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Second Quarter 2022 Results

Conference Call Transcript

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Speakers: **Denis Jasmin**
Vice-President, Investor Relations

Ian Edwards
President and Chief Executive Officer

Jeff Bell
Executive Vice-President and Chief Financial Officer



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Operator:

Good morning and welcome to SNC-Lavalin's Second Quarter 2022 Results Conference Call.

As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation there will be an opportunity to ask questions.

I would now like to turn the conference over to Denis Jasmin, Vice-President, Investor Relations. Please go ahead.

Denis Jasmin:

Thank you, Ariel.

Good morning, everyone, and thank you for joining the call.

Our Q2 earnings announcement was released this morning, and we have posted a corresponding slide presentation on the Investor section of our website. The recording of today's call, and its transcript, will also be available on our website within 24 hours.

With me today are Ian Edwards, President and Chief Executive Officer, and Jeff Bell, Executive Vice-President and Chief Financial Officer.

Before we begin, I would like to ask everyone to limit themselves to one or two questions to ensure that all analysts have an opportunity to participate. You are welcome to return to the queue for any follow-up questions.

I would like to draw your attention to Slide 2. Comments made on today's call may contain forward-looking information. This information by its nature is subject to risks and uncertainties, and as such, actual results may differ materially from the views expressed today. For further information on these risks and uncertainties, please consult the Company's relevant filings on SEDAR. These documents are also available on our website.





Also, during the call, we may refer to certain non-IFRS measures and ratios. These measures and ratios are defined, calculated, and reconciled with comparable IFRS measures in our MD&A, which can be found on SEDAR and our website. Management believes that these non-IFRS measures provide additional insight into the Company's financial results, and certain investors may use this information to evaluate the Company's performance from period to period.

Now, I'll pass the call over to Ian Edwards. Ian?

Ian Edwards:

Thank you, Denis, and good morning, everyone. Thank you for joining us today.

I want to start as I do every quarter to take a minute to recognize the tireless efforts of our 32,000 employees worldwide. From those who have been with us for their entire career, to the employees who have joined us since the beginning of this year, they continue to take pride in being part of the SNC-Lavalin community, and we're appreciative of their dedication to our growth and purpose to engineer a better future for our planet and its people.

With that, let's start on Slide 4. During the second quarter, we saw a continued uptick in top-line performance as total revenues increased 4.1% year over year to \$1.9 billion, driven by continued acceleration of our engineering services business. During the second quarter, our LSTK projects backlog decreased by \$128 million from the first quarter to \$828 million. I'll speak further to this a little bit later. But our visibility remains clear, on path to closing these projects over the next several quarters, and we remain confident in our initial assessment of their financial impact from now until completion.

SNCL services revenues were up 4.2% over Q2 last year to \$1.6 billion. Excluding the impacts of foreign currency, we achieved a robust organic growth of 6%. Segment Adjusted EBIT was \$146 million and represented a 9.1% margin.

In our Engineering Services business, we achieved a record high U.S. backlog during the second quarter, and our total backlog rose to \$4.2 billion, which represented an 11% increase year over year. We have the talent to deliver this backlog as our net headcount increased, and we continue to make strategic hires in areas that support our Pivoting to Growth Strategy. That purpose-driven strategy has influenced our

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deliberate approach to long-term value creation with a focus on expansion in strong and growing markets, mainly Canada, the U.S., and the U.K., driven by our long-standing customer relationships and a focus on public sector entities.

While the macroeconomic environment is challenging, and it's projected to be for the foreseeable future, our business model and our approach remains resilient, underpinned by multiyear investment trends by our customers and our operational focus on what we can control.

Turning to Slide 5, our Engineering Services business capitalized on the momentum from the last few quarters, delivering strong results during the quarter. Business remained robust in our core geographies, leading to 8% year-over-year organic revenue growth to \$1.1 billion. Segment Adjusted EBIT margin and Segment Adjusted EBITDA over net revenue margin were 8.5% and 15%, respectively, in our target ranges.

We witnessed key wins in the quarter across Europe, Canada, and the U.S., including in Denmark where we recently won a contract to design a new high speed rail line, while at home in Canada, we've captured a key win from multidisciplinary design work on the Chicoutimi Hospital.

We continue to generate wins in the U.S., as highlighted by our recently awarded three-year contract to provide program management and design criteria professional services at Florida's Pensacola International Airport, which follows the recent contract extensions we were awarded for our work on the expansion of Southwest Florida's International Fort Myers. These two projects demonstrate the general re-emergence of projects in the Aviation sector, and the commitment from the U.S. Government to spend on infrastructure development, as outlined in the \$1 trillion infrastructure bill. These wins and others elevated our backlog to \$4.2 billion, another record level and 11% higher as of June 30, 2021, which gives us confidence for hitting our revenue target for the full year.

I'd like to move to Slide 6 and the results for our Nuclear business. During the second quarter, Nuclear revenues and Segment Adjusted EBIT was similar to the prior year, with slightly lower revenue being offset by a slightly higher Segment Adjusted EBIT margin. We continue to make progress across the Canadian refurbishment projects at Darlington and Bruce Power. In addition, the life extension opportunities on the global CANDU reactor fleet remains robust, and we recently announced a \$64 million contract for the engineering and early procurement services for retubing work for the Cernavoda Unit 1 reactor in Romania.

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We see this type of work as a key driver to long-term value creation in the Nuclear segment over the coming years.

