



SNC • LAVALIN

SNC Lavalin Third Quarter 2020 Earnings Conference Call Transcript

Date: Friday, October 30th, 2020

Time: 8:30 AM ET

Speakers: **Ian Edwards**
President & Chief Executive Officer

Jeff Bell
Executive Vice-President and Chief Financial Officer

Denis Jasmin
Vice-President, Investor Relations



Operator:

Thank you for standing by. This is the conference operator. Good morning, and welcome to SNC-Lavalin's Third Quarter 2020 Earnings 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. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an operator by pressing star and zero.

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.

I hope you and your families are safe and well. We appreciate you taking the time to listen in today.

Our Q3 earnings announcement was released this morning, and we have posted a corresponding slide presentation on the Investors 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 and 3. 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. These measures are defined and reconciled with comparable IFRS measures in our MD&A, which can be found on SEDAR and on 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:

Thanks, Denis. Thank you all for joining us,

Please turn to Slide 5.

We continue to move forward on our strategic path, including building out our pipeline and delivering consistent performance and remain focused on exiting LSTK as effectively as possible. Firstly, we have continued to deliver solid results in SNCL Engineering Services, in line with our expectations. We continue to benefit from a diverse business mix, public sector work and long-term contracts and relationships. Secondly, the transformation of the Resources Service business is on track and we have moved quickly through restructuring reduced overhead while winning new services contracts. In SNCL projects, Infrastructure LSTKs continue to be affected by productivity losses due to COVID-19 and some reforecasts. Current Resources LSTK projects performed well, with a minimal loss. However, projects overall loss was disappointingly driven by an unfavourable arbitration ruling on a completed



SNC • LAVALIN

LSTK legacy resources project. Finally, our financial position remains strong. We have \$1.1 billion in cash, and successfully issued a \$300 million bond in the quarter.

Turning to Slide 6 and highlights from SNCL Engineering Services.

This was another quarter of solid results for Engineering Services, underscoring the strength and resilience of the business, which delivered an adjusted EBIT margin of nearly 10% and \$186 million in cash flow. Segment adjusted EBIT was slightly up compared to Q2 and EDPM Nuclear and Infrastructure Services' performance has remained consistent over the past six months. This demonstrates the essential and long-term nature of the services contracts within our Engineering Services business.

Please turn to Slide 7.

EDPM continue to perform well in our core areas of the U.K., Canada and the U.S. Revenues from the U.K. and Europe transportation and defence markets were particularly strong and we continue to win new business. We were recently chosen to be the commercial delivery partner for the U.K.'s High-Speed Rail 2 project. This is a state-of-the-art high-speed line critical for the U.K.'s low carbon transport future.

Winning work continues in the U.S., where we've recently won several advisory and design service contracts for the State Department of Transport. In the Middle East, where the market is currently slower, we're winning new work also, and recently have been awarded the master planning work for the new leisure park with Six Flags.

Overall, Q3 backlog was a solid \$2.8 billion, slightly higher than Q2, in line with Q3 2019. Our prospects pipeline remains robust at \$27 billion.

Please turn to Slide 8.



SNC • LAVALIN

Nuclear continues to perform well, with results for Q3 ahead of Q2. The segment benefited from a good mix of long-term contracts, field services, ongoing engineering, which have helped deliver enhanced EBIT. The U.S. has been a strong growth market for Nuclear, with two contracts moving forward with the Department of Energy, both relating to decommissioning and waste management work at the Hanford Site in Washington State. Our proprietary nuclear technology has also been well recognized with a number of contract and industry awards.

Moving to Slide 9

Infrastructure Services also saw higher performance in Q3 compared to Q2, with revenues and margin on target. Our Operation and Maintenance contract were at full service levels, as deemed essential, and we're active with both healthcare and power service contracts. Revenues from Linxon, our substation JV with ABB, increased for the U.K. and Europe. We saw a number of awards for Infra Services in Q3, including scopes relating to the ongoing pandemic and master service agreements in the hydro space.

Turning to Slide 10 and the capital highlights.

In Q3, the phased reopening of the Ontario Province and the Greater Toronto Area meant that the 407 ETR reported an improvement in traffic compared to Q2. SNC-Lavalin received a dividend of \$16.9 million from Highway 407 on September the 3rd. All these concessions are performing very well, with contracts based on an availability model.

Moving to Slide 11 and SNCL projects.

We generated a loss of \$25 million in segment adjusted EBIT for Infrastructure EPC projects, reflecting the continued impact on productivity as a result of COVID-19 and certain reforecasts. Negotiations continue to recoup these losses from our clients. We continue to expect that these Canadian light rail projects will be cash flow positive over their life.



SNC • LAVALIN

With two quarters already completed under COVID restrictions, and as we move through October, we have greater clarity on the impacts to productivity. We're now seeing industry productivity impacts of between 10% and 25% depending on the project and the activities involved. The highest impacts tend to be on projects with extensive activities including manual handling of materials, or working at height or in confined spaces, where the necessary safeguards to social distance during the pandemic have had impact on productivity. On all sites, additional hygiene breaks and the constraints on travel to site, have also affected productivity. Despite the lower productivity, we continue to run down the LSTK backlog, which stood at \$1.9 billion at the end of September.

