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SNC-Lavalin Fourth Quarter 2020 Earnings Conference Call Transcript

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

Jeff Bell
Executive Vice-President and Chief Financial Officer

Denis Jasmin
Vice-President, Investor Relations



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Operator:

Thank you for standing by. This is the conference operator. Good morning, and welcome to SNC-Lavalin's Fourth Quarter 2020 Earnings Conference Call.

As a reminder, all participants are in listen-only mode and the conference is being recorded.

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

Denis Jasmin:

Thank you. 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 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. 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. These measures are defined 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:

Thanks, Denis, and good morning everyone.

Turning to Slide 4, 2020 really has been a transformative year for SNC-Lavalin on many fronts. We took a series of actions focused really on two objectives: one, reducing the Company's risk profile as it relates to our legacy LSTK business, and two, accelerating SNC-Lavalin's transition to a leading professional services and project management company.

The actions we took included the closure, sale and strategic divestment of a vast majority of the Resources business, including a binding agreement to sell the Oil & Gas business announced on February 9; a review of all significant litigation matters and claims receivable in order to provide the most fulsome assessment of outstanding risk; and the continued wind-down of the LSTK projects backlog by approximately a billion dollars.

We also demonstrated through COVID-19 pandemic both our agility in responding to unprecedented global events and the resilience of our Engineering Services business. We quickly pivoted to respond to the challenging environment triggered by the pandemic, moving to remote working, reducing costs and enhancing our digital transformation. We have also collaborated with our clients to develop new risk-capped contracting models, and we have leveraged our public sector expertise and diverse service offering in our core markets to win new, and in many cases ground-breaking work, that reflects our ability to meet the changing needs of a post COVID world. These include some major nuclear transport



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infrastructure and social housing projects, and as we move to 2021, Engineering Services is strongly positioned to meet the needs of our clients for renewed infrastructure investment and the development of low-carbon assets.

Turning to Slide 5, I'll now walk you through the Q4 highlights and the 2021 outlook for each of the Engineering Services segments, starting with EDPM.

EDPM finished the year strongly across all regions, underpinned by a robust performance in our Roads, Railway and Defence service offering. Overall, EDPM generated strong cash flow and backlog grew by 8.9% in 2020, fuelled by Road and Rail wins in the U.K., rapid transit in the U.S., and new water and O&M projects in Asia Pacific, amongst others. With our robust pipeline of \$27 billion ahead of 2021, combined with governments' commitments to infrastructure spending, we are really optimistic about the return to growth in our core geographies, particularly in the second half of the year.

We have an ambitious growth plan focused on areas where we anticipate increased investment and where we have deep expertise, specifically in transportation infrastructure, water, environment and defence. In terms of geographies, the U.S. is a central focus. We see significant potential to deepen our penetration into the U.S. market, and we believe there could be much larger infrastructure spending bill passed under the new Biden Administration.

Turning to Slide 6 and highlights of the recent EDPM project wins, in February, SNC-Lavalin and its partners won a \$1.3 billion contract to design and build Phase 2 of the East-West Rail Project, one of the largest rail projects in the U.K. This project features a new alliance contracting model in which all partners work as an integrated team and the risks are shared and capped amongst them. It signals a new collaborative way of working with partners and clients, and it's the model that we hope to replicate for other projects in other countries.

Moving to Slide 7 and highlights from our Nuclear segment, Nuclear continued to perform well through Q4. A number of multi-year project extensions were awarded on contracts in the U.S. and Canada



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during the quarter and as we head into 2021 the pipeline is strong. We see significant opportunity for Nuclear going forward, fuelled by market demand and our own market-leading position. These opportunities include nuclear new build and reactor support, a number of projects coming up for tender by the U.S. Department of Energy where SNC-Lavalin already has a strong track record of wins, and nuclear decommissioning and environmental opportunities.

Turning to Slide 8, you can see some of the recent wins and industry awards, which include contracts in Canada and the U.S. as well as service support for the CANDU fleet in Canada and internationally.

Moving to Slide 9 and Infrastructure Services, the segment had a strong quarter reflecting the essential nature of Infrastructure Services in supporting critical infrastructure through the pandemic. Operations and Maintenance continued to operate at full service levels with strong activity in power, grid and industrial solutions. Linxon was also a strong contributor to the quarter and saw a healthy intake of orders.

As we move to '21, we see a strong pipeline of opportunity for Linxon, particularly in the transportation and transmission sectors. We are also focusing our business development in O&M in the U.S., the U.K. and Canadian transportation sectors as governments continue to invest in new infrastructure.

Turning to Slide 10, you can see the breadth of work in the Infrastructure Services backlog ranging from design, building and refurbishment of hydro plants, to defence work and COVID-19 related contracts, including a medical supply contract and the delivery of mobile health units.

Turning to Slide 11 and the Capital segment, with traffic volumes down by 44% on the 407 in Q4 due to return to lockdown, there were no dividend payments in the quarter. As the province comes out of lockdown, we anticipate an increase in traffic levels and continue to believe in the long-term fundamentals of the highway in the country's largest city and economic hub.



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Our remaining concessions continue to perform well and have not been significantly impacted by the pandemic.

