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Second Quarter 2023 Results

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

Operator:

Thank you for standing by. This is the conference operator. Good morning, and welcome to SNC-Lavalin's Second Quarter 2023 Results Conference Call.

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

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

Denis Jasmin:

Merci Ariel. Bonjour tout le monde. Good morning everyone, and thank you for joining us today. For those dialing in, we invite you to view the slide presentation that we have posted in the Investors section of our website, which we will refer to during this call. Today's call is also webcast.

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 assumptions, risks and uncertainties and, as such, actual results may differ materially from the views expressed today. For further information on these assumptions, 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 financial measures. Reconciliation of these amounts to the corresponding IFRS financial measures are reflected in our earnings release and MD&A, which can be found on SEDAR+ and our website.

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

Ian Edwards:
Thank you, Denis. Good morning, everyone, and thanks for joining us today.

We are very pleased with our performance during the first half of the year, as results were strong across all our businesses. Our "Pivoting to Growth" strategy, which has been our guide as we grow into a premier Professional Services and Project Management company, is really taking shape.

Performance this past quarter reinforces the benefits of this strategy and positions us well for long-term value creation. SNCL Services continue to grow, expanding revenue by 22% year-on-year, significantly outperforming our full year outlook range of 5% to 7%. Segment Adjusted EBIT grew 15% or $21 million as we continue to manage our costs to deliver our targeted margin percentage.

We achieved another record backlog this quarter, totalling $12.4 billion as at June 30, as demand for our services remains very strong in our core and end markets and geographies. Given our strong year-to-date performance, robust backlog and the pipeline of prospects, we are raising our SNCL Services organic revenue growth outlook for the full year to between 12% and 15%.

We also continue to successfully add high quality talent in the quarter, increasing our headcount by approximately 2,400 employees since the beginning of the year.

Subsequent to quarter close, we made progress against our strategic review through the sale of the Scandinavian Engineering Services business to SYSTRA Group, a France-based engineering and consulting group specialized in public transport and mobility solutions. We expect the transaction to close before the end of the year.

Our success this past quarter and the opportunities we see ahead further emphasize the strength and resilience of our business and is driven by the global focus on sustainable infrastructure, energy sources for the built environment. We continue to have great confidence in our forward-looking trajectory and we are well on track to achieve our newly elevated outlook for '23.

On Slide 4, we highlight our backlog growth across SNCL Services. Our 9% growth in the second quarter of 2023 versus the second quarter of last year was mainly driven by wins across our Engineering Services and Nuclear businesses. We are seeing key wins across many of the markets in which we operate, including transportation work in the U.S., building infrastructure development in Saudi Arabia, and asset management and nuclear life extension work at home, here in Canada. The wins highlighted on this slide demonstrate our ability to deliver growth now, and in the future.

Turning to Slide 5. Our Engineering Services business continues to drive robust organic growth for SNCL and saw significant year-over-year revenue growth of 25% during the second quarter. Our record revenue generation for this quarter was driven by continued growth in the U.S., one of the pillars of our "Pivoting to Growth" strategy, along with strong performance in the U.K., Canada and the Middle East. We also saw sustained performance in Australia and Asia, further demonstrating the resilience of our business in the region. Increased volume and productivity across the U.K. and Europe contributed to the profitability improvement in the quarter.

Segment Adjusted EBIT margin and segment Adjusted EBITDA over net revenue margin were 8.5% and approximately 14%, respectively, during the quarter. We continue to achieve record backlog results, which now stands at approximately $5.1 billion, representing 22% growth versus our backlog as at June 30, 2022.

On Slide 6, we provide further insight into each of our core geographies of the U.K., the U.S. and Canada. In addition to organic revenue growth, we also won several key wins across these markets that touched all of the Engineering Services that SNC-Lavalin provides.

In the U.K. and Europe, we saw continued revenue growth, which speaks to our position as strategic partners to governments as they focus on transportation, defence and water. Performance this quarter in these markets was driven by increased volume, productivity and profitability.

In the U.S., we continue to reap the benefits of our increased foothold in the market, and the government's commitment to infrastructure spending. This past quarter, we secured key wins in Transportation, Buildings &Places and Defence. Looking out, these opportunities in the U.S. are plentiful, backed by the U.S. commitment to spend more than $100 billion over the next five years.