We're also well positioned to capitalize on major upcoming new build projects and small modular reactors, where we're beginning to dedicate a greater number of highly skilled engineers to billable projects as we position our new build business for growth. The market conditions for new nuclear are looking more and more positive, driven by government commitments on climate change and an increasing desire, particularly in Europe, to improve energy autonomy and security of supply. The opportunity to participate in new nuclear projects is robust, including Hinkley Point and Sizewell C in the U.K., and the potential for Cernavoda Units 3 and 4 in Romania.

Moving to Slide 7 and our O&M segment, which generated \$105 million in revenue during the second quarter, in line with second quarter 2021. This sector continues to deliver strong Segment Adjusted EBIT with \$11 million representing an 11% EBIT margin above the long-term target of 5% to 7%. Year to date, we continue to see sustained financial performance with strong operational metrics across the O&M portfolio with a healthy pipeline of project opportunities, including roadway transit and healthcare work. Our teams have also been mobilizing the start-up on Eglinton, Trillium, and the REM project. We also see opportunity for growth in our strategic partnerships with key industrial players by leveraging our Capital Group to maximize bidding opportunities for future growth in our core markets.

On Slide 8, our Linxon business generated robust year-over-year top-line growth for a second consecutive quarter, increasing revenues to \$154 million, representing an organic revenue growth of 13.7% compared to the second quarter 2021. Year-over-year growth was aided by increased level of activity in the U.S. and the Middle East. As expected, the business returned to profitability in the quarter with Segment Adjusted EBIT totaling \$7 million and operating margins in line with our targets. This quarter, we are also disclosing Segment Adjusted EBITDA of net revenue for the first time, which we believe is a better reflection of the project management and execution profitability of this business.

Our backlog ended the second quarter at \$823 million, below our second quarter 2022 backlog, as we saw delay in awards. We continue to see significant opportunity ahead, as demand for Linxon services in growing and enhancing electricity transmission and distribution networks remain high.



Turning to Slide 9 and Capital, second quarter revenues declined to \$14 million and Segment Adjusted EBIT was \$11 million, mainly due to the disposal of our investment in InPower BC during the first quarter of 2022.

Amidst the easing of COVID-19 restrictions by the Province of Ontario, traffic pattern trends on the highway 407 grew by 56% versus the second quarter of 2021. We did not receive a dividend from Highway 407 ETR during the second quarter, but subsequent to the quarter we received \$14 million in July, which will be recognized in the third quarter.

Moving to Slide 10, and the update on our LSTK projects. Second quarter revenue grew \$15 million, or 6% year over year, to \$249 million, due largely to better-than-expected progress on our REM project. Our backlog continues to decrease at a robust pace with year-over-year decline from \$1.4 billion to \$828 million, representing a 41% decrease. Sequentially, the backlog saw a 13% reduction from Q1 as we continue to make steady progress on each of our projects.

Segment Adjusted EBIT continues to be impacted by the unprecedented factors that we've been managing as we work to complete these projects, including elevated inflation and building and construction indices, supply chain disruptions, and absenteeism due to labour strikes in Ontario.

As you can see on Slide 11, we're providing more detailed updates on the wind down of the LSTK projects. Overall, we saw a 29% decline in backlog during the first half, while recognizing close to \$465 million in revenue over the same period. Two of the three largest Canadian projects, Eglinton and Trillium, remain on track to be largely complete by the end of 2022. As mentioned earlier, REM continues to progress well and is over 65% complete at the end of the second quarter.

We have recognized \$67 million in EBIT losses during the first half of the year, with \$46 million of these losses relating to the \$300 million of total potential financial risk scenario to complete the LSTK projects. This is represented in the chart on the right-hand side of the slide.

With each passing quarter, we gain increased visibility into the completion cost and the timeline of these projects. We remain confident that any further additional financial risk should be contained within the \$300 million envelope.

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Before passing it over to Jeff, just to discuss the financial highlights of the second quarter. I want to take a moment to discuss our sustainability efforts. We will be releasing our annual sustainability report towards the end of September, which will provide a deeper analysis on our progress across E, S and G, as highlighted on the slide.

A few points to point out:

- 50% of our global revenues were assessed as sustainable revenues which contribute to a sustainable future and a carbon free economy.
- A major milestone in evolving our ESG story was the launch of Decarbonomics this year. This is a data-driven solution for builders and real estate owners and operators that can help decarbonize the build environment.
- We've increased our target as it pertains to female representation, and we continue to make inroads in building mutually beneficial relationships with Aboriginal and First Nation peoples.
- I'm delighted to share with you also that, as per the most recent results of our third-party employee engagement survey, our people told us how proud they are to work for SNC-Lavalin, and how enthusiastic they are about the purpose-driven strategy to deliver a more sustainable future. Scoring higher than last year and the industry benchmark.
- On the governance side, we are receiving positive recognition by third-party rating agencies for our achievements. We've also strengthened our ESG commitments by adding new oversight responsibilities for the Board. Later this year, we have plans to tell you more about how we're effectively managing material ESG risks and seizing significant opportunities to provide sustainable solutions to our customers.

With that, I'll now turn it over to Jeff to discuss the financial highlights.

Jeff Bell:

Thank you, Ian, and good morning, everyone.

