipeline remains strong, with a number of opportunities in their later stages. However, conversion has been slow so far this year. Of the order intake, I am pleased that we have made good progress in both of our new product types. We have signed a 7 megawatt 10 year solar diesel contract in Eritrea, and have been awarded two HFO projects each of around 26 megawatts. These are not yet included in the order intake as both are subject to contract.

We have also signed a number of gas contracts, one using our new more efficient next generation gas product. In Power Solutions we have signed a 30 month contract for 18 megawatts in the UAE, and in Myanmar another 10 megawatts for 5 years. In Rental Solutions we have won a couple of contracts, about 25 megawatts in total, supporting data centres, with more in the pipeline. The deployment of our new gas engines in developed markets is promising and an area I am keen to further exploit. These are all good quality contracts and reinforce the importance of our 5 year technology roadmap.

Returning to utility, the off-hire rate in Q1 was 10%, in line with our full year expectation of around 25-30%. On fleet capital, as stated in March, we expect to spend around £300m as we continue to deliver against our technology roadmap, including building the HFO fleet and upgrading the diesel fleet to our more efficient engine. As ever, we will manage capital spend tightly and flex it according to market conditions.

Turning to the outlook, which remains unchanged. Ex-Argentina, we expect the Group to grow this year, with growth in particular across Rental Solutions and Power Solutions Industrial. However, the impact of Argentina is, as you know, sizeable and we expect that this will more than offset the growth elsewhere, resulting in profit before tax and exceptional costs being lower than last year.

With regards to the half year performance, we expect the full year to be weighted towards the second half, though on a slightly more pronounced basis than 2016. This is due to three things: Rental Solutions, our more seasonal business being a higher proportion of our revenues following the repricing and off-hiring in Argentina; the demobilisation and severance costs associated with the reduced volume in Argentina; and the second half weighting of the additional £25m of annualised cost savings we spoke about at the full year results.

To close, it is early in the year. We are on-track to deliver the guidance we set out in March. And the work on implementing against our priorities, efficiency, technology and our customer, continues to progress well. In particular it is pleasing to see our technology agenda beginning to deliver results.

Thank you very much, and Carole and I will now take your questions.

QUESTION AND ANSWER SESSION

Question 1

Robert Plant, JP Morgan

Good morning Chris and Carole. In terms of the lower conversion rate, can you add any detail to that and do you think it's a temporary issue?

Chris Weston

Fair question, Robert. I mean always difficult to tell. The pipeline still remains strong and pretty well spread around the world. Activity though bringing contracts to a close is slower. We are confident we are not missing out on any tenders, and we are not losing tenders, so it's just slowed down. When you look at some parts of the world like Africa, I mean I think there is a lack of liquidity in some parts of Africa and that could well be part of the problem. But we're confident that we're not missing anything. The pipeline is there, it is just taking longer to convert. I wish I could give you a more succinct answer, but that's what it looks like at the moment.

Question 2

Toby Reeks, Morgan Stanley

How much HFO fleet are you targeting based on the current capex guidance for the full year? What do you think that fleet's going to be in terms of megawatts?

Chris Weston

Well it does depend a bit on market conditions, but at the moment we're assuming we're going to build 150 megawatts.

Toby Reeks

In total, yeah?

Chris Weston

Yeah, this year. Including what we built last year. If the order book strengthens we'll keep going.

Toby Reeks

When you were talking about that pipeline and conversion and the pipeline looking good, number of opportunities at late stages, how much of that is HFO? Could you give us an idea of how that looks, and are those opportunities at late stages large opportunities, or are they sort of similar to the normal contract size we've been seeing recently?

Chris Weston

When we first launched HFO we estimated the market size was probably around two gigawatts. The pipeline we see in HFO is getting towards a gigawatt at the moment. Generally I would expect to see projects of anywhere between 20 and 60 and 70 megawatts, that kind of ilk. I don't think you're going to see 100 or 200, that kind of size, and they will typically be for longer-term, anywhere between three and five years.

Toby Reeks

Just on the diesel and the gas pipeline, generally speaking are those number of opportunities at late stages sort of similar sizes to what we've seen recently or are there big ones in there?

Chris Weston

No, no. I think one of the trends we're seeing is more smaller contracts so probably sub-100.

Toby Reeks

Then if I can just ask one more on pricing in North America oil and gas. The oil and gas business grew in Q1 relative on Q4 sequentially is that right?

Chris Weston

Yeah.

Toby Reeks

Was there any pricing improvement in that?

Chris Weston

Yeah, we did. We've seen pricing improvement of the mid-teens or so.

Toby Reeks

Oh really, already?