Moving to Slide 12 and Infrastructure EPC projects, as discussed during our February 9th update, the three remaining Canadian light rail projects continue to progress well. We expect to continue to reduce the backlog by approximately \$1 billion by the end of '21. Two of the projects are expected to be complete by the end of '22, with the last remaining one, the REM, to be delivered in '24. While LSTK projects wind-down, we do see light rail as a significant growth opportunity as governments invest in low carbon rapid transit. SNC-Lavalin will continue to leverage its expertise in the light rail space but with a focus on collaborative and risk-capped project management and construction management services.

Turning to Slide 13 and the Resources segment, with the agreement to sell the Oil & Gas business, our remaining Resources business is focused on services in the mining and metallurgy sector. We have a long history in M&M, which generates revenues of \$163 million in 2020, and will be part of the ongoing Engineering Services offering.

Moving to Slide 14, I'd like to conclude my presentation by focusing on SNC-Lavalin's strategic priorities for '21. As I mentioned at the beginning of this call, we are focused on de-risking the business and generating consistent earnings and cash flow. This remains our focus and we have five key priorities: closing the Oil & Gas sale; successfully running off the LSTK projects; continuing to drive consistent performance in Engineering Services; building a connected, collaborative organization that can work and support clients remotely from anywhere in the world; and most importantly, driving growth and sustainable outcomes for our clients across the Company.

Turning to Slide 15, we are focused on a number of growth drivers. The first is centred on our core markets, the U.S., the U.K. and Canada, where we can leverage our expertise in Nuclear and Transportation Infrastructure, amongst other areas, to expand our market penetration across our full service offering.



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The second, as I mentioned earlier, is to expand our major projects business in Canada, U.S. and U.K. through risk-capped opportunities. We are also focused on expanding our Operations & Maintenance business, our water, environment and defence, in core geographies where we see opportunities to build our footprint. These efforts are underpinned by enhanced digital capabilities with improved productivity and delivery, and lower the carbon footprint for our clients.

The focus on digital transformation is closely connected to another key growth driver and a priority of the Company, which is sustainability. As engineers who design, build and service the build environment, we have an integral role in enabling countries and companies to meet their carbon reduction targets. As part of that effort, we have a comprehensive range of services around helping our clients in engineering net zero. Additionally, we are further developing our own ESG strategies and we will be sharing our targets with you in Q2.

In the second half of the year, we will also be ready to share the specifics around an overall growth strategy for the business as we head into '22 and we really look forward to sharing that with you.

With that, I will now pass the call to Jeff.

Jeff Bell:

Thank you Ian, and good morning, everyone.

Turning to Slide 17, as expected, the fourth quarter included a strong performance from SNCL Engineering Services while SNCL Projects experienced a significant loss. As announced on February 9th, Q4 2020 SNCL projects included an aggregate amount of \$480 million in charges, adjustments to provisions and claims receivable reduction, and a cost reassessment of the remaining Canadian LSTK Infrastructure projects. Capital Segment Adjusted EBIT totalled \$19 million compared to \$32 million and no dividend was received in the quarter from Highway 407.



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Corporate SG&A expenses totalled \$96 million and included \$48 million of negative adjustment to the provision for the Pyrrhotite case litigation, \$4 million of pension equalization provision and \$6 million invested in digital transformation initiatives.

All of this resulted in an IFRS net loss from Continuing Operations of \$323 million or \$1.84 per diluted share in Q4 2020 compared with a net loss of \$180 million or \$1.03 per diluted share for the corresponding period of 2019. The adjusted net loss from PSPM in Q4 2020 amounted to \$269 million or \$1.53 per diluted share, compared with an adjusted net income of \$110 million or \$0.62 per diluted share in the corresponding period of 2019.

Now looking at the segments in more detail, on Slide 18 we can see that SNCL Engineering Services delivered solid results and continues to be resilient through COVID-19. The Q4 revenue totalled \$1.5 billion, representing a 3% decrease compared to Q4 2019, in line with our expectations, but was 5% higher than Q3 2020. Segment Adjusted EBIT was \$153 million, lower than Q4 2019 but 7.5% higher compared to Q3 2020, and represented a margin of 10.1%, higher than our expectation. Backlog remains strong and totalled \$10.9 billion.

The EDPM segment revenue totalled \$943 million and its Segment Adjusted EBIT amounted to \$85 million, representing a margin of 9%, in line with our long-term target range of 8% to 10%. The EBIT amount was lower than Q4 2019, mainly reflecting the impact of COVID-19 across some markets such as aviation and commercial property, and lower revenue from the Middle East. This was partially offset by the strength of transportation and defence markets within the core region of the U.K. and Europe. EDPM backlog remained strong at the end of the year at \$2.9 billion, an increase of nearly 9% compared to the end of 2019.

The Nuclear segment revenue totalled \$245 million and the Segment Adjusted EBIT amounted to \$36 million, representing a margin of 14.8%, in line with our long-term target range of 13% to 15%. The EBIT amount was lower than Q4 2019, mainly due to a decreased level of activity on certain major



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Canadian projects that reached major delivery milestones earlier in 2020, partially offset by a higher contribution from the U.S. and Europe.

The Infrastructure Services revenue totalled \$334 million, largely in line with Q4 2019. The Segment Adjusted EBIT amounted to \$32 million, an increase of 58% and 27% compared to Q4 2019 and Q3 2020, respectively. The EBIT increase was mainly due to a higher level of revenue from certain Operation & Maintenance contracts, from higher activities on Project Management and Construction Management services, lower overhead costs and a higher contribution from Linxon.