Turning to Slide 12 and the Resources projects.

The combined loss for Resources LSTK and services were \$75 million for the quarter, primarily due to an unfavourable arbitration ruling on a completed legacy LSTK project. Obviously, I am disappointed with this ruling, which was outside our internal and external experts' assessment. While we believe our current litigation risk assessment processes are appropriate, we're undertaking a further review of the remaining legacy LSTK litigation matters to provide additional assurance.

On a positive note, the services side of the business performed better than expected and the loss on active LSTK projects was down to approximately \$3 million. The enhanced performance of the services was as a result of our ongoing efforts to rightsize the business through divestment and overhead reductions, combined with work winning and better execution. As previously stated, we remain on track to largely complete the backlog of Resources LSTK by the end of the year.

Moving to Slide 13, we can see a significant reduction in LSTK backlog since our strategic direction in June 2019 to stop bidding on this form of contract. You can also see that the Resources Services backlog that is currently contained within this sector has remained stable at around a billion dollars. This provides further confidence with our Resources Services transformation. Our goal, as you know, is to exit LSTK and we continue to focus on that.

Moving to Slide 14 and the transformation of our Resources business announced in Q2.



As stated, we have made significant progress in Q3 as we move towards profitability in the second half of 2021. In Q3, we announced the sale of the South African Resources business, divested our European fertilizer business, reduced the overhead and headcount to approximately 10,000, strengthened the order backlog with renewed key service contracts in core countries. We remain on track to break even by the first half of '21 and turn a profit next year.

With that, I'd like to move to Slide 15 and conclude my remarks before Jeff takes you through more detail on the Q3 numbers.

Our performance in the quarter continues to underscore the strength and resilience of the Engineering Services business and our continued closeout of legacy LSTK business. Currently, we are focused on four priorities to unlock value for all stakeholders. One, closing out LSTK business successfully. Two, ensure a continued, consistent performance across our core markets and geographies in Engineering Services. Three, positioning the Company for a sustainable future; driving organic growth by sharing capabilities across our core markets, including looking at those capabilities that can help and enable clients to deliver sustainable infrastructure and clean energy and leveraging technology; and collaborative working to apply our major project expertise and new contract models that benefit our clients and the outcomes of projects. And lastly, four, we are building a connective, collaborative organization to efficiently deliver our overall strategic direction.

I firmly believe that we have the business focused on the right markets and the right geographies and we're taking the right road to achieve our future.

With that, I'll thank you and I'll pass on the call to Jeff.

Jeff Bell:

Thank you, Ian, and good morning, everyone.



SNC • LAVALIN

Starting on Slide 17, the Company reported an IFRS net loss attributable to SNC-Lavalin shareholders at \$85 million or \$0.48 per diluted share in Q3 2020 compared with a net income of \$2.8 billion or \$15.70 per diluted share for the corresponding period of 2019. Q3 2019 included a significant gain on the disposal of a 10.1% stake of Highway 407 ETR of \$2.6 billion or \$14.74 per diluted share.

Note that the Q3 2020 income tax expense of \$45 million included a \$53 million reduction of deferred income tax assets resulting from a reassessment of the future recoverability of loss carry-forwards in the U.S., while the Q3 2019 income tax expense of \$309 million included \$83 million of income tax recoveries on capital losses related to the capital gain on the Highway 407 ETR disposal proceeds.

The Q3 2020 net loss also included Restructuring cost of \$33 million before taxes, mainly related to the Resources Services transformation. Year-to-date, we have recognized \$58 million in connection with the Resources segment transformation, which is in line with Management's expectation of between \$50 million to \$60 million for the year. The adjusted net loss from PS&PM in Q3 2020 amounted to \$58 million or \$0.33 per diluted share compared with an adjusted net income of \$165 million or \$0.94 per diluted share in the corresponding period in 2019. The variance was mainly due to lower segment adjusted EBIT in both Engineering Services and Project segment and a negative variation in income taxes.

The Company continues to maintain a strong financial position. At the end of September, we had \$1.1 billion of cash on hand, and an additional \$2 billion available to be drawn on the revolving credit facility.

Now looking at the segment in more detail, on Slide 18, we can see SNCL Engineering Services delivered solid results and continues to be resilient through COVID-19 with \$1.4 billion of revenue in the quarter, in line with the second quarter, but lower by 3.6% when compared to Q3 2019. Segment adjusted EBIT was \$142 million, representing a margin of 9.8%, in line with our expectations.

The EDPM segment revenue totalled \$899 million, a decrease of 7.3% compared to Q3 2019, and strengthened several sectors including transportation and defence within the segment core region of the United Kingdom and Europe, was more than offset by the adverse impact of COVID-19 in some



SNC • LAVALIN

other markets, notably aviation and commercial property. EDPM segment adjusted EBIT were strong at \$81 million, a 9% margin, in line with our long-term target range of 8% to 10%. Note that the Q3 2019 margin of 10.6% included some positive project settlements.

In Nuclear, segment revenue increased by 5.5% to \$225 million, mainly due to higher volumes across the geographies. Segment adjusted EBIT was strong at \$36 million, a 16.1% margin, above our long-term target range of 13% to 15%.