We have strong confidence for near-term and long-term opportunities in Canada, as the government plans to spend close to $15 billion until 2029 in reliable, fast, affordable and clean public transport. We are also at the forefront of supporting projects related to the development of EV batteries as proven by a key win this quarter. Long term, there is a focus on reducing GHG emissions by 90% by 2050, which will lead to further contract opportunities for SNC-Lavalin.

Global demand for our end-to-end services remain robust, driven by generational investment in infrastructure and climate resiliency and reshoring of manufacturing and the energy transition. We are successfully attracting and retaining top talent to support our growth pipeline. Future opportunities and our focus on operational excellence sets us up for top line and bottom line growth in our Engineering Services business across each of our geographies.

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

We demonstrated strong growth in the quarter, with an organic revenue increase of 11% compared to the second quarter of 2022. Our Nuclear backlog has also grown to $1.1 billion, which represents a 38% growth versus our backlog as at June 30, 2022. Operating margins fell to 13% due to changes in the business mix of Nuclear segment this quarter. Nuclear represents a significant opportunity for SNC-Lavalin, and our position in the marketplace. Our robust revenue and backlog growth further confirms that we are well positioned to capture long-term benefits as leaders in this thriving nuclear energy space.

On Slide 8, we highlight achievements in each of the Nuclear services that we provide.

Nuclear new-build represents a near-term and long-term revenue generating opportunity for SNC-Lavalin. The recent announcements by the Ontario Government in which they plan to build three Small Modular Reactors at the OPG Darlington site and their proposal to expand the Bruce Power Nuclear Station, are just two examples of how governments are acting on their commitments to Net Zero.

We remain active in reactor support and life extension projects, as indicated by our work across many of the core geographies. In Ontario, we continue to be actively supporting CANDU life extension work at the Bruce Power site, where we recently signed a 10-year commitment to life extend the remainder of the reactors. Our CANDU technology and proven success in life extension allow us to capture new opportunities, such as the recent announcement by Ontario Provincial Government approximating the extension of Pickering Nuclear for a further two years.

On waste management and decommissioning, we're seeing continued progress on our projects in the U.K. and in the UAE and have a strong pipeline of prospects in the U.S.

We are increasingly excited about the long-term growth potential of our Nuclear business, given our expertise and our recognition as a trusted engineering and delivery partner. We are consistently harnessing our capabilities across the globe to continue to set SNC-Lavalin up for further nuclear contract wins.

Now moving to Slide 9 and our O&M and Linxon businesses.

Our O&M segment generated $99 million in revenue during the second quarter, a 7% organic revenue decrease, mainly due to the completion of a large contract that offset revenue generated from new projects. Segment Adjusted EBIT margin was 8%, above our long-term target of 5% to 7%.

We continue to see opportunities for growth and expansion in Canada and the U.K. through wastewater facilities and building and road infrastructure improvements. We're also utilizing our strategic partnerships with key industry players and leveraging our Capital group to maximize bidding opportunities for future growth in core markets.

Our strategic review regarding Linxon remains ongoing, and we will provide an update, when applicable. Backlog increased by 16% to approximately $1 billion at the end of the quarter. The quality of the backlog should lead to an increase in revenue over the back half of the year and a segment Adjusted EBIT margin percentage closer to the low end of our outlook range in Q4. This market actually remains very strong with good opportunities, particularly in the Middle East and the U.S.

Moving to Slide 10 and our LSTK Projects and Capital business.

We recognized $13 million in losses in the quarter, in line with our expectations. As we finalize the LSTK projects for our clients, we continue to pursue recoveries that are owed to us. A significant portion of additional costs related to the pandemic, supply chain disruption, inflation, labour strike action, should be recoverable under the contracts we have with our customers, and discussions remain ongoing as we vigorously pursue recovery of these losses.

Testing and commissioning on our two Ontario projects is proceeding as scheduled. Our last project, REM, continues to progress well, with the South Shore portion having successfully opened on July 31.

Turning to our Capital business. Second quarter revenues and segment Adjusted EBIT both grew significantly versus the second quarter of 2022, as we received $10 million in dividends from our holding interest in the Highway 407, compared to no payment received this quarter of last year. In July, we received another $10 million in dividends. Traffic volumes continue to accelerate as more workers return to the office. Volume grew by 18% compared to the second quarter of 2022.