Turning now to SNCL Projects on Slide 19, in line with our LSTK exit strategy and the expected continuing backlog runoff of our major LSTK construction projects, revenues for Q4 2020 continued to decrease. SNCL Projects revenues fell by 57% compared to Q4 2019 to \$152 million. The Resources and Infrastructure EPC project segments had negative Segment Adjusted EBIT of \$93 million and \$319 million, respectively, mainly due to charges, adjustments to provisions and claims receivable reductions, as well as the cost reassessment of the remaining Canadian LSTK infrastructure projects as we announced on February 9.

Moving on to Slide 20, net cash generated from operating activities was \$122 million in 2020 compared to a use of \$355 million in 2019. Net cash generated from operating activities was \$105 million in the quarter compared with \$312 million in Q4 2019 with the lower cash generation primarily driven by a usage of cash from Discontinued Operations in Q4 2020.

SNCL Engineering Services continued to generate strong cash flow from operations of \$250 million in the quarter due to strong EBIT conversion and a low days sales outstanding in the EDPM segment of 64 days, a nine-day improvement compared to 2019.

For 2021, the strong operating cash flow attributes of SNCL Engineering Services are expected to partially offset by our return to a more normalized days sales outstanding level as the early government payment programs related to COVID-19 are expected to wind down during the year. In addition, SNCL



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projects are expected to see a usage of operating cash flow as a result of the significant backlog to be run off during the year and the timing of the collection of COVID-19 related claims. As a result, operating cash flow is expected to be largely breakeven this year.

At the end of December 2020, the Company had \$933 million of cash and its recourse debt remained stable with December 2019. The Company's net recourse debt to EBITDA ratio on the revolver credit facility calculated in accordance with the terms of the Company's credit agreement was 2.1 times, well below the required covenant level of 3.75 times.

And finally, turning to Slide 21, the Company expects that SNCL Engineering Services revenue for 2021 should increase by a low single-digit percentage compared to 2020. As the COVID-19 pandemic only started to significantly impact the business in Q2 2020, the Company expects a low single-digit percentage contraction in SNCL Engineering Services revenue for Q1 and then year-over-year revenue increases in the second, third and fourth quarters this year. We also expect SNCL Engineering Services Segment Adjusted EBIT margin to be between 8% and 10%, and continue to target the same long-term EBIT margin percentage for each segment.

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.

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

Yuri Lynk:

Hey, good morning guys.

Ian Edwards:

Good morning.



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Yuri Lynk:

Ian, just on the outlook for '21, as I think you and Jeff mentioned, the margin guidance is pretty much in line with what we've seen the last few years out of our Engineering Services, which is great in this environment, but wondering what levers you can pull going forward to improve the margins of Engineering Services and maybe tie that question in with some of the digital initiatives that you mentioned on the call and how that might translate into better margins going forward.

Ian Edwards:

Thanks for the question. I mean, I think the key thing for us as we have now kind of moved from de-risking the business into focused now on growth, particularly focused on organic growth, I think that maintaining margin levels is important and obviously ongoing optimization of cost is important, particularly through the things that we've learned in COVID such as remote working and digital technologies that reduce the amount of people content, but we really are focused on channelling our efforts into leveraging from that into organic growth. Beyond this year, that's what we see as one of our key priorities.

That isn't to say that of course we're not looking at making efficiencies, of course we are. But margin expansion is not particularly our core focus.

Yuri Lynk:

Okay. You also mentioned that EDPM has a growth focus in the U.S. where you'd like to be bigger. Is that a solely organic plan at this point, or when might you start contemplating some acquisitions, tuck-in or otherwise, to grow in some of the markets that you might be set to scale?

Ian Edwards:

Good question. Well, for sure it's both. The key right now for us is organic growth, and it's not just EDPM. I mean we see our business primarily focused on infrastructure in the southern states, and we have a drive to look to build on that through growth in the Northwest and the Northeast and California.



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We have obviously very strong Nuclear environmental management business with the Department of Energy and we see really strong growth potential from that. That's obviously all from an organic perspective, and we see great kind of potential from federal government investment, particularly the rhetoric around the new administration.

Beyond that, we will be putting together towards the second half of this year a capital allocation plan and our longer-term plan that we will communicate at that moment, but our priorities really right now is organic growth, closing the Oil & Gas, continuing to run off our LSTK, continuing to perform and continuing to have good cash conversion from the businesses we've got.

Yuri Lynk:

Okay. That all makes sense. I'll turn it over and get back in the queue. Thanks, guys.

Ian Edwards:

Thank, Yuri.

Operator:

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

Chris Murray:

Yes, thanks. Good morning, folks.

Ian Edwards:

Good morning.

Chris Murray:

Just thinking about 2021—and thank you for the detail on the guidance and the pattern—but just thinking about the billion dollars that you talked about consuming in terms of a backlog for the remaining LSTK project, how should we think about that now that you've made the adjustments and



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writedowns? How should we think about that through '21, in terms of both either margin or cash use and just a pattern of revenues?

Ian Edwards:

Okay, you mean from specifically the sector of the LSTK business, right?

Chris Murray:

Exactly, yes. I'm just trying to figure out if we kind of have the surprises behind us.