If you turn to Slide 14, total revenues for the quarter increased by 4% to \$1.9 billion compared to Q2 2021. SNCL Services revenue totalled \$1.6 billion, representing an organic revenue growth of 6%, driven primarily by Engineering Services and Linxon, while LSTK projects revenue totalled \$249 million. Total Segment Adjusted EBIT for the quarter was \$120 million, which was comprised of \$146 million for SNLC Services, \$11 million for Capital, and negative \$37 million for LSTK Projects. The EBIT for the LSTK Projects was \$11

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million lower than Q2 2021 and resulted from recognizing \$26 million in the quarter of the \$300 million potential financial risks disclosed in our Q4 2021 results and from the segment overhead costs needed to support the projects.

Capital EBIT was \$6 million lower than last year, mainly due to the disposal of our investment in InPower BC to SNCL Infrastructure Partnerships in the first quarter. SNCL Services Adjusted EBIT was slightly below Q2 2021 and totalled \$146 million, representing a margin of 9.1%, in line with our target range of 8% to 10%.

Corporate SG&A expenses from PS&PM for the quarter was \$25 million, in line with our expectations. We continue to expect that our corporate SG&A expenses for PS&PM should be about \$100 million for the Full Year 2022. Capital had \$7 million of corporate SG&A, in line with last year and our expectations.

IFRS net income from continuing operations this quarter was \$2 million, which was composed of a small net loss from PS&PM and net income of \$2 million from capital. The small loss in PS&PM was mainly due to the recognition of an expense of \$27 million following the approval of a remediation agreement with the Quebec Crown Prosecutor's office in May, as well as a higher segment adjusted loss and LSTK projects. The adjusted net income from PS&PM was \$54 million, or \$0.31 per diluted share, in line with Q2 2021, as the lower tax expense was mainly offset by the higher losses in LSTK Projects.

Backlog ended the quarter at \$12.2 billion, compared to \$13 billion at the end of Q2 2021, primarily due to a decrease in LSTK projects as we continue to run off the LSTK construction contract backlog. SNCL Services backlog totalled \$11.3 billion at the end of the quarter, which included an 11% increase in the engineering services segment backlog compared to Q2 2021. This segment was awarded \$1.4 billion of work in the quarter, representing a 1.27 book-to-bill ratio.

The Nuclear, O&M, and Linxon backlogs remain solid at \$808 million, \$5.5 billion, and \$823 million, respectively.

If we now turn to Slide 15, at the end of June 2022, the Company had \$567 million in cash, and the net limited recourse and recourse debt to Adjusted EBITDA ratio was 2.8 times. Management continues to focus on strengthening the balance sheet over time, one of our core financial priorities, and remains confident to meet its 2024 target range of 1.5 times to 2 times as we execute our strategy.

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Our day sales outstanding for engineering services continues to be lower than our pre-pandemic level and stood at 60 days at the end of the quarter, largely similar to what we saw throughout the last four quarters. We are also very pleased to have extended our credit facilities during the quarter to 2025 and to have introduced a sustainability linked framework, further strengthening our ESG commitments.

We now move on to Slide 16 and free cash flow. Net cash used for operating activities was \$129 million in the second quarter. SNCL Services continue to generate positive cash flow from operations with \$94 million for the quarter, while Capital generated \$13 million. After cash taxes, interest in corporate items, which includes the payments for government fines, restructuring, and transformation costs amongst others, you can see that we used \$69 million of operating cash flows, while LSTK Projects used \$60 million. On a year-to-date basis, SNCL Services generated \$153 million, and capital \$28 million of cash flow from operations, while LSTK Projects had a usage of \$225 million. After cash taxes, interest, and corporate items, total net cash usage for the first half of the year was \$263 million.

As Ian said, we are progressing well on the LSTK projects. But these continue to be affected by several external challenges such as supply chain disruptions, inflation, and, recently, provincial labour strikes, obliging us to fund the increased costs resulting from these events in advance of potential claim recovery. We continue to vigorously pursue claims associated with the increased costs we've experienced, and discussions with our LSTK Project clients remain constructive and ongoing.

However, it may take some time to come to a final resolution, at which point the related cash receipt will be incrementally positive to the company's net cash from operating activities. We do expect cash flow from operations to improve in the second half of the year.

Which brings me to our 2022 outlook, which is on Slide 17. In line with my previous comments, we are making one adjustment to our 2022 outlook, being the net cash from operating activities, which we are now expecting to be between negative \$50 million and negative \$150 million. All other financial outlook metrics for full year 2022 are being reaffirmed, including full year SNCL Services organic revenue growth, Segment Adjusted EBIT margin, and Engineering Services Segment Adjusted EBITDA margin targets.

With that, I'll now hand it back to Ian.



Ian Edwards:

Thanks, Jeff.

Turning to Slide 19, I'd like to conclude my remarks with a few key takeaways.

First, we're proud of the work of our SNC-Lavalin colleagues as we continue to make strides in executing our strategic transition to future growth. We remain focused on executing our Pivoting to Growth Strategy and optimizing our delivery of sustained revenue and free cash flow generation. Our core business is executing well and delivering strong financial performance with notable Engineering Services backlog expansion in high growth potential markets.

On top of that, we have a strong pipeline of new business opportunities positioning us well across all our core markets, fuelled by governments investing in new infrastructure and sustainability initiatives. Revenue generation for SNC-Lavalin is primarily driven through government entities that are steadily allocating budget dollars to these extensive projects through the ups and downs of the macroeconomic conditions.

This further demonstrates the resilience of our business and our ability to grow in a supply chain challenged inflationary environment, such as the one we could be entering. Through it all, we remain focused on operational excellence and productivity improvement and have identified multiple levers to pull in a downside scenario to help maintain our bottom-line execution.

