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Fourth Quarter 2022 Results

Conference Call Transcript

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Time: 8:30 AM ET

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

Ian Edwards
President and Chief Executive Officer

Jeff Bell
Executive Vice-President and Chief Financial Officer



Operator:

Good morning, and welcome to SNC-Lavalin's Fourth 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:

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

Our Q4 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.



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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. Good morning, everyone, and thank you for joining us today.

2022 was a good year for SNC-Lavalin, as we achieved many of the goals we laid out at the beginning of the year. The tireless effort of our 34,000 employees worldwide is what drives the Company every day. Our core purpose is engineering a better future for the planet and its people, and we're only able to do so through the hard work and dedication of our employees. I can't thank them enough.

On Slide 3, we outline our accomplishments against our Pivoting to Growth strategy, that we introduced during our Investor Day in 2021. As a reminder, our goal was to wind down our LSTK Projects and pivot into growing our SNCL Services businesses in our chosen geographies to drive long-term value creation. 2022 was a year of strong progress against this strategy. We are now, largely, physically complete on our two Ontario LSTK projects and we remain on schedule to hand these over to clients in 2023, and REM continues to progress well. We expect that this will result in positive free cash flow in the second half of the year. We also remain focused in pursuing all monies owed due to the increased project cost.

We continue to grow our Engineering Services business, expanding organically our revenue by 9% year-on-year. We achieved record backlog for the third consecutive quarter, as demand for our services remains very strong in our chosen markets.



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We continue to be recognized as leaders in the nuclear sector. Governments and public entities around the globe are making strides towards a greener power grid and to build new nuclear, and SNC-Lavalin is well positioned to win its fair share of these opportunities.

We have been intentional in our pivot into specific core geographies and our chosen end markets. Success this past year further emphasizes the strength of our new strategy, and our growth opportunities are unfolding as planned. We continue to believe the strategy put in place represents the best opportunity for SNC-Lavalin, and we expect to continue to deliver on our stated goals.

The macroeconomic environment is challenging, and is projected to be so for the foreseeable future, but our business model, which is focused on geographies and end markets that we have intentionally chosen, remains resilient, driven by public sector's focus on sustainable infrastructure and long-term energy solutions.

As we continue to deliver on our strategy, we are undertaking a strategic review to optimize our portfolio of businesses to ensure that capital and human resources are prioritized to the areas of the business with the highest value-creation potential.

On Slide 4, we highlight our achievements this past year versus our stated targets. Continued demand for our SNCL Services, coupled with our focus on operational initiatives across the businesses, led us to hit the top end of our target range for organic revenue growth, and in the middle of our segment Adjusted EBIT to segment revenue ratio range.

In 2022, developing our people and attracting new talent was a key focus area. As a result, we successfully grew our headcount by approximately 3,000 people, and we increased our focus on training and development. This resulted in an engagement score of 6% from our previous VOX Survey done in 2019. While I'm truly proud of this achievement, we will continue to focus on employee engagement and development as we grow SNC-Lavalin.



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We also continue to grow the sustainability of our operations, and I'm proud to say that our sustainable revenues now represent almost half of our total revenues. In addition, we are partnering and supporting Indigenous socioeconomic development in Canada, and extended our credit facilities through a sustainability-linked framework. We remain on track to deliver our 2013 Net Zero roadmap and our 2025 ED&I targets.

Turning to Slide 5, I want to focus on a few of the highlights from the fourth quarter.

We ended the year on a strong footing, as SNCL Services had an organic revenue growth of 7%, if we excluded the positive \$93 million outcome from an arbitration in the Engineering Services in the fourth quarter '21. Segment Adjusted EBIT was \$156 million and represented a 9% margin. Total backlog for SNCL Services rose to \$11.8 billion, which represented a 5% increase year-over-year, with a further strong growth in Engineering Services.

During the fourth quarter, segment Adjusted for our LSTK Projects was negative \$150 million, following what Management expects is the last material cost reforecast on these projects.

Today, we're introducing the 2023 outlook, which Jeff will provide in more detail shortly. We anticipate SNCL Services organic revenue and profitability to remain strong, and in similar ranges as our latest 2022 guidance. We have, largely, physically completed our two Ontario LSTK projects and are on track to hand these over to clients in 2023. We expect the operating cash flow to be positive in the second half of the year.

Turning to Slide 6, our Engineering Services business continues to drive robust growth for SNC-Lavalin and delivered strong results again during the fourth quarter. The business remains resilient and is accelerating in our core geographies, as evidenced by the 2% year-over-year organic revenue growth during the quarter, or 11%, excluding the \$93 million favourable outcome from the arbitration. Our year-over-year improvement highlights our ability to capture growth and provides a clear roadmap for the growth prospects for sustainable infrastructure demand in 2023, and beyond. Segment Adjusted EBIT and EBITDA margins were 9.6% and



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16%, respectively, during the quarter, at the high end of our target ranges, with particularly strong margin performance in the U.K. and the U.S.