Ian Edwards:

Yes, yes, okay. Let me get Jeff to explain about the cash flow, but clearly, from a margin perspective and a risk perspective, I think as we said on the 9th for these three jobs, I mean we're down to three jobs now, we're down to the Trillium, the REM and Eglinton. We are working through these jobs. We've got a good line of sight into these jobs. They've been affected by COVID. We chose not to take revenues against COVID, even though we feel we've got entitlement. We actually believe these jobs are in good shape for us as we move through this year and obviously move to close them out.

Specifically, to the cash profile, I'll just ask Jeff to talk to that as we work through them.

Jeff Bell:

Yes. I think the first thing I would say, from a revenue perspective, they're broadly equal over the four quarters, slightly more weighted to Q2 and Q3 because it's the summer months and it's easier to deploy more of particularly the construction element of them in the summer months. A bit of a weighting that way.

From a cash flow perspective, as you heard me say, we do expect them to be at an operating cash flow level to be a usage of cash in 2021, and that's really driven by two things because, overall, of those remaining projects we do expect them to be as a portfolio cash flow neutral to positive over their life, but in 2021 the combination, as we talked about on February 9, of continuing to have a prudent



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demeanour around COVID related costs and our ability to claim those back from the clients, which we think we're contractually entitled to, but staying prudent in terms of not recognizing those revenues until we've got better clarity through either commercial negotiations or third party arbitration if that's what's necessary—and we'd expect that to continue at least certainly through the first half of this year as well—and putting that much delivery of backlog to work during the year also means that at different points in the year we'll be—our cash usage will be running ahead of the actual payment we profile from the joint ventures of the customers themselves; that obviously works out over time but a bit of a timing drag on that in 2021 as well. I think that's what the cash flow will continue to look like.

Chris Murray:

Okay, fair enough. Then just turning back to some of your commentary around even Q4's Infrastructure Services margin, you did talk a little bit about the fact that Linxon was a big contributor. Maybe even a little bit to Yuri's question, thinking about M&A and growth, how open are you to looking at maybe additional joint ventures? I know you've got a few of them right now as a way to maybe generate some additional growth but keep that risk kind of more manageable?

Ian Edwards:

That's a good question. The Linxon joint venture as a specific kind of business venture has been a real success for us because we've used the best of our project management skills with the ABB and now Hitachi ABB equipment, so it offers a total solution for our customers. One plus one is equal to three, so to speak.

I think one of the key areas that we see joint venturing going forward is in major projects. We really were pleased to see the win on the East-West Rail in the U.K. because this is exactly where we want to be positioning our capability to deliver major projects in the future. It's a liability capped contract for us so it's not an LSTK. We get paid based on an alliance kind of target cost basis. We work with two other joint ventures companies on that project to offer the customer the best solution and we win on that basis. I think what's exciting about that kind of arrangement is we're actually seeing that this collaborative risk-capped approach for delivering major infrastructure is being adopted in many, many



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other countries and with many other clients and governments, not least of which is Canada, Australia, some places in the U.S. and across the U.K.

What I think is that by repositioning ourselves into this kind of project, we can fill the space that's been left by exiting the LSTK and use our capability.

Chris Murray:

Okay. That's interesting. Thank you very much.

Ian Edwards:

Thanks.

Operator:

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

Frederic Bastien:

Thank you. Ian, just wondering if you're happy with the management team that you have in place to lead the three businesses and make up Engineering Services, or do you need to go out and recruit some additional talent?

Ian Edwards:

Yes. Well, obviously, as you will have seen in the last 18 months of me leading the Company as CEO, we've developed both talent within the business and brought that up to the leadership team and the team that reports to the leadership team. We also brought talent in externally at a senior level and talent just below the senior level.

For me, particularly in our growth plans going forward, having the best talent to be able to win and deliver work is really important, and I don't see it as like a static environment. I see this as dynamic and



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as we build other parts of the Company then we'll look to develop our own people and still bring in the best talent.

I'm very happy with the leadership team that we have in place right now, but it's a moving and evolving and growing kind of environment for me.

Frederic Bastien:

Okay. Thanks for that input.

My second question relates to the \$6 million that you made into new digital transformation initiative. Would you mind speaking to that investment, and more broadly, what are your goals for the Company when it comes to developing or requiring new technologies? Is it a mix of sort of developing that internally and potentially acquiring more businesses through tuck-ins?

Ian Edwards:

Yes. The way I see technology is an enabler to deliver projects for our customers in a more efficient and effective way. Actually, when you think about design, when you think about that design moving through to build, when you think about the build moving through to the operation of assets, whether they're power assets, nuclear assets or railways or infrastructure assets, technology is really the golden thread that runs through the whole process to enable us to deliver successfully.

The way we look at this as SNC-Lavalin is in marrying that technology to our ability that we've developed over many decades, to work with customers to deliver a whole asset. It's slightly different perhaps than you might have heard, but for us it is an enabler. So, where we've put the investment is actually in building teams and onboarding tools and developing people to be able to deploy those tools. It's not—we're not trying to be and invent new technologies because we believe that the technologies already exist, that they're already there. It's the adoption of them and being very capable in the application of them to benefit our customers that we see the real, real market and benefit for us.



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Frederic Bastien:

Thank you. Much appreciated.

Ian Edwards:

Thank you. Thank you. Thank you.