Before turning to questions, I want to thank our people who continue to work day in and day out, focused on executing our long-term strategy of being a leading sustainable solution to companies and heads of government anywhere in the world that are looking to generate clean energy, decarbonize the build environment, or build new infrastructure responsibly. We have the technical expertise, the global experience, and inspired team members to make this happen.

Thank you, and we'll now open the call for questions.

Operator:

Thank you. We will now begin the question-and-answer session. Our first question comes from Jacob Bout of CIBC. Please go ahead.



Jacob Bout:

Good morning.

Jeff Bell:

Morning.

Ian Edwards:

Morning.

Jacob Bout:

My first question is around the LSTK. You highlighted the \$46 million in losses in the first half. As it stands today, when you look at absenteeism, supply chain inflation, are losses going to be higher or lower in the second half? And then can you just talk about the timing of potential claim recoveries and how much of this loss do you think is recoverable as you look at it today?

Ian Edwards:

Yes, yes. Thanks for the question. Probably a reasonably long answer, I'm afraid. There's quite a few parts of that question to unpack.

I think the first thing I'd say is, we have made really good progress on the three projects, and we are on track to largely complete the two remaining Ontario projects where we are having the most challenge by the end of this year. Those challenges, as you say, primarily, as we've discussed previously, the post pandemic kind of outfall of absenteeism, productivity losses, which are subsiding, supply chain disruption, which, again, we're getting a reasonable handle on the supply chain disruption.

Probably uniquely in Q2, we suffered from labour strikes in Ontario; the three-year bargaining agreements were due for renewal. I think the good news there is that those are now settled and the labour is back to work. So, it is pretty much the same as we've experienced in Q1 and the details that we experienced, and it's likely we'll face some challenges through to the end of this year as we complete these jobs.

However, as you said, what is the progress we're making on recovery? These losses, in our view, are recoverable losses under the contract from our customers. We are in negotiation on the Ontario projects to



recover that loss. Now, I can't obviously go into the detail. But principally, there are abilities in the contract to recover the pandemic and post-pandemic losses. The impact are mainly driven through the restrictions and the changes in law that were enacted through the course of the pandemic.

Now, obviously, pursuing these claims, we would want a negotiated outcome. The reason that we've taken a different view on our cash flows is we believe that that negotiated outcome is unlikely to come in 2022; more likely to come beyond '22. If we're unable to pursue an agree and negotiated outcome, we will litigate because we feel very strongly that we are entitled to recover part of this loss.

I don't know if that answers the whole question there, but reasonably long answer.

Jacob Bout:

How much did the Ontario strike impact the quarter from the LSTK?

Jeff Bell:

Yes, it's Jeff, Jacob.

It would have been part of that \$25 million that we talked about. Not solely, because, as Ian said, there would have been inflation, there was supply chain disruptions as well in there. Had more of an impact on the Trillium project, just because it's not as far percent complete as Eglington is, for instance. That's how I think about that.

Jacob Bout:

Okay. My second question, you maintain your services' margin guidance, maybe just talk about how you're managing through the inflationary pressures, labour, inflation, other costs, and what employee turnover has been like recently.

Ian Edwards:

Again, a couple of components to that question. I think, as we've said before, on the inflation side, it really is about the LSTK, and it's not about our services business. The services business, there's a few reasons why we don't believe that it will have a margin impact. One is a lot of the services business projects are on a short cycle, so they get rebid on a regular basis. The second is many of those projects are actually



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reimbursable, so we get reimbursed the cost, plus a fee on top of that. The last is that some components of our SNCL services, such as O&M and some of the larger master services agreements we have, have actually got inflation indices built into them.

Generally, we're feeling pretty good that the margin levels will be sustainable through a heavy inflationary environment. I think we've seen that in past cycles within the services business. So overall, I think we feel pretty good about the range that's out there and our ability to meet that range.

Jacob Bout:

Thank you.

Operator:

Our next question comes from Yuri Lynk of Canaccord Genuity. Please go ahead.

Yuri Lynk:

Hi. Good morning, everyone.

Ian Edwards:

Good morning.

Yuri Lynk:

Ian, as we get close to the end here on the LSTK, I just want to make sure that we're on the same page in terms of timing. So, when you talk about physical completion of Eglinton and Trillium this year. Can you just talk a bit about the tail risk that might remain into 2023 following the physical work being completed? I'm assuming there's a warranty period to get through and a ramp up and all that stuff, so just maybe talk about the tail risk, if any.

Ian Edwards:

Yes. Thanks for the question. Let me try and approach that, first of all, by giving you a little status update on each project so you can get a feel for where we are. I think the first thing I'd say is the REM project is going really well, and we're pleased in all respects. You will have recently seen the train roll over the Champlain

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Bridge, which is a great moment and a phenomenal achievement, considering the duration it's taken to get part of that railway into operation.

The Eglinton project, again, you will see trains running end to end on Eglinton. Our work there is really about completion of the stations, getting access into the stations, and getting the permit and regulatory approvals in place and pushing the system into operation next year. So, a lot of the physical work will approach completion by the end of this year.

Trillium, we've got a reasonable amount of work to do. Our assessment is that we can get the majority of the physical work done by the end of this year. It may roll into Q1 next year, but again, largely speaking, trains are running on part of the track. We will get that project into operation next year.