Infrastructure Services experienced a 1.6% revenue increase, mainly due to the growth in Linxon's revenue in the U.K. and Europe region. Segment adjusted EBIT of \$25 million drove a 7.8% EBIT margin, also higher than our long-term target range of 5% to 7%.

If you turn now to Slide 19, the SNCL Engineering Services backlog continues to demonstrate resilience against the backdrop of COVID-19, and at the end of September was \$10.7 billion, including awards for the third quarter of \$1.2 billion. EDPM had a particularly good quarter, with an ending backlog of \$2.8 billion, up 1.6% versus the end of Q2. Bookings in the quarter of \$943 million resulted in a booking to revenue ratio of 1.05, in line with the year-to-date ratio.

If you turn now to SNCL projects on Slide 20, in line with our LSTK exit strategy, revenues for Q3 2020 continued to decrease. Infrastructure EPC project revenues fell by 18% to \$237 million, mainly due to the continuing backlog runoff of our major LSTK construction projects. The Infrastructure EPC project segment delivered a negative segment adjusted EBIT of \$25 million compared to a small profit of \$2 million in Q3 2019. This quarter's loss was mainly due to some cost forecast adjustments and lower productivity due to revised working conditions caused by COVID-19. Note that during the quarter, the Husky White Rose project backlog has been reclassified from LSTK construction to reimbursable and Engineering Services, as this project has been de-risked following the changes in contractual terms.

The Resources segment recorded a negative segment adjusted EBIT of \$75 million, as you heard from Ian. The LSTK project business recorded a \$61 million loss due to the \$58 million provision taken for the unfavorable arbitration ruling. The Resources Services business, which is currently being



SNC • LAVALIN

transformed to complement Engineering Services, recorded a loss of \$14 million, slightly better than Management's expectations, as non-primary operations continue to be wound down.

Turning to Slide 21.

The decrease in capital segment adjusted EBIT was mainly due to reduced contributions from certain concessions and lower dividends from our Highway 407 ETR investment, for which we received \$17 million in dividends in Q3 2020 compared to \$42 million in Q3 2019, due to our reduced ownership stake. Traffic volumes continued to be affected by the COVID-19 situation, but we believe these are exceptional circumstances, and with 78 years remaining on the concession, we continue to strongly believe in the long-term value of our investment.

Moving to Slide 22.

Net cash used for operating activities was \$136 million in Q3 2020 compared to \$51 million in Q3 2019. The variance was mainly due to a timing difference between the \$200 million payment for the first wave of claims in the pyrrhotite case and the receipt of insurance coverage proceeds expected in Q4 2020, which should cover a substantial portion of the \$200 million.

SNCL Engineering Services generated cash flow from operations of \$186 million, due to strong EBIT conversion and working capital position, while SNCL projects continue to consume cash with a cash outflow from operations of \$73 million. While SNCL Engineering Services should continue to see strong EBIT conversion to operating cash flow in Q4, SNCL projects will continue to consume cash including the arbitration settlement payment. Combined with some unwinding in Q4 of the temporary working capital balance benefits related to COVID-19 government payment terms, and sales tax deferrals outlined in our Q2 results earnings call, net operating cash flow in Q4 is expected to be slightly negative.

During the quarter, we successfully issued \$300 million of debentures due in 2024, for which the proceeds were used to fund the repurchase of a portion of our Series 1 debentures and repay certain



SNC • LAVALIN

outstanding indebtedness under our revolving credit facility. At the end of September, the net recourse debt to EBITDA ratio on the revolver credit facility calculated in accordance with the terms of the Company's credit agreement was 1.7 times, well below the required covenant level of 3.75 times.

And finally, turning to Slide 23, with respect to Q4 2020 outlook, we expect, assuming no significant deviation from the current COVID-19 worldwide situation, that SNCL Engineering Services revenue should decrease by a low to mid single-digit percentage compared to Q4 2019, and we have tightened the outlook for segment adjusted EBIT as a percentage of revenue between 8.5% and 9.5% for the same period.

This concludes my presentation. We can now open the line for questions. Thank you.

Operator:

Thank you. We will now begin the question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. Once again, to join the question queue, please press star, then one now.

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

Jacob Bout:

Hi, good morning.

Ian Edwards:

Good morning.

Jacob Bout:

My first question here is, so you're indicating that you're undertaking a further review of the remaining LSTK legacy litigation matters. How many of these projects could be subject to this?

**Ian Edwards:**

Okay. Thanks, Jacob. I mean, let's just walk through how these things come about first and then put some context around what the number is in the whole. I mean, clearly, closing out LSTK is a priority for us in exiting the business. The intent of doing that is to complete all the live projects and close out anything that's from a legacy perspective. Now, generally, projects, they get settled, in terms of the accounts, get settled pretty quickly after we've finished the job in relative terms. And that's what we would expect to do by working with our clients and negotiating them out. In some cases, those actually turn to dispute and obviously we're not in the business of not getting paid for the work that we'd done and we're not about to leave money on the table. So, we pursue recovery through a dispute or a litigation where we feel that we can get recovery.