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

Jeff Bell:
Thank you, Ian, and good morning everyone.

Turning to Slide 12, total revenue for the quarter increased 14% to $2.1 billion compared to Q2 2022. SNCL Services revenue totalled $2 billion, 21.8% higher than 2022 or 17.7% on an organic revenue growth basis.

Total segment Adjusted EBIT for the quarter was $178 million, a 48% increase compared to Q2 2022, and was comprised of $167 million for SNCL Services, $24 million for Capital, and negative $13 million for LSTK Projects. SNCL Services Adjusted EBIT margin was 8.5%, in line with our target range of 8% to 10%.

Corporate SG&A expenses from PS&PM for the quarter were $29 million, while restructuring and transformation costs were $7 million.

Net financial expenses for the quarter were $43 million, higher than Q2 2022 due to a higher level of gross debt and higher interest rates on variable rate debt. We expect this level of quarterly expense to continue for the next two quarters.

The IFRS net income from continuing operations this quarter was $64 million, compared to $2 million in Q2 2022. This was composed of a net income of $50 million from PS&PM and $14 million from Capital.

Adjusted net income from PS&PM for the quarter increased by 34% to $72 million, representing $0.41 per diluted share, compared to $0.31 in Q2 2022.

Backlog at the end of the quarter totalled $12.8 billion, an increase of 5% compared to June 30, 2022, as the $1 billion increase in SNCL Services backlog was partially offset by a $400 million decrease in the LSTK Projects backlog, as we continue to progress on our LSTK exit strategy. SNCL Services backlog increased by 9%, and included a 22% increase in the Engineering Services segment, and a 38% increase in the Nuclear segment. Engineering Services and Nuclear were awarded $1.7 billion and $376 million of work in the quarter, representing a book-to-bill ratio of 1.17 and 1.53, respectively.

If we now turn to Slide 13, at the end of June 2023, the Company's net limited recourse and recourse debt was $1.7 billion and the net limited recourse and recourse debt to Adjusted EBITDA ratio was 3.1 times. This ratio is above the Company's target range of 1.5 to 2 times at the end of 2024, but we remain confident that we will be meeting the target at that time. Note that under our credit agreement the net debt-to-EBITDA ratio is calculated differently, and at the end of June 2023 was approximately 3.0 times.

Due to our continuing efforts on cash collection, our day sales outstanding for Engineering Services continues to be strong and stood at 61 days at the end of the quarter, broadly in line with the past quarters.

If we now move on to Slide 14 and free cash flow, as expected net cash generated from operating activities was negative in the second quarter mainly due to the cash outflows from LSTK Projects. As previously disclosed, we expect a positive net cash from operating activities in the second half of the year, with the expectation that it will be more weighted towards the fourth quarter, as the LSTK projects supply chain continues to be paid out and testing and commissioning activities continue in Q3. We are also actively pursuing claims associated with the increased cost we've experienced on the LSTK projects.

SNCL Services generated cash flows of $70 million in the quarter. After cash taxes, interest, corporate items and capital, you can see that we used $46 million of operating cash flows in the quarter, and including LSTK Projects, $156 million.

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

Ian Edwards:
Yes, thank you, Jeff.

We concluded the first half of the year on a positive note, with strong revenue and operating profit generation, as we continue to execute on our “Pivoting to Growth” strategy. We're strongly positioned with a leading presence across our core markets of Canada, the U.S. and the U.K., and we continue to see multiple opportunities for long-term value creation for SNC-Lavalin across all of these core geographies and our end markets.

And we are winning through our unique competitive differentiators and our ability to fully service the entire lifecycle of an asset – from consulting to design, all the way through to O&M and decommissioning. We are a proven, trusted partner with our clients, which bodes well for our future opportunities to capture key contract wins across our core businesses, as the world positions itself to lower its carbon footprint through sustainable infrastructure and clean energy solutions.

Lastly, we successfully increased our headcount by approximately 2,400 employees since the beginning of the year, and we have a strong, dedicated and growing workforce that helps us achieve these goals. I am thankful everyday for their loyalty and their diligence.

With that, let's open up for questions.

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. We will pause for a moment as callers join the queue.

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

Jacob Bout:
Good morning.