Operator:

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

Benoit Poirier:

Yes. Good morning, Ian and Jeff.

Ian Edwards:

Good morning.

Jeff Bell:

Good morning.

Benoit Poirier:

Thanks very much. I appreciate the colour about the free cash flow outlook for 2021, the fact that SNCL Engineering Services will be largely offset by EPC, but if we look beyond 2021, could you provide maybe more colour about what we should expect for the whole entity and specifically for Service Engineering in terms of free cash flow capabilities beyond 2021?

Jeff Bell:

It's Jeff. Why don't I take that one?

I think you're absolutely right, Benoit. I think 2021 is a bit of a transition year and there are a couple of things within there that we wouldn't expect necessarily to see going forward in 2022 and beyond. One



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is I talked about the days sales outstanding or the benefit we've seen from some of those early payment programs where some of that will unwind in 2021, sales tax deferrals we saw in a couple of countries will unwind, and I think we've talked previously about that being in the neighbourhood of \$100 million to \$150 million. You would think about that not being there in 2022 and beyond.

Therefore, the EBIT conversion percent naturally should be fairly high based on our normal tax rate of low 20%. You'd expect a pretty high EBIT percentage conversion in 2022 going forward. And obviously as the LSTK on the projects side run down and we get more clarity on claims related to COVID that we think we're entitled to and how that will play out. Again, when you get into 2022 you'd expect to see that much more normalized.

Benoit Poirier:

Okay, that's great colour, Jeff. Maybe any thoughts about the seasonality in terms of free cash flow. Let's say not on a quarterly basis but between first half and second half in terms of overall expectation for 2021?

Jeff Bell:

Yes, I think it will be more weighted to the second half than the first half. Obviously, we'll be doing—and as we have been through 2020, highly focused on cash flow, but the nature of it is such that we expect it to be more weighted to the second half than the first half.

Benoit Poirier:

Okay, that's great. Now, given the big announcement on February 9 with respect to the divestiture of the Oil & Gas business, how should we be thinking with respect to your remaining mining services business? Just wondering whether it would make sense to divest it and focus on core Engineering Services now that it's a much smaller portion of your business now?



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Ian Edwards:

Let's start—well, I mean currently we're looking to continue to grow that business as a services business in the mining and metal sector, and if you think about it, SNC-Lavalin kind of for a long, long time has been more kind of stronger and more weighted into mining than it ever was in oil and gas, so it's kind of part of the DNA of the business. But, you're right. I mean, we're very, very focused on specific clients. We're very focused on specific geographies. It's not a very, very major component of our Engineering Services businesses, but it is profitable and currently we remain supporting that and intend to grow it organically.

Benoit Poirier:

Okay. Okay, that's great, Ian. Last question for me. When we look at your leverage ratio you were able to get it to 2.1 times at year-end, and as we look through 2021 with EBITDA improvement in light of free cash flow expectation, how should we be thinking about your net recourse debt to EBITDA ratio in 2021 and what you would consider your optimal balance sheet longer terms in terms of leverage ratio and the opportunity to eventually deploy capital?

Jeff Bell:

I think I would answer that with two components, Benoit. I think the first is certainly we continue to see our—with the outlook that we've given to remain well within our covenant ratio metrics throughout the year. As it did in 2020, we'll likely vary around somewhat but should be well below any of our thresholds.

I think longer term, and we'll come back to this in the second half, as Ian said, when we talk more about our longer term growth strategy and the capital allocation that goes with that, and that will include the capital—what we see as the optimal capital structure of the business going forward, but I think as you've heard us say a number of times, I think we would continue to want to move towards having financial metrics that are consistent with being an investment grade company, for instance, from a balance sheet perspective, but how that fits in with our overall growth strategy and how we think about the deployment of capital, we'll come back to that later in the year, for sure.



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Benoit Poirier:

Okay, that's great. Thanks for the time.

Ian Edwards:

Thank you.

Operator:

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

Michael Tupholme:

Thanks. My question relates to the 2021 outlook you provided for SNCL Engineering Services. You're calling for low single-digit revenue growth this year. Wondering if you can take that one step further and just talk a little bit about the sub segments and how you expect those to perform in terms of EDPM, Nuclear and Infrastructure Services.

Ian Edwards:

Yes. Clearly the low single digit is a reflection of where we are right now. I mean, we're still in the pandemic and it's somewhat difficult to understand exactly when normality will prevail, but we would expect that growth will start returning to something a little bit more normal in the second half of this year.

We also see that in our core geographies—and our core geographies are Canada, the U.S. and the U.K. where almost 75% of our business is currently located, the go-forward business. All of those geographies have a very, very high commitment from governments to invest in infrastructure and there's a high commitment to invest in certainly nuclear in a different way in each geography. I mean, nuclear new build in the U.K. as well as environmental management, nuclear environmental management in the U.S., and life extension and environmental management in Canada. Our end



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markets in our core geographies, we see pretty solid commitment and pretty strong growth opportunities.

I wouldn't pick particularly any difference in how we see those particular segments in terms of the low single digit for this year. But what we will do when we come back with our longer term growth plan in the second half of this year, we'll be clear about that and where we see the most growth potential, and the sub segments to those sectors, if you like.

Michael Tupholme:

I appreciate that. Thank you.