So, that's a much small number of instances than the whole. I mean, this particular case it goes back to the early part of the last decade. So this is a long outstanding project that's been through an arbitration and as we go through those arbitrations we make the assessment of what the outcome's going to be. Obviously, in this case, we're pretty disappointed.

So, the answer to your question is, in context to the closeout of the whole of LSTK, we're talking about a relatively small number of projects here.

Jacob Bout:

Okay. And then my next question is just on the margin guidance you gave for EBITDA margin of between 8.5% and 9.5%. I think that's at the higher end of your previously disclosed H2 guidance range. Is this just a mix issue, a bit more nuclear or what's going on there?

Ian Edwards:

I'll let Jeff answer. I mean, it's a bit more kind of a stronger fix as we close out the year. But Jeff—I think you're on mute, Jeff.

Jeff Bell:



SNC • LAVALIN

I'm sorry. I was on mute. So our previous guidance was 8% to 9% and as I said in my script we've tightened to 8.5% to 9.5%. Now, you'd be correct in observing that the middle point of both those ranges is effectively 9%. I think the difference though at this point versus where we were at our Q2 earnings result is that we've got another quarter, in a sense, of the COVID backdrop against the business under our belt. And therefore I think we have better visibility on the impact that its having and how the business is responding, and as a result with one quarter to go we feel confident about tightening that range to 8.5% to 9.5% versus 8% to 10%.

So, I think that's where we think our guidance is comfortable.

Jacob Bout:

Okay. And as we go forward here and we do more of a ramp in the nuclear work, is that a higher margin work for you?

Jeff Bell:

Yes. I mean, I think as we'd guided, as you've seen us guide, we tied to 13% to 15%. Now, I think what we would say is, obviously, that is a higher margin business. It has to do with some of the very unique capabilities that we can provide to the market in that business and the importance of the quality, in effect, of the supply chain within the nuclear industry itself. I think over time as well, some of our growth areas, particularly in the U.S., will come through joint venture, net equity or income pickups, where we'll effectively be picking up revenue and margin in the same amount. So theoretically, over time, you might see an increase as well in the reported margin percent, although that will—as much have to do with us picking up the net income as opposed to revenue.

Jacob Bout:

Okay. I'll leave it there. Thank you.

Ian Edwards:

Okay. Thank you.



SNC • LAVALIN

Operator:

Our next question comes from Mark Neville of Scotiabank. Please go ahead.

Mark Neville:

Hi, good morning guys.

Ian Edwards:

Good morning Mark.

Jeff Bell:

Good morning.

Mark Neville:

If I could just follow-up on Jacob's question on the litigation. Appreciate your comments. I understand it's a small number of additional projects. But is there any way to sort of quantify the potential risk and/or sort of give us some comfort that this is really a one-off event?

Ian Edwards:

Yes. I mean, clearly, we're really disappointed. I mean, that's the first thing I'd say. This is a \$58 million deviation from where we expected this to land. So, we're disappointed. And I probably explained—like I said, I mean, this arbitration's been running for over a decade, and the way that we assess the outcome of these kind of arbitrations and litigations is obviously with external counsel, external legal advice and external quantum analysis, and we use our internal assessment process, risk assessment process to make a position that we either provide for and that we report on based on all the information. And that's a live process. I mean, as it will go through its hearings and as we get further information, that process is updated and we adjust any provisions or any reporting against that as the case unfolds.

Now, in this particular case, the hearing was some time ago and the actual award was in Q3. So, we do think, having got this, which was disappointing, it's important to look at the few cases that we've got and do a re-review of those cases we will kind of expect from that little change because the process we



SNC • LAVALIN

have is pretty robust already, but we will do that to give an absolute additional assurance that there's nothing there that needs abating.

Mark Neville:

Okay. And in this particular case, is there an appeal on your end or is there (multiple speakers)

Ian Edwards:

Well, sometimes. I mean, it depends on the stage of the litigation and it depends on the actual process itself. In this case it's somewhat binding.

Mark Neville:

Okay.

Ian Edwards:

So, obviously, that's why we've taken the loss.

Mark Neville:

Right. Okay. And just moving on. Just within the projects backlog in Infrastructure, and again I appreciate you guys sort of now have a better handle on where the inefficiencies exist, but is there any sort of remediation or actions that you could take to sort of get this to a breakeven sort of business in the current environment, or do you just sort of need more "normalized" working conditions before you sort of can stem the losses there?

Ian Edwards:

Well, no, for sure. I mean, we are actively looking to recover our losses from COVID. I mean, the contracts—we're down to three contracts, basically, but we're down to Trillium REM projects and Eglinton, and all those contracts, and they're all slightly different and obviously the clients are different. There is avenues of recovery through the contract and we will pursue those. And we have yet to recover anything, to be frank, but the discussions and the contractual case is being put forward based on the impacts as we see them.



So, in the fullness of time, we would expect to recover some of the losses specific to COVID and we will pursue that.

Mark Neville:

Okay. Maybe just one last one for Jeff. Jeff, I didn't catch your comments around Q4 cash flow expectations. You mentioned a few sort of discrete items and I just didn't catch it all.