Chris Weston

Yeah.

<u>Question 3</u>

Rajesh Kumar, HSBC

Good morning Chris and Carole. Just trying to understand how the sales people are adapting to the new remuneration structure. I believe you tweaked it to sales growth. Are they feeling comfortable with the flow pipeline conversion rate in terms of their income power and have you seen a bit of attrition in the staff given what happened last year?

Chris Weston

We haven't really seen any attrition in the sales team, the sales team is growing as we're putting more resource in to reflect the coverage that we want around the world. Last year's order intake of whatever it was, 1.3 gigawatts, I mean a lot of that was under the new sales incentive scheme and all the feedback we get from the sales force is extremely positive about the changes that we have made.

I mean, as you can imagine, like any sales force, when they're not converting and getting the contracts of course there's a degree of frustration but that is nothing to do with the incentive scheme that we've put in place, it is just the normal sales process. So I'm pleased with how that element of this whole work we're doing around priorities is going and the incentive scheme seems to be bedding in well.

<u>Question 4</u>

Nicholas de la Grense, Bank of America, Merrill Lynch

Morning guys, just a couple of questions on the industrial business if possible please. Quite a significant ramp up in Q1 growth, I was just wondering if you could give us an idea of the sustainability of that growth, and I know you said 2016 you gave us an idea of the level of order intake that you'd seen in industrial, I was wondering whether you could give us an idea of how that's going in 2017, or if most of the growth is from last year's wins?

And then specifically on the Middle East, you're talking about strong growth, that's the first time I've heard you being positive on the Middle East for a while, I was wondering if you could just elaborate on what might have changed that. Thanks.

Chris Weston

Yes, I mean how sustainable is it is always a difficult question to answer, but the business is performing well generally at the moment. The three main businesses, Eurasia, or Russia, and the Middle East and Africa have all delivered good growth. We saw growth as well in Asia in Q1, Latin America I think struggles a bit more. I mean some of it will be the order intake from last year, but also, I mean they've got off to a pretty good start this year in order intake. I mean Russia last year signed up 299 megawatts, they're definitely enjoying the benefit of that this year, but they've also signed 86 megawatts so far this year.

So we're continuing to see good growth out of Russia, their revenue is up about 50%, when you do the year on year comparison, quarter on quarter. So that looks very pleasing in its price probably due to mix as well as volume.

In the Middle East their revenues are up strongly at just under 20% which is great to see. A lot of it comes down to bigger activity on one or two projects that we're seeing in oil and gas. Last year they won a contract with Occidental to be a sole supplier of power generation at their well heads and that has begun to bear fruit and there have been one or two other interesting projects, including some using the QSK60, the gas engine that we have. So pleased to see that, and also some of the other sectors have been strong in their growth. So pleased with how that's doing.

In Latin America that's probably the weaker of the areas, that is where we're focusing our restructuring effort and that is beginning to bear fruit so we are seeing an improvement to the bottom line there. I think as the economies recover and commodities strengthen we should see better performance out of Latin America. I mean that's probably the best answer I can give Nick, but I'm encouraged by what I'm seeing there.

Nicholas de la Grense

Okay great. And just on Latin America, obviously we are starting to see a bit of a cyclical pick up in the region, is it still your view that you have got too much fleet there and it needs to be moved out or has your mid-term outlook improved somewhat?

Chris Weston

No, we will definitely rationalise the fleet in Latin America, I mean we are making a deliberate move to focus more on I think what we might have called in the past mini projects, so we're looking for slightly larger projects deploying more megawatts with slightly less transactional work so we are making sure that the fleet rationalisation reflects that strategy. So slightly larger projects, a bit more revenue, a lighter capital footprint for the depot network and fewer headcount and that seems to be bearing fruit at the moment, the bottom line has picked up.

I think we'd like to think that as the activity in the economy picks up which I think most forecasters are seeing happening and should strengthen through H2 I would like to think we'll see a pick up in the market as well.

<u>Question 5</u>

Emily Roberts, Deutsche bank

Hi, good morning. A couple from me if I may. Firstly, on your contracts with your new technology, your new products, could you give us some colour on your expected return on capital or profitability from those contracts? Are they expected to be accretive or dilutive to the Group ex Argentina? And secondly, if you could give a bit of colour on pricing trends in rental solutions ex oil and gas that would be very helpful. Thanks.

Chris Weston

On the new products, we're very comfortable with how those are pricing in at the moment and the returns that we're seeing in the contracts that we're winning, so I think when you look at it across the portfolio that will be accretive. I mean some of those wins are In Power Solutions Utility, some of them are in the industrial business and some of them are in Rental Solutions, so it's broadly spread across the Group, but the returns and margins are consistent with the medium-term targets that we laid out a while ago.

