

## Macquarie Infrastructure Corp (MIC)- 2Q20 Update

### Maintain BUY

We are maintaining our Buy recommendation on MIC even after the stock has recovered from \$22 to above \$30. The basic thesis remains intact that we think the company will unlock its value by selling the operating businesses and we believe the sum of the parts is worth more than \$40. MIC's management can earn a \$25 million bonus by completing a sale before January 1, 2022.

On the 2Q call, management deflected comments on potential buyers or timing. However, they did say they continue to actively pursue the sale and believed that a sale is likely to be done via several transactions rather than all to one buyer. The IMTT Tank business and the Hawaiian gas utility are more likely to be sold first. The aviation business is starting to recover and seeing volumes increase. However, this is likely the most valuable asset of the three and should command the highest multiple given its history of organic growth. Potential buyers are more likely to want to see how rapidly the recovery plays out and if it is sustained. MIC speculated that if the first two units are sold, they may simply have the aviation unit acquire the parent company and effectively have the cash proceeds from the first two sales and the equity in the aviation business spun out to shareholders.

- **MIC is generating positive EBITDA at all three units and all three produced positive free cash flow in 2Q. The worst may be behind it at this point as IMTT is growing y/y and still seeing strong demand for its tanks and Atlantic Aviation is now at 77% prior levels vs. 21% in April.**
- **The concern in April was that Atlantic Aviation may need external capital from the parent company. MIC now believes this unit will meet its obligations from internally generated cash flow.**
- **Capital spending is still forecast as \$60 million for maintenance and \$200-\$225 million for growth projects. The bulk of both are at IMTT which has seen utilization**

rates and EBITDA rise y/y. So far, \$135 million has been spent in the first half of 2020. That leaves another \$125 million this year. IMTT's free cash flow is at \$45-\$50 million per quarter. MIC expects to pay for some of the capital spending by drawing down its cash balance and effectively boosting net debt.

- **It is also important to remember that 2021 should also be a heavy year for growth capital spending at IMTT.** The projects have been contracted for and MIC has a set timeline to meet for its customers. Total growth spending at IMTT was forecast at \$350 million from 2020-22.
- **A return of the dividend is likely tied more closely to getting the Aviation and Hawaiian Gas units back to more normalized levels.** Hawaii would need to open its state to tourism as much of the gas demand comes from restaurants and hotels. EBITDA is regularly about \$60 million per year vs. the current run rate of just under half that figure. Aviation can do \$275-\$300 million in annual EBITDA but was only \$17 million in 2Q. Per management, it has improved noticeably from those levels, but they may want to see this unit performing at closer to \$50 million per quarter before they think about paying a dividend again.
- Given the nature of trying to sell the company within the next 17 months, the view may also be that a dividend is simply taking money from one pocket and putting it in the other if they are borrowing money overall. The debt level will be subtracted from the entity value to determine what shareholders receive from a sale. There are 87 million shares here. We doubt MIC brings back the \$1 per quarter dividend – but if the other two units have a period of sustained recovery, it would not surprise us to see MIC start paying a small dividend again at the end of 2020.
- A few areas where earnings were helped/hurt in the quarter beyond the obvious loss of business due to COVID:
  - The management fee declined from \$7 million to \$4 million y/y. This fee is computed based on the market cap of the business which is lower this year. This \$3 difference should remain a tailwind until the stock tops \$40 again.
  - MIC benefited with other income coming in at \$2 million representing some federal grants received to pay for some capital spending.
  - MIC accrued an environmental clean-up liability for the aviation unit of \$7 million that lowered earnings.

- Depreciation should become a headwind going forward as the heavy growth capital spending is completed for a number of projects. Some of these projects are now online with others coming in 3Q and 4Q.

## Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

### Key Points to Understand About the EQ Score

**The EQ Review Rating is much more than a blind, quantitative scoring method.** While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

**The EQ Review Rating is not comparable to a traditional buy/sell rating.** The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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