We achieved record backlog during the fourth quarter, marking our third consecutive quarter of backlog growth. Backlog now stands at approximately \$4.7 billion, which represents a 24% increase versus our backlog as of December 31, 2021. The strong backlog increase in the U.S. was achieved through several government contract wins; notably, through delivering management services for Hurricane Ian and highway design services. In addition, for further support against future natural disasters, we were recently awarded a design and engineering contract to replace the Shepard Broad Causeway bridge in South Florida, which will increase safety and enhance hurricane evacuation capabilities. These wins, in addition to others, elevated our U.S. backlog to another record level, and 30% higher than where we stood as of December 31, 2021. Our outlook for continued growth in the U.S. through our Engineering Services business remains bright, fueled by infrastructure governmental programs, such as the Infrastructure Investment and Jobs Act and the Inflation Reduction Act.

In the U.K., our diverse project portfolio, as well as our presence in all seven of our primary end markets, highlights the resiliency of our demand generators in uncertain economic environments. Our backlog is at an all-time high, and this past November, the U.K. Autumn statement signals a commitment to \$600 billion in infrastructure spend, providing good visibility for near-term revenues.

Over the past few years, we have focused on improving our position in these growing regions and end markets through digital investments and increased hiring and the use of our Global Technology Centre in India, and training all our Business Development and Engineering Teams. Results this year, and our outlook for the future, highlight these investments are proving fruitful and for the long term.

Looking out into 2023, our pipeline remains robust and we are well positioned to continue growing.

I'd now like to move to Slide 7, and the results of our Nuclear business.



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During the fourth quarter, Nuclear revenues and segment Adjusted EBIT were similar to prior year, with a continued uptick in segment Adjusted EBIT margin across all geographies. Our backlog stood at \$937 million as at December 31, and we saw bookings growth in all of our geographies during 2022. This level represents double-digit growth versus 2021. As we continue to see growth across all of our core geographies, we are also witnessing accelerating activity in each of our core nuclear end markets. We remain bullish on the nuclear sector, as several countries around the world continue to make commitments to Net Zero. Government entities see nuclear as a low-carbon way to produce electricity, creating new build opportunities to deliver baseload power into an evolving and greener power grid.

We are very excited about our recent award with GE Hitachi to build the Darlington Nuclear Generation Station's small modular reactor. This SMR is the first to be built in North America and could become a game-changer for the nuclear industry. This is a great example of the substantial opportunity for our full lifecycle services business in our core geographies. Additionally, a recent decision by the U.K. government to fund the Sizewell C new build is another example of our capabilities being in demand for new build opportunities needed to deliver greener baseload power.

We remain active in reactor support and life extension projects, as indicated by our work in Europe and Canada. In the U.S., there are number of opportunities with the National Nuclear Security Administration and potential projects that would utilize our learnings from the work we have begun on the Ontario Power Generation SMR. The high-quality prospects across our three nuclear subsectors show the potential growth opportunities happening now and for years to come. Our track record and technology expertise has put us in an enviable position, and we continue to make strides to be the partner of choice.

Moving to Slide 8, and our O&M segment, which generated \$132 million in revenue during the fourth quarter and a 12% organic increase year-over-year, segment Adjusted EBIT margin last quarter was 7.8%, above our long-term target of 5% to 7%. Revenue this past quarter was primarily driven by transit projects. As our LSTK Projects moved towards operation, we are mobilizing for the O&M startup at REM south shore Eglinton and Trillium. We continue to see opportunity for growth in the U.K. through building and road



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infrastructure improvements. We are also utilizing our strategic partnerships with key industry players and leveraging our capital group to maximize bidding opportunities for future growth in core markets.

On Slide 9, our Linxon business revenue was impacted by lower bookings in prior periods in Europe and Asia-Pacific, which was only partially offset by significant revenue growth in the Middle East, and as a result, organic revenue decreased 17%, compared to the fourth quarter 2021. We also needed to take an additional charge on certain European projects that were completed, or nearing completion, to reflect cost reforecast, resulting in a \$14 million EBIT loss in the quarter and a \$10 million EBIT loss for the full year. We have already taken action to improve profitability of the business, and we are also undertaking a further strategic review.

Turning to Slide 10, and Capital, fourth quarter revenues decreased to \$49 million and segment EBIT fell to \$45 million, mainly due to decreased contribution from InPower B.C. following its disposal in the first quarter of 2022, and lower contribution from a power asset due to a plant maintenance shutdown. We continue to see opportunities to release value from the Capital portfolio, and in the fourth quarter, we exited our investment in a fund of the Carlyle Group. We will continue to assess our portfolio of investments to determine long-term strategic fit and to look to release value where we see opportunities to realize additional value. Our Capital concessions remain consistent sources of income for the business; most notably, our stake in the Highway 407 ETR yielded dividends against this past quarter in the amount of \$37 million. Looking out, we remain very active on the business development front and progressing on our new strategy and alignment with the O&M segment.