Pricing in Rental Solutions, I mean it's different in different parts of the world as you can imagine. We've seen a pick-up in pricing in oil and gas in North America which is encouraging, so slight uptick in different parts of the world depending on the sector they're in, it's very difficult to give a meaningful average across the whole of Rental Solutions.

The other thing you should just bear in mind, we are introducing HFO as obviously a new product so we are building that fleet so we're pleased with the contracts that we're writing there and the returns that we're getting, but as you build that fleet utilisation will be lower so that will be a drag on returns in HFO in the nearer term, so you should just bear that in mind Emily as you think about that.

<u>Question 6</u>

Rory McKenzie, UBS

Morning all. Just with the industrial growth and then the rental pricing improvement how should we think about the drop through in those divisions after the recent falls in margin? How quickly can the profitability recover in those two divisions do you think?

Carole Cran

Yes Rory, we would hope for a drop through of probably in the order of 50 to 60 cents on the incremental revenue, I mean there can sometimes be a mixed effect as you know if there's more sort of non-rental revenue which is lower margin, so that can skew it, but yes, we'd be looking for that 50 to 60 cents drop through.

Rory McKenzie

Okay, fair enough. And then also I guess at a Group level is the weak order intake. Are there any thoughts in your head about accelerating any cost reduction plans or what are you thinking about the cost base of that business at the moment?

Chris Weston

I mean I think one of the changes over the last two years is we're very aware of our cost base and we're always looking at ways to improve our efficiency. So the work that we talked about at the beginning of the year in March, that continues. We're doing all the stuff that we announced then around continued procurement efficiencies, looking at planned and unplanned outages in our fleet. So I mean that is part of the way that the Group operates at the moment, there's no particular one-off project that we're looking at beyond that though.

Rory McKenzie

Okay, fair enough. And then following up on some earlier questions, you've said before that you really look to ramp up capex to accelerate the roll-out of new technology. What signals are you looking for as these new projects kind of start in the market and you see how the customers react to them and the sales force? When would you look to really accelerate any of these new technologies from your point of view?

Chris Weston

We've given a guidance for the full year on capital of £300m, within that we will spend to achieve a fleet of about 150 megawatts in HFO. In all these things it is a balance, how much fleet do we build? And you have to balance that against the order intake and the contracts that you are winning. And it is a judgement.

I mean, if we were to see contract wins that warranted more spend on capital, it may mean that we spend a bit more this year, but it would be for very good reason. I'm pretty confident at the moment £300m is about where we'll end up though. It's a judgement Rory.

Rory McKenzie

If you see good interest would you ever want to frontload bringing the fleet on board so the sales force can go to market with it stronger? Or would you very much just balance it because of the current utilisation rates in the group?

Chris Weston

Very much try and balance it. I can't be too definitive about it because the joy of Aggreko is we can be responsive to the signals that we get from the market, so of course if it really started to pick up we would start to produce more. But in reality you are balancing pipeline against capital expenditure; we reckon at the moment 150 megawatts of HFO this year is going to be about right.

Rory McKenzie

Sounds very joyful. Thank you.

<u>Question 7</u>

David Philips, Redburn

Good morning guys. Could I just ask a question about utilisation in the utility business between gas and diesel and how that's standing at the moment and how the win rate year to date has panned out between gas and diesel?

Carole Cran

So, Q1 utilisation, David, were diesel sitting at 82% and gas is sitting just shy of 60%, so it's a bit lower because the 95 of the 325 megawatts in Bangladesh, the site at Ashuganj it off-hired at the end of last year, beginning of this year. And then also we built last year about 200 megawatts of the next gen gas. So, it's a bit lower at the moment but with some of the wins coming through we'd expect it to pick up.

On the composition of the order intake there were two gas jobs of note that Chris mentioned in his script, so there was about 30 megawatts of gas out of that 156.

David Phillips

Great thanks. Just a follow up on the older gas engine variant and what you plan on doing with those engines if you do prove to be successful on the next generation gas. Is there going to be more of a movement between the utility business and the rental solutions businesses? Maybe some of that kit moves to Eurasia? Or do you still think there's enough of a market in emerging markets for the old gas variant engines?

Chris Weston

Firstly we'll try and leave it on supply where it is. I think there is still a market in the utility business in emerging markets around the world. Some markets are less sensitive to fuel efficiency. There is definitely a home for them in Russia, Eurasia where it performs well. And also I think that some of it will get deployed into the Rental Solutions markets. Some of the revenue streams that you can earn in some of the markets is less dependent on fuel efficiency, and it might be in grid support or backup generation where fuel efficiency is less of an issue.