The challenges we've faced in terms of the losses that we've posted have been in connection with cost overrun and cost overrun to the physical construction work on the projects. So, we see that the majority of risk in terms of cost overrun being connected with the physical completion of these works. Now, that's not to say the risk is completely over when that physical work is done. But in the main, that's why I would feel very confident of the outturn of these projects now, and that's why we actually put some outlook at Q4 on the table, because we can see an end to this now and start really feeling the prediction of the cost to the end.

We feel good about the outlook of \$300 million that we did in Q4. As you can see, the burn rate against that so far is \$46 million. We actually do feel pretty good about seeing the end to this.

Yuri Lynk:

Okay. That's very helpful. My second question, I just want to dig into the engineering services business a little bit. Can you just describe the type of work you do in that segment that would be subject to the type of project settlements that that you realised in the quarter? It sounds like you're doing more than just selling engineering hours in there if you're getting these project settlements. So, just what, where and how do you do that type of work, and what type of volatility might it represent in that segment going forward?

Ian Edwards:



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Yes. Okay. The first thing I'd say is, if you look at the track record of the engineering services business, it's been pretty consistent since we've separated out as a segment on its own over the last three years. So, in and out the margins have remained in the same range, and it's been a consistently performing business.

It's exceptional that we would get into large disputes or large settlements, because, primarily, most of the work is coming from government entities, they're either master service agreement, or short cycle projects or small projects. There are some larger projects that we do on design build contracts or major projects. That was the one that gave rise, for example, to the settlement in Q4 on the goal line. But those are more the exception than the rule, so you wouldn't normally see issues such as that in this business.

Yuri Lynk:

That's what I thought. Okay, I'll turn it over.

Operator:

Our next question comes from Michael Tupholme of TD Securities. Please go ahead.

Michael Tupholme:

Thank you. Good morning.

My first question relates to your updated 2022 cash from operating activities guidance. Your revised guidance implies second half net CFO of about positive \$100 million to positive \$200 million. I'm just wondering if you can talk about what gives you the confidence that you'll see cash from operating activities turn positive in the second half, and how we should think about cash flows in both Q3 versus Q4?

Jeff Bell:

Yes, it's Jeff, Michael. Why don't I take that?

First of all, you're absolutely right, and I think, as we indicated in Q4, we did see the second half of the year being stronger than the first half of the year. And there's two drivers of that, both from an SNCL services side, there continues to be a rebound in that part of the business to a more normalized or approaching pre-pandemic levels of working capital. So, we could see some of that phasing in the first half of the year, but we see most of that having normalized largely now, and therefore much less of a drag in the second half of the



year. I would expect to see a stronger EBITDA to operating cash flow conversion in the second half of the year. So that would be one element of it.

I think, as Ian has said on the project, while we continue to see cash flow usage in those, we do expect to see an improvement in the second half of the year. Part of that is as we approach the end of the year, we will be approaching physical completion, and so by its nature our spend on the project will start to reduce.

To your point about Q3 to Q4, I think we'll progressively continue to expect improvement over the year in that second half in that way.

Michael Tupholme:

That's helpful. Maybe just one follow-up for clarification there. On the project side, are you in that \$100 million to \$200 million overall net CFO being positive for the second half? On the project side, are you assuming negative or positive CFO?

Jeff Bell:

I think we continue to probably see a drag on operating cash flow usage from the projects in the second half of the year. But as I said, our expectation is we would see an improvement on that from where we are in the first half of the year.

Michael Tupholme:

Thanks. Second question. Strong SNCL services backlog growth in the quarter, but you also talked about the economic environment being challenging. Recognizing that much of your work is with public sector entities, can you talk about what sort of conversations you've been having with clients over the last month or two in particular, and how the more uncertain economic outlook may be influencing their thinking around moving projects forward?

Ian Edwards:

Well, I think that it's good question. I think a lot to be positive about. A lot to feel positive about where we positioned the Company. Specifically, where we have positioned our engineering services business, as you know, is over 80% of the revenue is coming from Canada, the U.S., and the U.K. But over 70% of the revenue is coming from government entities. If we think about those three geographies, all three have got



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very significant infrastructure investment programs, over a five- or even a ten-year period. I mean, the Biden \$1.2 trillion hasn't even started kicking in yet. We're not even seeing the effects of that in our revenues yet and with our customers, so the States will be getting more support, and we'll be investing more in infrastructure.

The U.K. and many large capital projects which have been committed to, certainly energy transition to nuclear and clean energy, transport, investment, very, very strong, long-term commitments, which is making us feel really good. Not just about the immediate future, but also the medium-term future.

Then back here at home in Canada, Ontario, Quebec, big programs of investment and infrastructure. We're obviously seeing those opportunities flow through, and they're long-term projects. I mean, the commitment for these projects is, once the commitment is there, it's a five-year commitment. So, I think we're feeling pretty good about where we've positioned the Company and the markets where we're operating.

Michael Tupholme:

Great. Thank you very much.

Operator:

Our next question comes from Maxim Sytchev of National Bank Financial. Please go ahead.

Maxim Sytchev:

Hi. Good morning, gentlemen.

Ian Edwards:

Good morning.

Jeff Bell:

Good morning, Max.





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Maxim Sytchev:

I just had a quick question in terms of how we should be thinking about O&M profitability on a go-forward basis, because as you provision on some of the construction projects that you're completing, what impact should we see on future profitability of those projects from an O&M perspective? Thanks.

Ian Edwards:

Do you mean the—sorry, just to be clear about the O&M question. Do you mean the O&M component of the large projects, such as around Trillium and Eglinton?