Jeff Bell:

Yes. No, that's fine. What I effectively said was we expect to see continued good EBIT conversion to EBITDA and operating cash flow in Q4. We will continue to see a use of cash in the SNCL project space and as Ian was saying there's a few contributing factors to those, including the need eventually to recover on some of the COVID-19 productivity impacts. There's also an element, and I talked about this in Q2, of government support programs where we see prompt payment terms that are advantageous to us, we see sales tax deferrals, for instance, in the U.K; all of which have been effective in terms of providing us with positive working capital, but will unwind to some extent through the end of this year but also into 2021.

So, the combination of all those means that our best view is that operating cash flow will be slightly negative in Q4.

Mark Neville:

Okay. Is that also with the \$58 million settlement?

Jeff Bell:

Yes. Yes, exactly. I said that in my script as well. But that's obviously a contributing factor also. And I think the other observation to make is, nine months into the year we're actually just about breakeven from an operating cash flow perspective. We're slightly positive at about \$17 million. So, obviously, where we end up in Q4 is effectively where we'll end up for the full year as well.



SNC • LAVALIN

Mark Neville:

Sure. All right. Thanks guys. I'll turn it over.

Ian Edwards:

Thank you.

Operator:

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

Sabahat Khan:

Thanks and good morning.

Ian Edwards:

Yes, good morning.

Sabahat Khan:

Good morning. Just looking at the Resources segment, maybe outside of this arbitration ruling against you. I know they've got about one quarter and a little bit of work left. How are you feeling about the remaining Resources LSTK work that you're doing?

Ian Edwards:

Yes. I mean, I think on the presentation it shows \$0.2 billion of remaining backlog. It actually showed that in Q2. And it's not that we haven't had any movement in the quarter, it's just a rounding. We've burned about \$60 million in the quarter of backlog. And as you can see, the loss is pretty minimal from those projects, and as we get through to the end, then obviously we're looking forward to putting the whole of the Resources LSTK business behind us.

Now, I would—we've always said that there's not—it's not zero risk going forward, but I think we've got a pretty good handle on the rundown to the end and we should be on track to put this behind us, certainly, by the early part of next year.



So I think it's a good quarter in terms of progress and a good quarter in terms of closing out.

Sabahat Khan:

Okay, thanks. And then I was seeing quite a few headlines coming out of the U.K. with the government focus on nuclear. The Canada government I think is investing a little bit in some SMRs here. Can you maybe talk about the pipeline of Nuclear and where you're involved or what some of those opportunities might be for you?

Ian Edwards:

It's specifically nuclear or just generally?

Sabahat Khan:

Nuclear more so, but generally as well.

Ian Edwards:

Yes. So, I think our range of capabilities in nuclear is really extensive, because it comes from several origins. So, we have decommissioning capability, we have cleanup nuclear waste remediation capability, we have newbuild capability that's being applied to the Hinkley Point power station in the U.K., we own the CANDU technology, we have lots of vendor support through existing CANDU reactors, we have a technology business, which really is quite innovative in providing technology solutions to the nuclear industry globally. We see really good opportunity in absolutely our core markets, which is the U.K., who are committed to build new nuclear. There's a lot of rhetoric at the moment about Sizewell and whether the Sizewell project will go ahead. We will be there with the client, EDF if that goes ahead. We have a great relationship with EDF.

There's significant opportunity in decommissioning. I mean, all the power plants in the U.S., the U.K., and to some extent in Canada, are coming to the end of life and our expertise in decommissioning and remediating existing power plants to the natural environment is something which we're obviously very proud to have as capabilities and that we would expect to obviously grow our market from.



So, I mean, obviously I could talk for quite a long time about this because it's a pretty exciting part of our business, but I think that gives you a bit of a flavour.

Sabahat Khan:

And then just one last one for me maybe on the Infrastructure EPC side. You called out three big buckets, I guess, REM, Trillium and the Eglinton project, and I've seen some headlines around some litigation started on the Eglinton project. First to think about where you're looking to get for recoveries or some cost offsets going forward, I guess, is there one we should focus on more so than the others or are your cost headwinds due to COVID spread evenly among the three big ones?

Ian Edwards:

No, I think the productivity issues that we're facing are pretty even. And it depends on the absolute specific nature of the activities on the job. So, tunnelling, for example, is a confined space and it's very difficult to social distance and there's a bigger impact. Traveling to height in an elevated platform is difficult because you can only get two people in a platform and in a platform normally you could get 20—that kind of thing that leads to the productivity loss. But we're absolutely experiencing it on all three jobs and we're absolutely pursuing our recovery in all three jobs. And as you rightly say, we felt on Eglinton that the right step to take, having been trying to pursue this for quite sometime, is to file a claim into court. And that job we really need to get alignment with our client as to the impact for many reasons; not just recovery, for time reasons. And I'm sure we will absolutely get there. But these things take time and they obviously take demonstration.

Sabahat Khan:

Great, thank you.

Ian Edwards:

Thank you.

Operator:



SNC • LAVALIN

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

Yuri Lynk:

Hey, good morning guys.

Ian Edwards:

Yes, how are you?