Moving to Slide 11, and an update on the LSTK Projects, we achieved a major milestone during the fourth quarter, as our two Ontario projects, Eglinton and Trillium, are now, largely, physically complete, a significant step towards our goal of being a professional services and project management company. Our last project, REM, continues to progress well and is more than 75% complete as of December 31. Segment Adjusted EBIT continued to be impacted by the macro factors that we've been managing over the past several quarters, including supply chain disruption, elevated inflation and material rates, labour shortages. This led to a full year impact of \$217 million of the \$300,000 risk envelope we outlined at this time last year to complete



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these projects. As I indicated earlier, we see this as the last material cost reforecast for the LSTK Projects. As was previously outlined, we believe a significant portion of these additional costs related to the pandemic, supply chain disruption, inflation and labour strike action is recoverable, and ongoing discussions are in progress to recover these losses.

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

Jeff Bell:

Thank you, Ian, and good morning, everyone.

Turning to Slide 13, total revenues for the quarter were \$1.9 billion, in line with last year. Total segment Adjusted EBIT for the quarter was \$51 million, which was comprised of \$156 million for SNCL Services, \$45 million for Capital and negative \$150 million for LSTK Projects.

SNCL Services Adjusted EBIT margin was 9%, in line with our target range of 8% to 10%. The negative EBIT for LSTK Projects resulted from recognizing \$140 million in the quarter of the \$300 million risk envelope, and \$10 million, primarily from the segment overhead costs needed to manage the completion of the LSTK projects, and pursue the material cost reimbursement claims that Management believes we are entitled to under the contracts.

Corporate SG&A expenses from PS&PM for the quarter was \$24 million

Restructuring and transformation costs were \$54 million, mainly due to higher than forecasted non-cash charges incurred to right-size the office real estate footprint to align with new working practices.

Net financial expenses for the quarter were \$47 million, higher than last year, due to the increase in interest rates experienced during the year and the higher level of gross debt.



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The IFRS net loss from continuing operations this quarter was \$54 million, compared to \$15 million in Q4 2021, and was composed of a net loss from PS&PM of \$91 million and a net income from Capital of \$36 million. The Q4 2022 adjusted net loss from PS&PM was \$33 million, or \$0.19 per diluted share, as a result of the losses in LSTK Projects.

On Slide 14, you can see the selected financial metrics for the full year.

Total revenues for the year increased by 2% to \$7.5 billion, compared to 2021. SNCL Services revenue totaled \$6.6 billion, 4.9% higher than 2021, or 6.8% on an organic revenue growth basis, at the top end of our most recent outlook, and excluding the \$93 million positive impact of a successful arbitration outcome in Engineering Services in 2021, the underlying revenue growth was even higher.

Total segment Adjusted EBIT for the year was \$413 million, which was comprised of \$581 million for SNCL Services, \$93 million for Capital and negative \$261 million for LSTK Projects.

Corporate SG&A expenses from PS&PM were \$99 million, in line with our outlook of approximately \$100 million, and we expect a similar level in 2023, as cost efficiency will be largely offset by inflationary pressures.

Restructuring and transformation costs for the year totaled \$83 million, higher than our original 2022 outlook, due to the same reasons I explained for the Q4 variance. We expect these costs to decrease and be around \$30 million for the full year 2023, primarily driven by our ERP system implementation and further functional cost transformation.

Net financial expenses for the year were \$116 million, due to the higher debt level and increased interest rates. We expect the interest expense to be higher this year, with a quarterly run rate in 2023 similar to that of Q4 2022.



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IFRS net income from continuing operations was \$10 million for the year and the adjusted net income from PS&PM was \$113 million, or \$0.64 per diluted share.

Backlog ended the year at \$12.6 billion, a similar level with last year, with a roughly \$0.5 billion increase in SNCL Services backlog being offset by a decrease in the LSTK Projects backlog, as we continue to execute our exit strategy. SNCL Services backlog increased to \$11.8 billion at the end of the year, which included a 24% increase in the Engineering Services segment backlog. This segment was awarded \$5.6 billion of work in the year, representing a 1.19 book-to-bill ratio. It is also noteworthy to mention that the Nuclear backlog had a very solid fourth quarter, with a book-to-bill ratio of 1.4, ending the year at \$937 million.

If we now turn to Slide 15, at the end of December 2022, the Company's net limited recourse and recourse debt was \$1.3 billion and the net limited recourse and recourse debt to Adjusted EBITDA ratio was 2.9 times. While this ratio is above the Company's end of 2024 target range of 1.5 to 2 times, balance sheet strength and financial resilience remain a core financial priority, and we remain confident that we will be meeting the target at that time. Note that under our credit agreement, the net debt to EBITDA ratio is calculated differently, and at the end of 2022 was approximately 2.5 times.

Due to our continuing efforts on cash collection, our days sales outstanding for Engineering Services remained strong and stood at 57 days at the end of the quarter.