Just similarly in terms of the outlook for 2021 in terms of the margin expectations, I think if we look at 2020 EDPM came in around the 8% level, so sort of toward the bottom end of the range you provided for 2021. Is it reasonable to think about the midpoint of that range and think about expecting some improvement in EDPM in 2021? And what would be the factors that would sort of drive that improvement, if that's the case?

Jeff Bell:

It's Jeff here. Maybe I'll take that one.

I think I'd point you to in 2020 EDPM had quite a challenged first quarter from an EBIT percentage perspective. If you looked at Quarters 2, 3, and 4, those would be much more representative of what we would consider to be the quarter-over-quarter EBIT percentages and much more in the mid part of the range of the 8% to 10%. I think 2020 overall was impacted by that first quarter which we wouldn't necessarily see repeating this year.

Michael Tupholme:

Okay. Thanks for that, Jeff.



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Then just one last one. I didn't see anything in particular mentioned about this in terms of any changes, but can you just provide an update on the last remaining Mining & Metallurgy LSTK project. I think it's supposed to be done in Q2, but just any update there and whether or not you see any areas of remaining risk there.

Ian Edwards:

No, it's progressing well. It's \$75 million, I think, from the end of the year backlog, which we look to close in Q2, the middle of this year. So far, there's nothing unusual to report about that project. It's going well.

Michael Tupholme:

Okay. Thank you.

Operator:

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

Devin Dodge:

Thanks. I wanted to come back to Infrastructure Services. Margin performance in Q4 was really strong, I mean nearly 10%. I'm just trying to better understand what's driving that margin performance in Q4 and just generally in 2020, and why the guidance of 5% to 7% next year, essentially implies some margin compression next year.

Ian Edwards:

Yes. I mean, Infra Services has got a few different components to it, which Linxon is the joint venture company with ABB. All our Operations & Maintenance business is within Infra Services, and then we've got the services part of it which really provides services to hydro and power, to the medical industries and to industrial solutions. In fact, all of those kind of performed very, very well and have been very resilient, if not even received good wins through the COVID period because of the very nature of those



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businesses. So, for sure, they are performing very well, and as you rightly said, performed particularly well in the last quarter.

Just on the specifics of the quarter margin, I'll just ask Jeff to talk to that.

Jeff Bell:

It was very strong, and you're right, Devin, we wouldn't expect necessarily to see that on an ongoing basis. It was a combination of a few things. It's a business that has a smaller overhead base and they were particularly effective at reducing costs that we saw in the quarter. Some of that was COVID related so that was good to see; not sure that we would see that carrying on, particularly as hopefully we come out of COVID later through the year. We also saw some good delivery on some of our O&M projects where we realized better margins on a few of those key projects. Again, that was specifically related to circumstances in 2020. On an ongoing basis we'd expect those to return to a more normalized level in the 5% to 7% range.

Devin Dodge:

Okay. Thanks. That was good colour. Maybe just another one for you, Jeff. There continues to be a lot of cash on the balance sheet. I think it was just under a billion dollars at year-end. Can you provide some colour on that cash balance? Is that the right amount or is there an opportunity to streamline that cash position and maybe put that capital to work in other areas of the business?

Jeff Bell:

I think it's a good question. You wouldn't be surprised. Our demeanour in 2020 has been around financial flexibility and liquidity, particularly in a COVID environment. I think as we look going forward though, we see more confidence in terms of being able to maximize the efficiency of our cash on the balance sheet. I'd make a couple of observations.

There's a natural level of cash, particularly with the large infrastructure projects that we have, as well as the Oil & Gas business and the scope and breadth of that, that I would say our kind of natural cash



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balance is naturally in the sort of somewhere between—around \$600 million-ish is what we would normally expect because of the way some cash is tied up in joint ventures or is in different parts of the world or is needed for the working capital requirements of things like infra projects. Therefore, we do have some level of excess cash, but we'll be looking to see, for instance, how we deploy that. In the first quarter here we have a small debenture bond coming due. At this point we wouldn't necessarily see retaking that into the market, so there's different ways we may look to bring that cash balance down to optimize where we are. But the business does have a reasonable level of working capital in terms of cash that it requires.

Hopefully that helps.

Devin Dodge:

That was helpful. Thank you very much. I'll turn it over.

Ian Edwards:

Thank you.

Operator:

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

Mark Neville:

Hey, good morning guys.

Ian Edwards:

Good morning.

Mark Neville:



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I just want to follow-up on the cash flow conversation. I want to make sure I'm sort of understanding all the puts and takes. Jeff, you mentioned, I think, \$100 million to \$150 million was it tax? Was that just tax or was that sort of the working cap investment for the year?

Jeff Bell:

It's a combination of working capital, primarily related around days sales outstanding. I think as we noted in the MD&A and I noted in my script, we were about nine days better. We were down at 64 days in EDPM, for instance, whereas more normalized, we'd expect to be in the low 70s. So, we do expect that to return to a more normalized level in the low 70s. Don't get me wrong. We're looking at all opportunities to improve that sustainably over time, so if we can find—and are working on working capital initiative to try and release cash from the balance sheet, but I think our view is to be prudent you would assume that would return to something that's more normalized.

That kind of accounts for \$75 million to \$100 million-ish in terms of cash flow benefit in 2020 that you'd expect to unwind in 2021.