Yuri Lynk:

I wanted to follow-up on the three Canadian LRT projects just to be clear. In your pursuit of these—to get these COVID losses back, if you're not successful in recouping these costs, do we see a cost reforecast in the future because of that, or do the numbers already assume that you're not going to get these recoveries?

Ian Edwards:

I think what I would say is we're making a prudent assessment of where we think the outcome's going to land, because, obviously, we're in the business of existing this business line. We don't want to carry risk forward into the future.

So, I think we're being prudent, is the way I would answer that.

Jeff Bell:

Yes. This is Jeff. I think that's right. I mean, obviously, we take our best assessment as we've done it at the end of Q3 on that. We're concerned—or we see a position where we think we need to reflect that in the financial statements. We have. But as Ian said earlier, we think under the different contracts we're entitled to recover, with significant amounts of COVID-19 impact.

Yuri Lynk:

Okay. And to circle back on the arbitration issue. Is there a way to quantify the number of projects that might be—that you're still in arbitration on? And I guess a follow-up to that is, if you want to have a



SNC • LAVALIN

robust process, why wouldn't you just book a loss, assume you're going to lose this process? And if you do, then you don't have to report anything, it's already in the numbers, and if you win, then it's going to be a positive reforecast? I'm just trying to understand what's still left out there in terms of tail risk and if there's any change to your approach warranted?

Jeff Bell:

Yes. It's Jeff. Maybe I'll take a view, response to that. As you heard us say, there's a small number of these. We generally settle out and negotiate commercially on these. But there are a small number of any significant value that are there in some form of litigation from many years past and that's where this one is. As you heard Ian say, I mean, we employ experts' advice, internal view, external views to try and make the best assessment. And part of the reason for that is in some of these cases you can get quite a wide range that often ends up in litigation. One side asks for a larger number, another side asks for a smaller number, and therefore, you have no choice but to try and take your best assessments of what you think the outcome will be based on the best input that you can get. We've obviously had a look at that. As part of receiving this arbitration settlement, we think our provisions where necessary are appropriate. But we'll absolutely essentially double-check that and triple-check in terms of how we got the best view on all of them.

So, we think that's the right way forward and that's the process we'll undertake here over the next few months.

Yuri Lynk:

Okay. I'll sneak in one more for Jeff while I've got you.

Jeff Bell:

Sure.

Yuri Lynk:



SNC • LAVALIN

I think we've had a change to the calculation of your net-debt-to-EBITDA ratio and I don't think we've had an update in a while on that. So can you just give us the covenant if it's still at 3.75 and where you peg your current ratio in relation to that?

Jeff Bell:

Yes. I mean, I think as always—the slightly tricky part is that the calculation under our covenant ratio for the revolver credit facility isn't a straight net-debt-to-EBITDA. There are a number of adjustments that happen within there. And therefore, as we go forward, we are thinking about, certainly as we get into the first half of next year, how we can be clear in terms of our thinking going forward as the LSTK projects have continued to run down further and we have better visibility on what cash flows look like going forward and our ability to forecast those. Without some of the variability that comes with the LSTK projects, I think it'll be easier to link a net-debt-to-EBITDA from the financial statements, so to speak, as opposed to just the covenant ratio calculation. But as you saw in what we were doing, certainly with the level of cash and financial flexibility that we have, our focus on cash flow and our level of net debt, we are well within that covenant ratio at the current time.

Yuri Lynk:

Okay. I'll turn it over. Thanks.

Ian Edwards:

Thank you.

Operator:

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

Benoit Poirier:

Yes. Good morning everyone.

Ian Edwards:

Good morning.



Benoit Poirier:

First question, with respect to the loss of productivity around the pandemic, could you maybe quantify the amount that has been lost so far and the potential amount that you're looking to recover from clients? And any thoughts about the opportunities around the government subsidies?

Ian Edwards:

So, as we've incurred these losses, as we've incurred them through Q2 and Q3, I think we've been clear what our assessment of that is. Now, obviously, we are in somewhat discussion and negotiation and proof of loss with all the clients. So, we don't actually want to get into the finite numerical details of that. But what I—maybe Jeff, if you can perhaps just add to that from what we posted in Q2 and Q3?

Jeff Bell:

Yes. So I think in terms of Benoit I think you're asking about the government support programs. Is that right?

Benoit Poirier:

Yes.

Jeff Bell:

Yes. So for Q3, there was about \$22 million of benefit. It's one of the notes to our financial statements, Note 16. I guess I'd make a couple of observations. The first is, that's globally, so that's not just Canada, for instance. There's a government support program, for instance, in the U.K. around retaining furloughed workers. So the observation I'd make is that's the government grants we've received, but really that is there and has been used to offset the increased cost we've seen from either holding on to workers and employment levels that otherwise we would not have or returning workers from furlough or temporary leave. So, we used it in that way.

Benoit Poirier:



SNC • LAVALIN

Okay. And for Resources Service business, could you talk about the ongoing restructuring efforts and whether you have more clarity, visibility on the potential margin profile of this business in the long term?