Ian Edwards:
Good morning.

Jeff Bell:
Good morning.

Jacob Bout:
So, strong organic growth in the quarter and I guess in first half. It appears you're outperforming your peers. What do you think is driving this outperformance? Is this a mix or are you seeing higher run rates or what would you attribute that to?

Ian Edwards:
Yes. Yes, thanks for the question. Clearly, we're pleased with the results that we're getting. I mean, it's all about our strategy and it's all about the “Pivoting to Growth” strategy that we've put in place and communicated back in '21 when we had the Investor Day. When we positioned this Company, deliberately, in markets where we believe that governments are going to invest in the replacement of aging infrastructure and the investment in new cleaner infrastructure in addition to assets that are needed for the energy transitions in Net Zero 2050, when you think about those geographies that we're particularly focused on, 80% U.S., Canada and the U.K., the budgets from those countries and their commitment to spend on those issues has really increased since we actually put the “Pivoting to Growth” strategy in place.

I think there's a couple of other key elements here in that, we are weighted towards government work deliberately, because we see that as a resilient strategy and we see that as less cyclical, particularly with the need to meet Net Zero. But also, the nuclear resurgence, the nuclear power that is coming back as a true alternative to clean power is really boosting our Nuclear business.

So, all in all, I think that the deliberate positioning of the Company and our "Pivoting to Growth" strategy is working, and we're pleased with the results that we're getting.

Jacob Bout:

Okay. Thanks for that. I guess on the Nuclear side though, I mean, it doesn't appear that the revenue growth is keeping up, keeping pace with the sequential increases in backlog and it looks like Nuclear organic growth is lagging the overall Company's—are you expecting acceleration here on a go-forward basis?

Ian Edwards:

For sure. I think you've got—I think there's a few contextual points here. From a services business, the businesses is kind of stable and has been stable and growing, as you would expect a services business to grow, but on the new nuclear side, we go through this process of prefeasibility, engineering feasibility, engineering design, and then into projects themselves.

A good example of that would be the life extension projects of Bruce and Darlington in Ontario, Canada, that the ramp-up needs to go through those engineering processes, so whilst the backlog obviously improves, as you win those contracts, the ramp-up towards them is a bit slower. What you will see, particularly from the life extension projects, is a ramp-up of revenues '24-'25 from the work that we can already see, both won work and work that we believe we're going to win.

Jacob Bout:

And just one last quick one. Maybe just talk through the organic revenue growth that you saw in the U.K. versus Canada and the U.S.

Ian Edwards:

Yes. U.K. business, very strong. The specific sectors are shifting a little bit. We're seeing more defence work. We're seeing more water work. Historically, our business has always been strong in transport, and it's still strong. But I think the growth is really coming out of more defence and more water work. Resilient business, obviously, a business that's been around for over a hundred years and is proven to still grow in the market that we have in the U.K.

Jacob Bout:

Thank you.

Operator:

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

Yuri Lynk:

Good morning, guys, and congrats on a nice quarter.

Ian Edwards:

Good morning. Thanks.

Yuri Lynk:

Yes. So, growth surprised to the upside, particularly in Engineering Services. Maybe just dig in a little bit on the margin there. I was surprised that the EBITDA margin on net revenue was down about 130 bps despite the strong revenue growth. So, what's offsetting the—I guess you would assume there'd be some natural operating leverage in that business, but it doesn't seem to be pulling through.

Ian Edwards:

Yes. Okay. Jeff and I both will answer this question. Maybe I'll take it from the strategic point of view. When we analyzed our EBITDA to net revenue margins across the whole business, which obviously has been part of the strategic review, major parts of our business operate at peer-level margins, and we have areas of the business, such as Scandinavia, that we announced we're going to divest, that were operating below those margins. So the strategic review for us is all about ensuring that all of our business in our portfolio is operating at peer level or above.

So, we are on that journey and we are acutely aware that in parts of the business we are below, but we see no reason why we won't get to the same place.

Jeff, I don't know if you'd add anything to that.