If we now move on to Slide 16 and free cash flow, net cash generated from operating activities was strong in the quarter and totaled \$176 million, driven by SNCL Services EBITDA delivery and improved working capital management, including the reduced DSO level I just mentioned. As a result, the full year net cash usage from operating activities was \$245 million, better than our latest outlook.

For the full year, SNCL Services had another strong year, generating cash flows of \$552 million, while Capital generated \$28 million. After cash taxes, interest and corporate items, you can see that we generated \$180 million of operating cash flow for the full year.



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LSTK Projects had an operating cash flow usage of \$425 million, due to the cash outflows needed for the progression of the remaining LSTK projects. As the two Ontario projects have reached the major milestone of being, largely, physically complete, we expect that the LSTK Projects cash outflows will reduce in the second half of 2023, as the supply chain is paid out and testing and commissioning activities wrap up. Therefore, we expect that operating cash flows should be negative in the first half of the year, while they should be positive in the second half of the year. Also note that we continue to actively pursue claims associated with the increased costs we've experienced on the LSTK Projects. While it is difficult to forecast exactly when these claims will be resolved, when they do, the related inflow of cash will be incrementally positive to the Company's cash position.

With the expectation that the operating cash flow profile of the Company will improve later this year, and the potential for settlement on LSTK claims, capital allocation priorities are aligned with our 2021 Investor Day framework. We remain committed to ultimately achieving investment-grade financial metrics over time, but also see the ability to deploy free cash flow for the benefit of our strategy and our shareholders. Therefore, as you would have seen earlier today, we have filed, and announced, an NCIB share buyback program which allows the Company to repurchase up to 1.5 million shares over the course of the next 12 months.

I'd like now to turn to my final slide, Slide 17, and summarize our 2023 outlook. Given our robust backlog and strong pipeline of opportunities in SNCL Services, we are expecting our organic revenue growth to be between 5% and 7% in 2023, compared to 2022, slightly higher than our 2022 to 2024 annual financial target; SNCL Services should also continue to deliver strong segment Adjusted EBIT and segment Adjusted EBITDA to net revenue margins in the range of 8% to 10% and 14% to 16%, respectively; and as mentioned, we expect net cash from operating activities to be positive in the second half of the year.

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

Ian Edwards:

Thanks, Jeff.



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Our core business is executing well, we continue to do what we said we would do, and we remain laser-focused on executing our Pivoting to Growth strategy. We are delivering strong financial performance, with notable backlog expansion in Engineering Services, and have a strong pipeline of new opportunities in Nuclear. Recent results further demonstrate the resiliency of our go-forward business and the ability to grow in the current macroenvironment. We are strongly positioned, with a leading presence across our core markets of Canada, the U.S. and the U.K. We continue to see several opportunities for long-term value creation for SNC-Lavalin across these core geographies and our end markets. Infrastructure investments by governments and the resurgence of the nuclear market around the globe show continued signs of growth. And, as I previously noted, we are undertaking a strategic review to optimize our portfolio of businesses, including Linxon. We will be diligent in our approach, and we will provide an update, when applicable, on the development of our review.

We achieved a major milestone for our Company, with our two Ontario LSTK projects now, largely, physically complete, REM continues to progress well, and we're also continuing our discussions with our customers to recoup the total cash owed for the work we have completed.

I say this every quarter, but it really is an exciting time to be part of SNC-Lavalin.

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

Operator:

Thank you. We will now begin the question-and-answer session. We will pause for a moment as callers join the queue.

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

Yuri Lynk:

Hey, good morning, gentlemen.



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Ian Edwards:

Yes, good morning.

Yuri Lynk:

Ian, on LSTK, can you put a little more meat on the bone in terms of the milestone, and I'm asking this question in the context of, you know, looking over the last couple of quarters, on Eglinton, for example, you've been 90%, 95% complete, with 100 and some odd million in backlog for three or four quarters now, and suffered write-downs along the way, so what's changed such that we're going to see that backlog actually go to zero and this thing finally be put to bed?

Ian Edwards:

Yes, no, that's a good question, and I actually see the way forward really, really clearly, and I'll try and explain why we expect not to have anymore material risk going forward.

When I say the physical work is largely complete, what that means to us is that the risk element of the job, the construction work, where we've seen these issues unfold in the post-pandemic world, as far as cost overruns, inflation, labour and materials, supply disruption and trying to get materials over from overseas, the strikes that we've had, and all of those productivity issues that we've had through the pandemic and post-pandemic, I see that as done, and that was all attributed to the construction element of these projects. What we did in this last reforecast is assess, obviously, the impact of all of that in Q4, but also assess the small remaining part of the construction work, and as we're at the end, that's pretty easy to predict and reforecast to the end point.

Now, as you rightly say, these projects are not 100% complete, but the remaining work on these projects, I see as professional services work, and that work includes the testing and commissioning, it includes putting all the documentation together and handing that documentation over to the client, it includes getting the safety permits for the operation of the railways, it includes all the regulatory approvals and getting occupation permits for the stations, and then we have to agree with the client, hand the asset over, train all their people, the drivers, because we don't drive these trains, and get the system bedded down into operation and



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maintenance. So, all of that work is not construction work, that's professional services work, and you'll see these assets going into operation in the second half of this year. So, for that reason, we feel we're in a very different situation than we've been in the past on these two projects.