I think the second element is that we did see, for instance, there was a U.K. VAT deferral program for the middle of 2020 that the government had announced as part of helping businesses around COVID-19 and cash flow, and that effectively deferred the payment of that VAT tax out until 2021, largely, and we saw a bit of that in the U.S. as well. That's where the kind of combination of those you get up into the upwards of \$150 million.

Mark Neville:

Okay, so the 150 is tax and working cap. It just seems to me that I guess with sort of neutral operating cash flow that the drag from the projects seems quite significant. I mean, I wonder if you can maybe—maybe my math is off, but maybe you can provide some numbers around sort of what you're expecting the investment for the projects this year.



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Jeff Bell:

Yes, I mean I think—I think what my observation would be that it is and our expectation it is negative and largely offsetting what we see in Engineering Services, but obviously part of that is at an early stage in the year here we're continuing to have a prudent demeanour around things, as I said, like our recovery of COVID-19 claims on those projects, and as I think the year unfolds I think we'll get more clarity on that and then our ability to both book the revenue related to those and see the cash coming in will allow us to then assess where we are as we go through the year.

I think that's the colour I'd provide at this point.

Mark Neville:

Okay. Okay. Maybe on the leverage, just so I'm clear, the 2.1 times, are you making—do you get to sort of exclude all the claims and provisions that you took in Q4 from that calc, or was that actually still included in the EBITDA?

Jeff Bell:

We excluded what we considered to be the one-off items in that calc, which would primarily be the Oil & Gas fair value adjustment, as well as the adjustments that we made for legacy litigation matters and claims reassessments. What we didn't exclude, because we consider it part of the ongoing operations of the business, is primarily the \$90-odd million charge we took on the live projects here in Canada, and then a smaller component that was related to the one remaining Resources project.

Mark Neville:

Okay. All right, I'll turn it over. Thanks.

Ian Edwards:

Okay, thanks.



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Operator:

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

Sabahat Khan:

Great. Thanks and good morning. Just a question on you highlighted this kind of a JV model that you're undertaking projects in and I think you highlighted the one here in the East-West Rail project. I'm just trying to understand, I guess, how would this project—how would this have been done in the past, I guess? If you are on the design side here, would there have been some risk in the past? What does this new project structure mean for the risk profile relative to what we would have seen in past on the EPM side?

Ian Edwards:

These alliance or target costs or collaborative contracting models if you want a catch-all for all of it, I mean there's various kind of nuances to the theme, but the major difference is the liability is capped from our perspective. Our fee would be at risk, but beyond the fee we would not have any liabilities for cost overruns or time overruns of any sort of events. Traditional kind of lump sum turnkey contracts, you're liable for any cost overrun, and you've obviously got to claim anything that you think is recoverable from the client. That's why a lot of these things end in litigation.

The model is completely different, and I think it's becoming pretty much recognized by a lot of governments and a lot of clients that actually this lowest cost wins LSTK model is not delivering the outcomes that really we're all looking for. We're looking for jobs to be complete on time. We're looking for them to be more sustainable from an energy and client impact perspective. We're looking for them to be innovative, and this type of model enables all of that and it enables companies like SNC-Lavalin who have a very, very large breadth of capability to apply all of these capabilities to the customer for the best outcome.

We're seeing a number of them; we see them here in Canada, British Columbia, Ontario. We're seeing contracts come out under this form. The nuclear sector, most contracts are awarded on that basis



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simply because in the nuclear sector the clients don't want to put time and cost pressure into the process because safety is paramount. We see this as a very, very key growth area for SNC-Lavalin. We're quite excited at the prospects of being able to pivot from LSTK to this lower risk model.

Sabahat Khan:

Okay, great. Then just on the Nuclear side as we kind of come out, hopefully at some point this year, from the pandemic, can you maybe talk about the progress of work on your existing projects, and over the course of 2020 did you find continued progress and discussions on the nuclear saddle (phonetic 57:34) in the U.S., U.K. or Canada? How are you kind of feeling about that broader market as we head in to 2021?

Ian Edwards:

Yes. It's different—in each of our three core geographies it's slightly different. If we start with the U.S. first, it's really about environmental management. It's about cleaning up nuclear waste and decommissioning power plants. We're seeing that the Department of Energy have a really strong commitment to continuing to invest in that clean-up with some very, very significant contracts, not least of which the Hanford one that we won in 2020, and in fact, an extension to an existing contract in 2020. We see that as an important component.

In the U.K., I mean obviously we're involved in the new build in Hinkley, and I think it's a likely that new build will continue in the U.K. through to Sizewell, and that's a very significant opportunity for us as well as decommissioning and helping some clients actually keep their power plants running for life extensions, through engineering contracts.

Then, Canada is all about our CANDU technology and supporting reactors around the world from the CANDU technology, but also the reactor life extension work that we're doing at Darlington and Bruce.

I think you think about all of those different components and the market that's out there, the potential for growth in our particular sectors within the end markets within Nuclear is quite strong.



Sabahat Khan:

Okay, great. Then on the Infrastructure EPC side, obviously you've taken a number of provisions related to some projects where you are having discussions with the client. Can you maybe walk us through what we could expect if there was a recovery or partial recovery? Maybe from the accounting side, would there be a revenue recognition and then the costs, and I guess the full kind of income statement recognition? Or would there just be a EBIT or EBITDA flow through? If you can maybe walk us through what it could look like if there is a positive recovery at some point? And maybe any visibility on timelines there over the course of the next year or two.