Jeff Bell:

Yes. I think the only other thing I'd add is, we continue to drive the business on EBIT margins in which we think is the best representation of our business from an operating perspective, and those are very consistent year-over-year. We did see a bit of change in mix just in terms of the amount of flow-through revenue between gross revenue and net revenue, and that really drove the difference on EBITDA to net revenue. But we are largely looking at EBIT margins and continuing to drive those margins. Over time, we see opportunity to continue to improve those, as we work through some of our cost transformation activities and continue to optimize the portfolio in terms of our businesses. But we're pleased with where we saw our operating margins in the second quarter.

Yuri Lynk:

Right. Those for Engineering Services, if I recall, those would have been flat year-on-year, right?

Jeff Bell:

Yes. Yes, 8.5 and 8.5.

Yuri Lynk:

Yes. Okay. You're still calling for a positive operating cash flow in H2. Positive, that's a wide range. Is that dependent in any way on these settlements and can you quantify it at all, because the leverage is pretty high. So, wondering how to model that leverage ratio in the back half of the year is really what I'm trying to get at.

Jeff Bell:

Yes. I mean, as we talked about before, very much the first half was in line with our expectations. We did expect to be negative because of that LSTK Projects cash flow drag. As that winds down in the second half of the year, as we've said, expect to be positive operating cash flow in the second half of the year. That's not dependent on the settlements. Yuri, we will very much expect and will deliver positive operating cash flow and will be weighted towards the fourth quarter. As we said, there is a natural transition to that drag from LSTK through Q2 and Q4. I don't think we'd provide any more specific guidance around that at this stage, but very much—by the end of the year, we will have a business on a go-forward basis that we think will generate strong cash flows.

From a balance sheet perspective, therefore, we do see this as the high watermark in terms of our leverage ratios, and therefore, as we drive operating cash flow positive over the second half of the year, we expect the leverage ratios to fall, and as I said, be very much on a trajectory to hit our target in 2024. I'm very comfortable with our liquidity and where we are from a balance sheet perspective, so have no concerns that way.

Yuri Lynk:
Okay. Thanks for the colour guys.

Ian Edwards:
Thank you.

Jeff Bell:
Thanks.

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

Chris Murray:
Yes, thanks folks. Good morning. Maybe following on the capital discussion a little bit. Part of what we talked about at the investor day was once we're past, I guess, the more challenged LSTK Projects, you'd start to look at maybe M&A and deployment of some of that available cash flow into M&A. I guess the question is, how are you feeling about your ability to start executing on that, and do you have the structure and people in place now, or that's probably feasible as we move into 2024?

Ian Edwards:
Yes. Thanks for the question. Clearly, M&A has got to be part of our growth strategy in the medium to long term. I mean, that's clear. We have very clear aspirations of moving from a top 20 player in the U.S. to a top 10 player in the U.S. That's key to our "Pivoting to Growth" strategy. We are obviously doing well on organic growth, and the time will come when we enter into an M&A program.

We obviously—I've always said, about capital allocation, is it would strengthen the balance sheet and then consider M&A or returning to shareholders when we reach a point which we would expect during the course of next year, where we can look at M&A and actually carry out transactions. But we'll take a very methodical approach to this and start—we're talking acquisitions that build our capability, ensure that we're able to exploit synergies and integrate those businesses, both financially and culturally, into our business, and then we will continue and be at the cadence of our peers in M&A moving beyond '24.

So, yes, very much in the plan, but we're not quite there yet.

Chris Murray:
Okay, fair enough. Maybe my other question is around strategic review. We've kind of touched on a couple of different pieces of this through the call today. I guess, in aggregate, what are your thoughts around kind of the final timing of this review? I appreciate you're probably constantly evaluating the business on a normal course, but I guess the whole strategic review piece—you know, you've got Linxon, there's been some discussions about divestitures and margin expansion or lines of business maybe or areas that you don't want to be in. What's left to do in terms of your evaluation at this point and do you think you could have it wrapped by year-end as I think you've kind of indicated previously?

Ian Edwards:
Yes. Yes, that's a good question. We are on track and it's progressing really well. I mean, if we think about what was the intention here? The intention is to look at all part of the portfolio, businesses and business to make sure that we are on a path to be at peer margins, or exceed peer margins. As you've seen in the Scandinavian investment, we felt that that was a drag and we felt that we had that business for some time on an improvement plan, and right decision for us to divest it.

Now if we take a look at all the other Engineering Services businesses, we have finished that review. So, you would not expect to see further divestments from the Engineering side through this particular review.