Yuri Lynk:

Okay. So, all we should see going forward for this year is the overhead losses, about \$40 million, \$45 million negative EBIT, that's what you're saying?

Ian Edwards:

Yes, and, clearly, the overhead is just support, everything I just said, but it's also to support the recovery of our losses and the negotiations and the rigorous kind of pursuit of getting our money back from our clients. So, that kind of run rate that you'll see, \$10 million-ish every quarter, is to enable us to make sure we close out the projects, both from an operational perspective, but also from a commercial perspective.

Yuri Lynk:

Okay, thank you for that. Second question, just on Engineering Services, good results, outside of Linxon, but just a bigger picture—I mean, almost all of your peers in Engineering Services have increased their EBITDA margins over the last two, three, four, five years, with plans for continued improvement in '23. You seem to be a bit of an outlier in that respect, so can you just talk about the reason for that, and how we should think about the ability to improve margins over time?

Ian Edwards:

Yes, for sure. We certainly have significant parts of our Engineering Services business that operate at the same level of margins and operate at the same level of cash conversion, etc., etc., but there are parts of the business which don't, and part of the strategic review is looking at that and making sure that we have a very achievable plan to get those parts of the business to the same or exceed our peer groups, or take another decision on them and take a different route. So, we're really, really focused and committed to getting the whole of the Engineering Services business up to the same, or better, metrics that you'll see through our peer group.



Yuri Lynk:

Thanks, guys.

Operator:

Our next question comes from Jacob Bout of CIBC. Please go ahead.

Rahul:

Hi, good morning. It's Rahul on for Jacob.

Ian Edwards:

Good morning.

Rahul:

I just had a question on the strategic review and it would be helpful if you could shed some more colour on this. You mentioned specifically that Linxon is part of the review. Should we read that as you're considering a potential sale of this business or exiting certain regions? I'm just trying to understand the strategic rationale.

Ian Edwards:

Yes, sure. The strategic review is really about portfolio optimization, and to the comment I made just a moment ago, clearly, we want to be performing in all of our businesses at the highest performance that we see in the industry. I mean, that's our goal and that is what's at the heart of the review in its entirety.

Our markets are really strong. If you look at the industry as a whole, the markets are almost outstripping supply, so it's really important, we see, that where we operate and who we operate with, as far as clients and governments, that we're positioned in the best possible place, using our capital and our human resource to optimize value creation. I mean, that's really in summary.



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Now, on the specifics, we will—yes, Linxon is part of the review. Clearly, we are disappointed in the Linxon performance. The first thing we need to do with the Linxon business is get it back to profitability, which we believe we can, and the second is to review all options. Nothing's off the table with respect to Linxon, specifically. And I repeat, the whole strategic review is about maximizing profitability, cash flows and growth.

Rahul:

Okay, thank you, and maybe just going to the LSTK, maybe if you can just update us on how you currently stand in terms of that previously provided maximum risk envelope of \$300 million, and is the remaining risk, in your view, contained within that \$300 million envelope?

Ian Edwards:

The remaining risk, absolutely is contained within that envelope. At the end of 2022, we were at \$217 million of the \$300 million, but what I would reiterate is what I said in the previous question, and also in the presentation, we don't expect any further material risk going forward, other than the overhead run rate that we've articulated.

Rahul:

Okay, thank you, that's helpful.

Operator:

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

Devin Dodge:

Yes, thanks. Good morning.

Ian Edwards:

Good morning.

Devin Dodge:





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Maybe a question for Jeff here. Just on the cash flow guidance in 2023, it looked negative in the first half, positive in the second half, are you able to put some numbers or goalposts around what that could mean for the full year?

Jeff Bell:

Yes, happy to, Devin, and let me make a couple of comments to that. I think, as you heard us say, we expect it to be negative in the first half of the year. We've got to pay out the supply chain on construction costs, so there is a delay in that, versus where we are from a P&L perspective, and also there's the costs around testing and commissioning and the professional services element Ian talked about. I would expect that to largely look in the first half of 2023 pretty similarly to what we saw in the first half of 2022, in terms of the LSTK cash flow usage, which was roughly \$250 million. Then, as we said, as in the second half of the year we're wrapping those up, we're turning those over to customers, the natural cash flow generation ability of the go-forward business will obviously continue to come through, but without the drag of LSTK. I think the other thing that I'd say is that—and you heard Ian talk about—we're putting a lot of effort into trying to resolve these claims with customers, and that possibly gives us additional upside in the year from a cash flow perspective. We're not going to provide any kind of specific number or guidance, but that's very much how we see the shape of cash flow over 2023.