Ian Edwards:

So, I think the first thing I would say is what we said we would do in Q2 is on track. I think we gave guidance for the Services business for Q3 and for Q4, and then into 2021 return it to profit. So, actually, we've come in slightly ahead in terms of loss than we said. So we're slightly better than what we put out there for progress in Q3. So obviously, we're pleased about that. I think the other positive is that to get this business profitable it's about rightsizing the overhead and winning work. Certainly, the rightsizing of the overhead has gone well. We're down to about 10,000 staff now, which was a significant decrease over 2019, where we were around about 15,000 staff.

So, we've continued to push ahead with the restructuring and the rightsizing.

In terms of winning work, we're really pleased to have picked up a framework agreement in the quarter from BP. This is exactly the kind of project that we want and exactly the kind of mandate that we want, which gives us the framework to do engineering services and inspection work on a number of their assets. And as we said, I think when we put this together last quarter working for IOCs and NOCs is the way forward for this business.

And I think before we get ahead of ourselves, obviously, we've got to continue this effort to get it into profitability during 2021, but we're looking beyond that is to get the profitability up to a complementary level to the other Services businesses. And obviously, that's the intent and beyond '21.

Benoit Poirier:

Okay. And very quick one for me, pyrrhotite case. Could you provide additional details on the case and maybe share your level of confidence that this payment will be reimbursed and any colour about the timeline with respect to the pyrrhotite case?



SNC • LAVALIN

Sure. It's Jeff. Why don't I take that one, Ian. So I think what you've seen and as we mentioned in the presentation, so the first wave of claims related to pyrrhotite required a payment or at least our share of the payment of \$200 million, and we have clarity, having actually gone to the Quebec court system, that we will be paid \$140 million, should be this quarter, from the insurance group. And in fact, there's another \$33 million on top of that.

So, there's about \$175 million of the \$200 million that we would expect to receive back on that. And the rest we had already provided in Provision 4 in prior periods. So we don't see a change from a P&L perspective as a result of that. Obviously, there's a second wave of claims going on, but that settled out in the first wave.

Benoit Poirier:

Thank you very much.

Ian Edwards:

Thank you.

Operator:

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

Devin Dodge:

Hi, thanks. You have a number of framework agreements with clients in your Resources Services division. Just wondering, have you seen or has there been any movements toward revisiting the pricing under these agreements? On the one hand the pandemic may have impacted your cost performance, but on the other hand clients might be getting squeezed by lower commodity prices. Is there any colour you can provide there?

Ian Edwards:

No, I don't see that on the framework agreements that we've got in the Resources business. I mean, I think that the LSTK part of the Resources business, which obviously we're going to exit, is probably



SNC • LAVALIN

becoming more competitive as the market tightens and there's obviously been oil price fluctuation. But no, no, I don't think we're seeing that kind of pressure yet. We're very comfortable with the level of profitability in the framework that we've won from BP.

So, no signs yet.

Devin Dodge:

Okay. And then a bigger question for Jeff and picking up on an earlier question on the leverage. But I guess what are you targeting in terms of financial leverage for the business? Does it change as those LSTK projects wind down? And then at what point would you feel more comfortable being more active on the capital deployment for another 5x?

Jeff Bell:

Yes, no, I think it's a fair question. I think I'd start with—2020 in my view has about—has been about building the financial flexibility and resilience. I think the first catalyst for this was just coming off everything from 2019, but then obviously COVID has put us in the same situation. So, as a result, very focused on cash flow, converting earnings to cash flow, preserving cash flow and really getting the business highly focused on that.

I think as we go forward—and particularly if the LSTK portfolio that creates generally variability to our cash flow delivery and our cash flow forecasting, and you can see that over the last few quarters. But I think we've said previously as we get into first half of next year we will have delivered a significant amount of the LSTK runoff. You saw from Ian's slide, we started back in mid 2019 around \$3.4 billion. Between Infra projects and Resources, we're down to just over 2, by the end of the year we would forecast to be just under 2, and have delivered a fair number of those projects.

So I think as we get into the first half of next year, we have a lot better confidence in our ability to project that and I think our demeanour generally at this point is to have a balance sheet that would be consistent with investment grade financial metrics. But we'll take our—we'll have to take a view on how fast and how long it takes to get back to that. And as a result, I would expect that our kind of gross debt



SNC • LAVALIN

would be at a similar or lower level than where we are now and I think at the same time that starts to give us some opportunity to think in 2021 about where we have positive cash flow, how we would appropriately deploy that. But we need to come back and give more visibility on that as we get closer to that point in the first half of next year.

Devin Dodge:

Helpful. Thank you.

Ian Edwards:

Thank you.

Operator:

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

Frederic Bastien:

Yes, thank you and good morning. I was wondering if you could please go back to the comment you made about the Husky White Rose project being removed from the LSTK backlog. What's behind that?

Ian Edwards:

Yes. Well, firstly, the project's gone through two postponements. As we hit COVID the client was pretty quick to postpone the project for a year, and as we've gone through COVID and its prolonged currently, our understanding is that the project's not going to restart until 2022. Although, I do believe that's under review. In addition to that, the contract was somewhat not a traditional lump sum contract anyway. It had some risk sharing in it. And at the beginning of this year we went through a period with the client of relooking at the contract and recasting the contract to the point that it's not something we would craft as an LSTK now. The risk sharing is not under that profile.

So, if the project does come back, and we are not clear about that right now, but if it does, it'll be a good project for us with limited risk.