Ian Edwards:

Let me answer half of that and let Jeff come in on the specifics of the revenue margin recognition.

I think the first thing I'd say is, you're right. I think we've taken a prudent approach to COVID recovery on all three of the jobs that we have going, and clearly the jobs have been impacted and clearly there's vehicles through the contract for us to claim that loss.

The burden of proof is on us, so we have to go through a process with our clients—hopefully through a negotiation, not litigation—to really pursue those recoveries and pursue those entitlements, and it's complex because they're very, very huge, large contracts with lots of kind of moving parts and labour, and the impacts are complex to prove from a productivity perspective. I wouldn't want to get into a commitment as to when we're going to see those recoveries, but we are in good, positive kind of dialogue with our customers.

Then, Jeff, perhaps just on the specific, how you see that.

Jeff Bell:

Yes, I mean we would expect obviously to book the revenue at the point at which we have resolved those with the client. It is subject because we account for this project on a percentage of completion



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basis, effectively the revenue goes into the total expected revenue on the project overall and then the revenue and the costs and the margin that fall out of that are accounted for in that way. So, you wouldn't necessarily see the—assuming there is a settlement at some point, you wouldn't necessarily see all of that in that particular quarter, but you would see it coming through over the remainder of the life of the project.

Sabahat Khan:

Okay, great. Thanks very much for the colour.

Ian Edwards:

Thank you.

Operator:

Our next question comes from Mona Nazir of Laurentian Bank. Please go ahead.

Mona Nazir:

Good morning and thank you for taking my questions.

Ian Edwards:

Good morning.

Mona Nazir:

Just firstly, in regard to the forecast for SNCL Engineering Services, the low single-digit growth, you did touch on federal stimulus in your core markets, the U.S., Canada and the U.K. I'm just wondering if the guidance has stimulus factored in or a significant amount? Just some colour around that.

Ian Edwards:

Yes, okay. That's a good comment and I think you'd probably say no because we're still in the pandemic and we're still trying to understand what the exit to the pandemic looks like, and we're still



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trying to understand when that might be in each of those core geographies, and it's somewhat kind of dynamic and somewhat unspecific at this time.

For sure, I mean you look at the current commitment for the infrastructure bill in the U.S., that will get passed at some point and that will be very significant, and I would expect that the improvement and the flowthrough will probably not happen this year. I mean, if it is this year it's going to be towards the end of this year.

In the U.K. and Canada, I mean there is an ongoing commitment and all the way through COVID we've seen new contracts and new investment. But likewise, there's some fairly major projects out there, particularly in Canada, that I don't think we're going to see the revenues flowing this year but we are going to see revenues flowing beyond this year.

I think the real impact and the benefit that we're going to see is probably beyond this year, just to try and give an overview of that question.

Mona Nazir:

Okay, that's great. Then just secondly, looking at the pro forma business from a geographic footprint and mix perspective, I do understand that you've stated you're working through the capital allocation plan later in the year, but I'm just wondering if we could expect a material shift from here? Could the U.S. be a significantly larger percentage of the mix for you going forward? I'm just wondering, given the move to sell Oil & Gas was in fairly rapid order, could we similarly see a fast trigger pulling if you come upon an acquisition opportunity, or is it really just organic growth story at this point?

Ian Edwards:

For sure, the U.S. is a key focus, undoubtedly. I mean, 20% of our business currently comes out of the U.S. where it's 30% and high 20s in the U.K., so for sure with 5,000 people there we're not at the scale of our peers. We see significant opportunity both in the Nuclear and the Infrastructure, so yes, I think the very simple answer in the U.S. is yes, you're going to see organic growth.



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As far as our inorganic growth plans and where we might apply that capital, we will come back and be a lot clearer about that, but it's going to follow the end markets and the geographies that we see as opportunities right now. I mean, the trajectory of the Company is not going to change; it's going to sooner enhance it.

Mona Nazir:

Okay, that's great. Thank you for that.

Just lastly for me, I know you've spoke about investments on the IT side. I'm just wondering from your perspective if you think there's been an acceleration for IT to be married or weaved into the offering. With work-from-home environment, do you feel that customers are having more demands, or is it really capability requirements that you feel are needed, or are competitors offering more forward-looking solutions? I'm just wondering if you could speak a little bit more about the current and potential future IT investments and the drivers of such. Thank you.

Ian Edwards:

Yes, well, I think our sector, the engineering and construction sector, is generally seen as a slow adopter of technology, digital technologies, use of data, and I think obviously through COVID the whole remote working and the whole kind of thought process of how technology can assist the building process has become a lot more kind of focused, both from the industry itself but also from what customers are looking for. I see all of that as an opportunity. I see all of that for SNC as an opportunity because we've got the basic abilities, certainly within the Atkins acquisition we did in '17 and the way that we've fostered that and built upon that within the Company, so I see this as a space to offer our capabilities, yes.

Mona Nazir:

Okay. That's it for me. Thank you.



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Ian Edwards:

Thank you.

Operator:

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

Denis Jasmin:

Thank you very much for having joining us today. If you have any further questions, please don't hesitate to contact me. Have a beautiful day, everyone. Thank you very much. Bye-bye.

Ian Edwards:

Thank you.

Jeff Bell:

Thank you.

Operator:

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