Devin Dodge:

Okay, no, that's good colour, okay. Then, I was going to ask about the Nuclear, a question on the Nuclear business. I think there's a couple of good-sized projects with the DOE in the U.S. that are set to expire in 2023. Do you think SNC is in a good position to be awarded the replacement contracts for those opportunities?

Ian Edwards:

Well, look, one never knows. Clearly, we are always rebidding these DOE contracts in the U.S. They often come up for renewal and we often rebid them. They're done in consortium with other partners. There is a large one up for rebid right now, that we feel we have a great team, a great set of partners and a great value proposition, but you can never really predict the outcome of these things until the award is done. But, they



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often come up for renewal and there are several DOE contracts across the country in the different nuclear sites. As you allude, we win in others, so it generally levels out, and we've had a fairly consistent and waste cleanup business across the U.S. in our Atkins Nuclear Secured business for some time. But, be assured, as soon as we win, we'll be announcing it.

Devin Dodge:

Okay, thanks. I'll turn it over.

Ian Edwards:

Thank you.

Operator:

Our next question comes from Chris Murray of ATB Capital Markets. Please go ahead.

Chris Murray:

Yes, thanks, folks. Good morning.

Ian Edwards:

Good morning.

Chris Murray:

Ian, just maybe turning back to the U.S. Engineering business, some of your peers have talked about the fact, with some of the new funding coming through, they're looking for organic growth in the low-double-digit type number, and I appreciate you guys have laid out an organic growth number kind of in the 5% to 7% range, but when I think about the portfolio—and this is kind of maybe near term and very specific, and not a longer term goal, but is there any reason to believe that you guys shouldn't be able to benefit from some of these new funding sources, particularly, in the U.S. or the U.K.?

Ian Edwards:



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Yes, no, that's a good question, and we've clearly done a lot of analysis on this, as our land-and-expand strategy, that we talked about in the Investor Day, and following through on that land-and-expand strategy. Particularly, the Infrastructure Investment Jobs Act and the Inflation Reduction Act, we're actually seeing funds flowing through the states now, particularly from the IIJA, and we see this—I mean, these are very, very significant sums of money that are committed over a decade, and we see a lot of it flowing through the transport side, we're seeing some of it now flow through the energy transition side, and we're also seeing quite a bit of it flow into what I could call light water and environmental programs, not just water quality, but also flood defence and flood remediation, drainage, etc., from a resilience perspective, and you might have seen we actually won a few jobs in our core states from a flood mapping and a flood control perspective, which were good wins in Q4.

But, where we're at, I've said it before and it's still stays the same, in Texas, Florida and Nevada, Colorado, Georgia, North Carolina, we operate at Tier 1. Our issue is that that's only a handful of states and our peers are operating in all states, so we've got to move the business from where it is today to a future place where we're equivalent to our peers. Now, we have landed and expanded in the Northeast states, New York, Virginia, Pennsylvania, Illinois, we have landed in Washington State and we've landed in California. That was the work that we were doing last year. We're winning work and we're seeing growth from that. So, I think that our plan and our future is, obviously, because of our size, and I think develops a very significant opportunity to get higher growth rates than you would normally see from an organic perspective. But, we're pretty pleased with where this is going right now.

Chris Murray:

Okay, that's helpful, and then one other question on LSTK. Maybe, let's just assume that everything on the two Ontario projects works out and by mid-year, we're kind of where you expect you're going to be. How do we think about the rest of the runoff, and I guess it's really only the REM project at this point? Should we be thinking that there'll be any contribution, cash flows, or should we kind of be thinking that the back of '23, and into 24, as you run off the rest of this project, it'll keep digging a bit of a hole that you're going to have to overcome, or should it really get back to neutral?



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Ian Edwards:

Maybe we'll both answer this. I'll kick off by saying the REM project has not been one of our challenging projects. I mean, it's always progressed well. We're happy with the performance. Yes, it does give a contribution. It's really been about the physical construction work that has given us the challenge in exiting the LSTK work on the two Ontario projects. So, that's kind of the overview. But, I don't know, Jeff, if you want to talk specifically on cash flows again.

Jeff Bell:

Now, I would just add, I think, and don't necessarily want to get into 2024 guidance at this point, but I think the overhead costs that we have this year, that we've talked about, those will clearly reduce towards the end of the year, as those two Ontario projects go away to, I would expect, a largely immaterial amount, and as Ian has already said, the REM project generates a positive contribution. So, I think that probably gives you the sense of where we think that's headed post-2023.

Chris Murray:

Okay, that's fair enough. Thanks, folks.

Ian Edwards:

Yes, thank you.

Operator:

Our next question comes from Benoit Poirier of Desjardins. Please go ahead.

Benoit Poirier:

Yes, good morning, gentlemen. If we come back on the strategic review, could you maybe provide some colour on what it doesn't include, and do you see an opportunity to maybe monetize some assets that you have in your Capital portfolio, such as the Highway 407?