Maxim Sytchev:

Correct. Yes.

Ian Edwards:

Yes, so, obviously, when we complete these projects and when we put them into operation, then that transfers into our O&M entities. The contract structure for these, it's very, very different. And the link to the SPV the concession is (inaudible 41:21), albeit with the same company. There's no overhang from the kind of construction phase of the project into the O&M.

We generally, as you can see, operate this business with very consistent performance and consistent kind of margins within our range. There's a couple of exceptions which have pushed the range up this particular quarter. Actually, not from those kinds of P3 projects, from smaller projects.

Not concerned about running those into operation, and obviously these contracts are 30- or 27-year contracts.

Maxim Sytchev:

Okay, so we should still expect, obviously, positive contribution from EBITDA and so forth.

Jeff Bell:

Yes, it's Jeff, Max.

Yes, we would absolutely expect positive contribution from an EBIT perspective on projects.



Maxim Sytchev:

Okay. Perfect. Thank you.

Ian, in your prepared remarks, you talked about some initiatives that you're putting into place to drive further efficiency margin and so forth. Do you mind maybe sort of expanding on this and how that could potentially provide some upside to the engineering services margins over the medium term? Thanks.

Ian Edwards:

Maybe both of us will do this.

I mean, obviously, we've had a transformation office, and a transformation function in the Company as we have restructured the Company and as we have changed the emphasis into a project management and professional services company from what it was three years ago. That function in that office remains, and it's continually looking at operational efficiencies, how we support the business, and how we can become more efficient in supporting the business.

Clearly, one of those is the technology and tools that we use to both support the business, but also to execute the business in terms of design, and in terms of using data driven solutions and digital solutions, which will help our productivity.

I think the second component, which we're very proud of, is the global technology centre that we have in India, with 2,500 very, very smart engineers in that centre. This is not a back office. I think you've probably heard me say that before. It's a very advanced, sophisticated digital data-driven capability, which supports our businesses globally, particularly in engineering services, in consulting and design in project management. Our intention is to continue to increase the amount of work that is carried out by that centre, with an ambition to grow that centre even more.

Those are kind of from the engineering and execution, operational perspective.

Jeff, maybe from any overhead perspective?



Jeff Bell:

Yes, from a functional perspective or an overhead perspective, Max, we would be doing a number of things as a part of that program. So as an example, we had multiple ERP systems, we're now on a path to one and are moving into the pilot stage on that. That will help over time drive down our cost base. We've been rationalizing our real estate, which has been giving us good improvement in terms of cost reduction, and we've been utilizing the centralization of functional services, using offshore service centres where possible, all in terms of driving that towards, ultimately, top-quartile benchmark.

Clearly there's some cost pressures against that. Wage inflation and other areas, but it's that sort of continual process improvement in cost reduction that, over time, will inspire us to head towards the top end of our target margins as opposed to the lower or mid-part of that, and we think that's an important target.

Maxim Sytchev:

Okay. Super helpful. Thank you so much, gentlemen.

Ian Edwards:

Thank you.

Operator:

Our next question comes from Frederic Bastien of Raymond James. Please go ahead.

Frederic Bastien:

Good morning.

I was wondering if you could spend a bit of time on the performance of Linxon. During the quarter, we saw a nice improvement sequentially. I was wondering if this is the sort of runway that we should be expecting on a go forward basis.

Ian Edwards:

Yes, yes, for sure. I think the first thing about Linxon is we see a very strong demand for the services that we sell in Linxon. As countries move to a clean energy transition, the substation work that we do through Linxon,



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and the installation of substation work, is seeing a real kind of positive market. We have been busy focusing the Linxon business, primarily to match the geographical footprint of the rest of SNC-Lavalin.

We do see consistency in the margin profile, and we've put the range out there for 6%. I think the other thing that we would say there, there's a lot of flow through work from our partner, Hitachi, in terms of equipment, so we've also started putting in an EBITDA to net revenue, so you can actually see the profitability against the project management element, the actual execution element of Linxon itself.

I think we are bidding strongly across. We're waiting for a number of awards. There's no reason that we feel we wouldn't see a consistent outcome for this business and good growth potential for it.

Frederic Bastien:

Thanks, Ian. Second question for me. We haven't heard much from SNC Capital in last six months to 12 months, so just wondering where it sits right now within the business and if it's still part of SNC long-term game plan.

Jeff Bell:

Yes, it's Jeff. Why don't I take that?

Yes, we absolutely see SNC Capital as a core part of the strategy. As Ian mentioned earlier in his script, there's actually a very good overlap between it and, for instance, the O&M business. Therefore, continuing to source and make investments where we see an opportunity not only to earn a good return, but also to encourage our engineering services and have a link to our own end business. We've found both historically and currently to be something of interest to a lot of customers. So, we continue to see that.

We don't see it as a large call on our capital, and it does have the ability to recycle capital. You saw us do that earlier in the year. We took the InPower BC investment, and John Hart investment, and sold that down into the infrastructure fund that we're involved in. A lot of the capital that we think we can invest going forward there is really recycling of the capital and good returns we've earned historically.

That's how we see the business, at least at the moment.



Frederic Bastien:

Okay, but is it fair to say that the value proposition of SNC Capital will improve as your own balance sheet improves as well?

Jeff Bell:

Sorry, say the first part of that question again.

Frederic Bastien:

I was just wondering if it's fair to assume, though, that the value proposition of SNC Capital will probably appreciate as, you know, the strength of your balance sheet improves?