So, I think there are quite a lot of opportunities for us to redeploy it and we're reasonably confident at the moment that we will keep it busy to the end of its life.

David Philips

Thanks very much. And just a follow-up on the G3+ conversion plan for the next, say, 12-18 months. How many units do you plan on updating?

Chris Weston

I suspect this year it will be 300-odd, 350. Again, it will depend on pipeline; it is a product that's in demand. But I would work on that kind of assumption David.

David Philips

And similar next year do you think or is it too far away?

Chris Weston

It's probably too far away, but it's not an unreasonable assumption to make, David.

David Philips

Great, thanks very much.

Question 8

George Gregory, Exane BNP Paribas

Morning, just a few follow-ups from me. And apologies, I'm not sure if it's been clarified already, just on oil and gas in the Rental Solutions business. Chris, you mentioned price improvement in the mid-teens, is that on the Q4 average? And what are volumes doing against that?

Chris Weston

That is on the Q4 yes, it is, and volumes are slightly up. We're seeing volumes going up about anywhere between 3% and 5% a month at the moment, broadly weighted towards diesel rather than the smaller gas sets.

George Gregory

Great. And just on Argentina, has that standby capacity now fully off-hired?

Chris Weston

No. The tender process that ran we ended up winning 30 megawatts at fairly depressed prices, but we continue to have 152 megawatts running under the old pricing regime, and they're running quite hard. We do expect them to off-hire any time soon. I think the competitor that won the majority of the standby volume is struggling to sort themselves out, so we're on until ENARSA ask us to remove it and then we will redeploy it elsewhere in the world. Utilisation in the diesel fleet looks pretty good at the moment and I think we'll find a home for it.

George Gregory

And just on that latter point I guess at the yearend we were talking about that standby capacity off-hiring; has that additional 150 megawatts given you a bit of breathing room? Clearly it's very richly priced. To what extent does that create an additional headwind going into next year?

Chris Weston

I should be clear, George, it's not at the original contract prices. There was a stepdown at the end of, I don't know, Q4 last year, where prices stepped down to what we think are reasonable returns and consistent with our medium-term targets, but are better than the final auction prices we saw come through this year. So, it's not at the original rich margins. It is great to see it on supply, it is earning a little bit, but it is nothing material keeping to that.

George Gregory

Clear. And then finally on the debtor book I just wondered if you had any incremental comments there?

Carole Cran

I think the best way to characterise it is to explain that in the first quarter we collected a little bit more than we invoiced, so that was helpful. But I suppose in the round there's still a handful of more challenging overdues that we're working through. So, back in March we referenced some commodity-dependent countries in Africa that were a bit more difficult at the moment. Obviously Venezuela is still sitting there and everyone has read about the challenges that they're having at the moment.

So, yeah on balance a similar picture to the one I described in March, and more broadly obviously we're getting after working capital improvements that includes payables and inventory as well.

<u>Question 9</u>

Toby Reeks, Morgan Stanley

Maybe two from me. The off-hire rate of 10% that's not consistent with 25% to 30% for the full year, so we should expect the off-hire rate to come down Q2, Q3 and Q4, is that right?

Carole Cran

Within that 10% there's, just to explain some of the bigger pieces of that, there's the 60 that Chris has just described in Argentina. So, we came into the year with 212 of the standby, but 60 has come off to sit at the current 152. We also said that had a bearing on earnings, but you may recall that we've had 70 megawatts sitting in Libya for a period of time, not earning revenue but waiting to see if it could be switched back on.

It still lives in the county and we're still speaking to the customer but we've taken the decision to record it as an off-hire so that we're just not getting the skewed picture of no revenue being earned off of it. So, that 70 megawatts is in there too. And then there was a bit more of the gas off-hired in Mozambique.

So, Q2 you will still see a reasonable amount of off-hire in Q2 with the expectation of that 122 of Argentina still to come off. And then beyond that there's no other really big ticket ones really Toby, so that leads us to conclude at this stage that the 25% to 30% is a reasonable full-year assumption.

Toby Reeks

Okay. Do you guys get an Easter impact?

Carole Cran

A what kind of impact, sorry?

Toby Reeks

Easter impact, so more trading days, does that affect you or not really?

Chris Weston

I thought you were talking about a chocolate rush or something!

Toby Reeks

Not the Easter egg hunt!

Carole Cran

No we don’t, sadly.

Toby Reeks

Thank you.

Chris Weston

Thank you everyone for listening in and for your questions. Thanks a lot. Bye-bye.