Ian Edwards:



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Yes, thanks. It's kind of looking at everything. I mean, you'll see from—and I won't repeat myself about the portfolio optimization, but the goal here is to maximize profitability, cash flows and growth. That's the goal, to create the most value we can with the capabilities that we have, the strong markets that we see ahead of us, and that's the heart of the review.

Capital is absolutely part of the review. You will have seen that in '22, we recycled the John Hart asset, you'll have seen we recycled the Carlyle investment fund that we had, so Capital is part of the review.

Specifically, on the 407, this has been a very valuable asset for the Company. It's obviously clearly a really good asset. It's been a very important part of the overall portfolio of the Company, particularly, as we have had challenges with LSTK and challenges with cash flows from executing and exiting the LSTK part of the business. As we move to normalize free cash flows in the SNCL Services business, and positive free cash flows, perhaps, the importance of the 407 becomes less, but when we reach that time—and I don't think we're at that time now—when we reach that time, we'll definitely be reviewing the long-term kind of position that we feel on the 407. I wouldn't say it's in the review immediately, but there will be a time where it will be in the review.

Benoit Poirier:

Okay, and just in terms of capital deployment, Jeff, could you maybe talk about how the NCIB compares with other opportunities you might have given your leverage ratio now, and also the higher interest rate environment?

Jeff Bell:

Yes, happy to, Benoit. First of all, we think the NCIB fits absolutely within the capital allocation framework and priorities that we laid out at our Investor Day there in September 2021, and just as a reminder, it was about balance sheet strength and improving the balance sheet to financial-grade metrics, and then also the potential of either investing to further accelerate our growth strategy or return funds to shareholders, and our view was we could do more than one of those things at the same time. Our view, as we move the business to its go-forward state, which is a positive cash-generative business here in the second half of the year, and



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beyond, our view is we're very much on track to deliver investment-grade financial metrics over the timeframe that we had envisioned, and also it gives us the opportunity, we think, to deploy some additional capital, and so the NCIB really ensures that we have the ability to access all of those capital allocation priorities that we laid out. Clearly, at current levels of the share price, we see a lot of value in our shares and our Company going forward, and we think that gives us good optionality going forward.

Ian Edwards:

I'd probably just build on that, that the optionality is important, not only for the strategic review and any recycled capital that might come out of that, it's also important in case we achieve success on recovering our losses in a short timeframe from our LSTK Projects. I mean, we are pursuing the recovery of those losses very, very rigorously, and if we can get a negotiated outcome, all of those will be positive cash inflows.

Benoit Poirier:

Okay, and maybe just a quick one. Any colour about the timing to recover those costs?

Ian Edwards:

Well, that's the issue, isn't it? I mean, in any negotiation, there's two parties, and the parties have got to get to an agreed position. We are in very detailed and collaborative discussions, but I can't predict the outcome. I genuinely can't. I mean, it could happen in the short term, it could take longer. At the worst-case scenario, it could take some litigation. I would hope not. Because, we feel we've done a great job on these projects and we feel we need to recover the loss.

Benoit Poirier:

Thank you.

Operator:

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

Michael Tupholme:



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Thank you. Good morning. Regarding the Nuclear segment, strong margins in the quarter, I think it was about 18%. That is above what you've historically talked about that segment as sort of being the target market range. So, I guess the question is can you talk a little bit about what happened in the quarter, what drove the margins, and how we should be thinking about that segment going forward?

Ian Edwards:

Let me talk at a kind of macro level first, if I can. The change in the nuclear sector over the last 12 months has been pretty dramatic. The resurgence of nuclear new build power as a genuine green power and an alternative to other forms of green power is becoming a real realization to governments, and we're seeing across the industry increased activity, increased interest, but also real, real opportunities, and you'll have seen the announcement that we made on the small modular reactor at Darlington. So, clearly, the industry is about to take off and launch into a pretty fabulous opportunity, particularly for SNC-Lavalin, because we have the rights to the Candu technology, we feel that Candu technology is a good new build technology for large nuclear reactors, but we're also helping other technologies on the small modular reactor side; notably, GE Hitachi, where we've won that contract.

I think that there are specific nuances to Q4 which drove the margins up on particular projects, and I wouldn't see that the general run rate of the business in the medium to long term should be different than what we've seen in the past, within the range that we've got out there.

Jeff, I don't know if you want to add something to that.

Jeff Bell:

No, I don't I'd add anything material to that, Ian. You're absolutely right, it was closing out some projects at the end and some strong kind of cost control. But, to your point, we've typically operated mid- to the mid-high end of our target range, and I think that would be the range, at least at this point, we would be forecasting going forward.

Ian Edwards:



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We confirm that for '23.

Jeff Bell:

Yes.

Michael Tupholme:

Okay, perfect, and then just a couple of additional questions on the LSTK Projects side. The backlog there was up slightly, and I think you explained why that was the case, but with the two Ontario projects being, largely, physically—largely on physical construction, at what point do we start to see you get past the point where backlog increases in that area, or even sort of a possibility? Does the REM project still, potentially, drive those? Just trying to think about how we should expect that to play out.