Jeff Bell:

I'm not sure I would directly link the two from a value perspective, and I think we talked about this at the Investor Day. Historically, the investments we've had there have made mid- to high percentage teens IRR in terms of the return. So, it created a lot of value for us in the past, and we continue to set a high threshold for any incremental investment within that portfolio.

Like the rest of the business, as we move forward, ultimately, with the opportunity to reach a free cash flow positive environment, and then look at our capital allocation, and then we compete for capital with some of the other opportunities we have as well at the time.

Frederic Bastien:

Okay. Thank you both, Ian and Jeff.

Ian Edwards:

Thank you.

Jeff Bell:

Thank you.

Operator:

Our next question comes from Devin Dodge of BMO Capital Markets. Please go ahead.



Devin Dodge:

All right, thanks. Good morning.

I wanted to start with the engineering services business, just looking to see if you can give an update on that land-and-expand strategy. Just trying to get a sense for how it's going so far, are there more markets in the U.S. that you're looking to get into, and how we should be thinking with that margin drag from that expansion in that back half of this year and into 2023.

Ian Edwards:

Yes, for sure. Clearly, we are very pleased with the growth that we're achieving out of the engineering services business. I mean, with an 80% growth in the quarter, we're making the progress that we set out to make when we communicated the growth plan that you just referred to in the Investor Day.

Specifically, on the land-and-expand, and you remember, when we talked about that, we said that we are successful and play at the top-tier level, but only in a handful of states; Texas, Florida, Georgia, Carolina, and Colorado, for example. But we intend to continue to expand that success into new states where we've already re-established offices such as Washington State, California, New York State, and we're seeing contracts come through. You'll see in the awards that we have announced in the quarter, and post quarter, that we've got some good wins. We're also seeing this re-emergence of the Aviation sector and some good winds from that in the U.S.

Record backlog in the U.S., which is fuelled, certainly, in part, the record backlog in ES, so that's a forward-looking indicator of the good growth that we see.

I would also repeat that the \$1.2 trillion commitment of the Biden Administration is yet to flow through the States, and we're able to build this business already. Almost business as usual in the States. So, when we actually see further funds flowing through state to state, we're feeling pretty enthusiastic about our ability to build a business.

Devin Dodge:

Yes, clearly you had some good success there. Any comment on the margin drag as we look forward?



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Jeff Bell:

Yes, I think, as we said at Q1, we obviously saw some margin drag in the first quarter around a heightened level of bidding, and that has obviously fed into, amongst other things, the record backlog we've seen. But as you've seen in the results in Q2, that's largely dissipated, as we anticipated. So, we're in very much a business-as-usual perspective, I think, going forward.

Devin Dodge:

Okay. Good colour. Thanks for that.

Ian Edwards:

Thank you.

Devin Dodge:

Second question. I wanted to ask about the West White Rose project, I believe the client is looking to restart it next year. Just wondering, is this going to add another fixed price project that you'll need to wind down, or will it evolve into something closer to a cost-plus, given the restart? Just any colour there would be helpful.

Ian Edwards:

No, it's not a fixed price contract. We converted that some time ago, and communicated that, and reported it under a different segment than LSTK. Then the project got suspended. Now, the project, as you rightly say, is going to be restarted. It's a great project for us. I mean, it's a profitable project. It's an iconic project. We've got good partners there. We're actually commencing the preparation work for the restart now, and we should see the revenues flow through in '23.

Devin Dodge:

Okay. Thanks for that. I'll turn it over.

Ian Edwards:

Thank you.

Operator:

Our next question comes from Dimitry Khmel'nitsky of Veritas. Please go ahead.



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Dimitry Khmelnitsky:

Hi, and thanks a lot for taking my call.

My first question that has to do with contract assets. I was wondering whether the increase in contract assets relates to any disputed amounts. What is the collection on those?

Jeff Bell:

Yes, so Dimitry, it's Jeff.

The contract assets naturally build as we import and build the projects themselves. There is an element of just increasing as the contracts and the projects themselves are building up. There's some element, because as you heard Ian say earlier, because some of those elements of cost increases are ones that we think, ultimately, should be claimable back from the clients, then you would expect some portion of that. But we've remained quite prudent in terms of how we booked that so that, going forward, we're reasonably prudently based on that.

Dimitry Khmelnitsky:

And so the contract asset does reflect your estimate of certain recoveries related to...

Jeff Bell:

Yes.

Dimitry Khmelnitsky:

...COVID, right?

Jeff Bell:

Yes. That would be correct.

Dimitry Khmelnitsky:

When would you expect to start collecting? When do you expect the contract assets to start reversing?

Jeff Bell:

Within the contract assets themselves, as they complete and then turn over into operation, they will naturally fall as—that piece will naturally fall within the contract asset class.

As Ian said earlier, it may take some time, in terms of costs that we believe are recoverable and due to ourselves. It may take some time to do that. We remain in constructive dialogue with our clients; but if we're not able to settle those out in a negotiated way, we may need to go down and dispute resolution process, in which case it could take more than months, it could take a few years at the outside to try and collect it. But through that process, we're trying to resolve those as well as we can.

Dimitry Khmelnitsky:

But beyond the cost overruns that you expect to recover, is it fair to assume that the contract assets will start reversing as you finish the physical construction components, so, in other words, early next year?

Jeff Bell:

Some will, as it relates to where we have capital investment. For others, it will relate to as we actually collect the cash.