SNC • LAVALIN

Frederic Bastien:

Okay, but did that decision compel you take a provision on that project in the quarter? I'm just curious if there was any financial impact on that?

Ian Edwards:

No. No. No.

Frederic Bastien:

Okay.

Ian Edwards:

No, the client has actually been very fair in its approach to shutting the project down. We would love to have people there to kind of maintain the status of the project so that it can be restarted. So, we work closely with the client and I think we've got a good relationship there where we've been flexible to what they need and obviously we've not incurred any loss from it.

Frederic Bastien:

Okay. And can you provide an update on how the Trillium project's going?

Ian Edwards:

Well, obviously it's having some effect through COVID, but pretty much like the rest of the jobs, it's relatively early days in terms of completion. The big year for Trillium project is next year. I mean, we're entering the winter phase now where work will become limited until spring next year. But we've got a big campaign planned for next year and it's a critical year for the success of the job. Apart from that, we're pretty much on track. But as I say, the proof of it is really next year's work.

Frederic Bastien:

Okay. Thanks. I appreciate the colour. Thank you.

Ian Edwards:



SNC • LAVALIN

Yes. Thank you.

Operator:

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

Chris Murray:

Yes, thanks guys. Good morning. Just maybe going back to the EPC project for a second and just trying to understand how we should be thinking about margin profile going forward. Let's assume that—and I think in your comments you indicated that you're learning how to work within some of the COVID restrictions now, and let's assume that your discussions with your clients will be ongoing, but how do we think about the margin profile over the next little while? Because I know you talked about kind of free cash flow neutral, call it, historical margins. But just with the reforecast now done, how do we think about this for Q4 and into '21?

Jeff Bell:

Yes. Ian, maybe I'll sort of take a crack at that. Chris, I think—and you're absolutely right. We've talked about them being cash flow positive over their life, and as a result we'd obviously see them as profitable over their life. Part of the reason for the comment, of course, particularly on the cash flow side, is that the cash flows can be a bit lumpy, because obviously we're incurring the cost often on a reasonably ratable way, whereas the cash payment profile within the contracts can obviously be a bit more lumpy that way.

As you heard Ian say, we are aware we're seeing cost impacts, taking those as we go along. We do think—and so that ultimately may drag the margin down a bit, but ultimately when it comes to COVID we think that the cost themselves are largely recoverable through time and through money within those contracts.

So, I think part of it is it's early days. We've been taking this quarter by quarter. I mean, it seems like we've been living in COVID forever, but, in reality, at least here in Canada, with respect to these projects, the impact's really just been in the last two quarters. So we've been trying to assess that



SNC • LAVALIN

quarter by quarter. The position we've taken at the end of Q3 is the visibility that we see, and I think that takes it into the winter and then as we get into next year we believe have a chance to have worked through some of these issues with our clients and have a good idea about what that means for the construction period next year.

Chris Murray:

Okay. That's helpful. And then my other question just is in terms of—we talked a little bit about the Resources business and certainly some of the comments I think were more energy focused. But one of the questions or some of the commentary, and maybe it's a different way to think about if you're thinking about oil and gas, but just energy broadly, part of the transition, and the energy transition there's also been some discussion around the mining business and resource requirements to build some of this new infrastructure. Could you just talk a little bit about how you're seeing some of the funding, especially out of the Canadian government that's looking to create this transition and how you think that that may impact you in the coming year?

Ian Edwards:

Do you mean funding of energy and infrastructure, the whole market, Chris?

Chris Murray:

Yes, exactly.

Ian Edwards:

Yes. I mean, I think the term that's generally being used in our core markets is 'shovel ready, shovel worthy,' right, and the shovel worthy component of it really means investment in infrastructure that gives an economic benefit, but also is sustainable in its nature. And there's several announcements that obviously you're familiar with in Canada, but it's pretty much the same story, I think, certainly in the U.K. and to some extent in some states in the U.S. And that for us is a very, very big positive. Because actually delivering sustainable infrastructure and actually how we think about that and both the type of capabilities that we've got and how we apply those capabilities, are pretty much in our sweet spot of the capabilities we have.



If you think about clean energy, obviously, we've got extensive capability around hydro and clean energy wind farms in the U.K.; we've got a nuclear capability, which is in our consideration clean energy. We have just won this mandate in the U.K. for the high-speed rail, which, absolutely, because of their net zero 2050 legislation, has to consider its carbon footprint, and we've done a lot of work looking at the carbon footprint in partnership with the client there.

So, we see the whole industry moving a bit more towards an outcomes-based industry rather than just thinking about let's let work on an LSTK basis and get the cheapest price we can.

So, I think where we're taking the Company and the capabilities we've got play directly into this.

Chris Murray:

Okay, that's helpful. Thank you folks.

Operator:

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

Denis Jasmin:

Thank you very much for joining us today. I know there are a few analysts still in the queue there but we are running out of time. Please don't hesitate to contact me. I'll be pleased to answer any of your questions. Thank you very much everyone and have a beautiful day. Bye-bye.

Jeff Bell:

Thank you.

Ian Edwards:

Thank you.



SNC • LAVALIN

Operator:

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