Jeff Bell:

It's Jeff. It's certainly around the two Ontario projects. We would expect to see that backlog working down quarter-by-quarter, until the projects wrap up later this year and are handed over. I think, on REM, we continue to see very steady progress on that project and wouldn't expect any kind of material change to that direction of travel in terms of the backlog work-off. It's a little higher. We do a little more work in some quarters, a little less, costs move around a little bit, but we would expect to see, as it has been, a fairly consistent working off of that backlog as we progress.

Michael Tupholme:

Okay, that's helpful, thank you. Then, just a clarification on the prospect of claims recoveries. Ian, I take your point that predicting the timing of that is extremely challenging, but just to be clear, are the recoveries that you're seeking, are these in relation, specifically, to the two Ontario LSTK projects or are there other projects, past LSTK projects, that you're still pursuing claims recoveries in relation to?

Ian Edwards:

No, they're all past projects, also, that we're still pursuing. I can't really go into the finite details of each project, because, obviously, some of these negotiations are confidential, but it's beyond the two, yes.



Michael Tupholme:

Okay, all right. Thanks very much.

Ian Edwards:

Thank you.

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.

Maxim Sytchev:

Jeff, I guess I had a question in terms of sort of the pacing of cash flow drive in H1, because you have one commission right now, so why is the drag kind of similar to last year? Is it predicated on the milestone dynamic, or how should we think about this? Thanks.

Jeff Bell:

Yes, it's a bit of the milestone, Max. Frankly, it's a bit about—or it's a lot about just paying out the supply chain for the construction work that's been done, and it's just around the payment terms of that, that flows into Q1 and a bit of Q2, and then you add in the sort of finishing off of testing and commissioning and punch listing, and all those things Ian talked about, so that's why. It's really just that delay between what you're recognizing from a profit and loss perspective and what you're actually paying out as part of the cash flow of the project.



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Maxim Sytchev:

Okay, and REM has a different cash flow profile?

Jeff Bell:

It's one that has a much more, I would say, balanced cash flow profile, in terms of the way it's been set up and running, so it, largely, hasn't had the same sort of issues and hasn't had the same sort of financial drag, just in terms of its setup. Also, over and above, as Ian had said, it's been progressing very well and remains a positive contribution to the group. It has a fundamentally different kind of cash impact than the other two projects.

Maxim Sytchev:

Okay, fair enough, and then just one question for you, Ian, more sort of from a strategic perspective. Let's say, like, if we teleport ourselves in the future, once LSTK is done—you kind of talk about land-and-expand strategy. Just curious on your sort of thought process around kind of counterbalancing the investor fatigue, which is represented in the pretty low trading multiple, and some discussion around M&A, and things like that. So, yes, just curious what are your thoughts on there. Thanks.

Ian Edwards:

Max, in terms of—the question is around the strategy going forward and how we think about the Engineering Services business from that perspective? Sorry, did I get your question right?

Maxim Sytchev:

Correct, yes.

Ian Edwards:

Okay. Yes, okay. Clearly, we have a consistently performing, growing Engineering Services business. We intend to continue to improve the performance of the business in all metrics, whether that's growth, profitability or cash flows, and because we see the markets, particularly the markets where we have chosen to operate, are so strong, we will continue to look to make sure that we are positioned in fast-growing



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markets and that we have the ability to leverage local and global capability to customers and governments that we have strong relationships with. The plan going forward, for example, the U.S. plan, is a very, very specific plan to maximize our growth potential, stay consistent or improve, and we take that approach to all our geographies. Canada is very, very focused, the U.K. is focused on keeping its leadership position, the U.S. is focused on growth, and we're actually seeing some pretty exciting opportunities in the Middle East right now, and you're seeing, maybe, an uptick in our growth and backlog in the Middle East, as well. So, all in all, pretty good markets, pretty good capability. I think we've got the right plan. M&A, for sure, from a tuck-in perspective, to help us build out some platforms and further relationships, when the time is right and the capital is available and it's the right time to deploy that, but it's all a step-by-step process.

Maxim Sytchev:

Okay, fair enough. Thank you so much.

Operator:

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

Frederic Bastien:

Yes, thank you. Good morning. My question revolves around what was just discussed with Max. When do you expect to be in a position to dial up growth by acquisition? Based on what I heard around the timing of cash flows, the NCIB and the internal review, it feels like it won't be until next year, at the earliest, so I just wanted to get your views here.

Jeff Bell:

It's Jeff. I think we've always said it's very much linked to our ability to consistently deliver positive operating cash flows, so I think that opportunity begins to exist in the second half of the year, but, as we've said, we'll look at what creates the most value for shareholders over that time, and partly for the NCIB program is to make sure that we have, and are available, to compare opportunities that way. So, I think we could see the opportunity later this year; certainly, as we move into 2024.



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Frederic Bastien:

Thank you.

Jeff Bell:

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 further questions, please don't hesitate to contact me. Thank you very much, and have a good day and a good weekend. Bye-bye, everyone.

Operator:

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