Dimitry Khmelnitsky:

Okay. All right. The cash collection related to transit next, which I think is in the related part, is that expected to—the collection and the reversal of the receivables and the contract assets related to that, when do you expect, essentially, that to start? The collection there to start?

Jeff Bell:

Yes, I think that is going to be fairly dependent on the negotiations and the discussions with clients. It's hard to pin down on that one the exact timing, but we'll continue to try and make as much progress as we can.

Dimitry Khmelnitsky:

But are we looking 2023, or are we looking further years?

Jeff Bell:

It could be in '23. But as I said, the actual timing of that resolution, if we're not able to negotiate an agreeable settlement with the client, and we have to use one of the dispute resolution, processes could take longer.

Dimitry Khmelnitsky:

Okay. All right. Thank you. The last question, on the nuclear backlog. If you can talk a little bit more about your expectations as to the trends in the backlog; if you expect the backlog to rebound. It's been now shrinking over some time. Connected to that, work contracts, do you feel optimistic that you believe you have a good chance of obtaining to increase the backlog?

Ian Edwards:

Yes, let me answer this. It's a good question.

Clearly, as the world looks towards alternative energy, and particularly alternative clean energy, then the nuclear proposition is becoming a very real scenario for governments. We're seeing, definitely, an increased interest in feasibility and actual projects, for example, in the U.K., for new nuclear.

I would say that in our business, we have three strong areas of growth for nuclear. First of all, the life extension of CANDU reactors. This is probably the most efficient way to create sustainable clean energy that a government could invest in. Now, obviously, Bruce Power and Darlington we're already into life extension projects. But what you'll have also seen in the quarter is that we have engineering studies at Cernavoda to look at the life extension and re-tubing of the two reactors in Romania. Also, a project in Qinshan in China to look at re-tubing and life extension.

Those initial contracts are the feasibility that will lead to large contracts where we will have a large element of technology and services work that we will contribute to those life extension projects.

I think the second area is new builds, and we're definitely seeing strong demand in the U.K. with obviously our Hinkley project that we're currently working on. But the next to come up the ranks would be Sizewell C, and we will take a very significant part of that. But also, we're actually deploying engineers to assist the U.K.



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and Canada in the research and development of the SMR reactors for the companies that are primarily leading those initiatives.

Lastly in nuclear is waste cleanup. We already have large contracts for the DOE in the U.S. and for Sellafield in the U.K., and we see a good strong pipeline of opportunities from both of those customers for continued nuclear waste cleanup.

All in all, we're feeling pretty good about the future of the nuclear business as it becomes re-emerged as an alternative power.

Dimitry Khmelnitsky:

Understood. Thank you.

Operator:

Our next question comes from Sabahat Khan of RBC Capital. Please go ahead.

Sabahat Khan:

Great. Thanks, and good morning.

There was some commentary earlier around the U.S. and some of the expansion there. I guess, when you talk about the Biden plan that probably kicks in more into '23, do you have sort of hiring targets, a number of people you want to get in seats, before the spend from that program really gets going? How are you thinking about at this point with the winding down of LSTK, thinking about your investments and sort of defence in terms of wrapping up these projects versus starting to kind of recruit and spend on getting positioned well for those investments that are coming through.

Ian Edwards:

Yes, yes. Obviously, overall, we've got an aspiration to grow the engineering services business within the 4% to 6% range. I mean, I think, as you can see, through our Pivot To Growth Strategy that we presented at the Investor Day, we've actually already kind of started good growth in engineering services, and a lot of that is fuelled by the U.S., as you say.



One thing that we're very pleased, even in the current kind of professional services labour market, we are able to increase our net headcount. Our net headcount has actually increased by 1,300 in H1 this year. Even in spite of attrition rates going back to pre-pandemic levels, we are able to recruit the people we need to grow the business, and I think that's a real positive sign that we're pleased to see. A lot of that is coming from the U.S., and a lot of the growth that you see is also coming from the U.S.

I think the plan, basically, that we've put in place to organically grow the business is actually working.

Sabahat Khan:

Okay, and then just one quick follow-up on the organic side, particularly on the engineering services side, looked to be a good number for this quarter. Can you share a little bit of colour on the price versus volume mix in that and sort of which end markets within the engineering services that really drove that? I guess, as you look to the back half of the year, where are you expecting to see more of the organic growth to come from in terms of end market or even across your three geographic regions?

Ian Edwards:

Yes. Our strongest market where we generally play at Tier 1 is in transport. So, roads and bridges, railway; I mean, we're renowned for being a market leader in our core geographies with U.S., U.K., and Canada. So, for sure.

As I also said, we're seeing a resurgence of the Aviation sector with some good wins in the quarter, primarily from the U.S., but we're also seeing an investment in aviation in the U.K. and Canada. I think there're also some kind of specific opportunities outside of the three core geographies that we are focused on, which is very targeted, such as the NEOM project in Saudi Arabia, which is a multi-billion dollar program that we will be looking to provide project management reimbursable services. So, generally strong markets, as I said earlier, and playing to the strengths that we have in our core geographies.

Sabahat Khan:

Good. Thank you.

Ian Edwards:

Thank you.

Operator:

This concludes the question-and-answer session. I would like to turn the conference back over to Denis Jasmin for any closing remarks.

Denis Jasmin:

Thank you very much, everyone, for joining us today. If you have any questions, please don't hesitate to contact me. Thank you, and have a nice afternoon. Bye-bye now.

Operator:

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