On the Linxon side, we are still evaluating our options. We expect to have developed a conclusion to those options and to conclude the actions that are necessary to deal with Linxon by the end of the year.

So, in the main, that would close out this particular strategic review by the end of this year.

Chris Murray:

Okay. That's helpful. Thanks folks.

Ian Edwards:

Thank you.

Operator:

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

Sabahat Khan:

Great. Thanks and good morning. You made a comment about just kind of the nuclear opportunity out there and then you also talked about having added a decent amount of staff. I'm just thinking, particularly in that market, which is very specialized, how are you thinking about staffing up ahead of this opportunity? Given some of the timelines for these projects are very long, when do you start looking and hiring and bringing those people on board?

Ian Edwards:

Could you just repeat the last question? I'm sorry, we had a bit of an IT problem where you tuned out for a second. I've got the nuclear question.

Sabahat Khan:

Yes. Just in terms of the timeline, just given how long dated some of these projects could be, when do you start to look and hire and onboard these people and just given how specialized and maybe potentially hard to find they could be?

Ian Edwards:

Yes. Okay, great question. Now, we gave a fairly short answer on the Nuclear side previously. Let me give you a longer answer, and I'll kind of apologize for the length of the answer, but I think it's a good question and it's good to try and understand what the growth is going to look like here.

I mean, the world has changed in terms of attitude to new nuclear power generation, and it needs to, because if we are going to reach Net Zero we need nuclear power as a baseload to that clean energy future. And I see our business in three parts. Certainly, three parts in terms of how the growth will flow through the business.

The three parts are our Services business, our new Nuclear business, not CANDU, and our Nuclear business, CANDU, where we own the sole rights to the Canadian technology.

The Services business has been the backbone of our business for years. And it's been stable and it's good margins and it is now starting to incrementally grow as we do decommissioning, waste management and support, kind of nuclear clients and facilities in our core geographies.

The new Nuclear, not CANDU, there are projects like the SMR at Darlington for OPG, the work we're doing with Rolls Royce in the U.K. on SMR, the vast amount of work we're doing at Hinkley in the U.K. to support EDF, and that will move to Sizewell, as Sizewell gets underway and built. This is growing now. We're seeing backlog come in here now and we will see engineering studies and a flow-through of work actually within the short term.

And then on the CANDU side, there's two parts to this. One is extending the life of existing CANDU reactors around the world, which we've been doing at Bruce and OPG, and you will have seen further announcements for even further reactor life extension projects at Bruce and Pickering. We would hope to win that work and we would expect that that will bring in significant revenues, ‘24, ‘25, ‘26. And then there's the absolute new-build CANDU that we're in discussions with numerous clients domestically and internationally. Now you will see actually execution, probably, of those contracts towards the end of the decade, but pre-engineering, pre-studies, feasibility, we will see in the short to medium term.

So, all in all, this is a pretty exceptional time for the Nuclear business and we're primarily positioned with the solarised to the CANDU technology and our capability. Now, clearly, we have to grow the number of people and we have trained regular engineers into being nuclear engineers. And we're in that process. We have upskilled many people to take on the backlog that we already have in the Nuclear business. With our value proposition, our talent value proposition, where we're able to increase the number of people by 2,500 people in the first half of this year, we think that's complementing the demand for Nuclear and our ability to upskill people, is the answer.

So, I'm sorry if it was a bit of a long answer, but I think the question deserved that.

Sabahat Khan:
No, that was good colour. I guess, maybe just along those lines, there was a question earlier on the margin profile. I guess, as you're bringing all these folks just into the organization, is there some element of maybe under utilization or inefficiencies that you expect should sort itself out over the next 12, 18 months as those new hires become more productive, or is margin improvement more of kind of the mixed up that you talked about a little bit earlier on? And just what's your outlook on that front?

Jeff Bell:
Yes, it's Jeff. Why don't I take that? It's not really a utilization factor within there. The utilization within the nuclear sector has remained quite consistent. It really is that mix of businesses. Between services, new-build, and the waste management, it does fluctuate around a bit quarter by quarter just depending on the mix that we have in there, and so it can create sort of small changes or small elements in terms of the nuclear mix.

Over the long term, we absolutely expect to continue to deliver the sorts of margins we have on average in the past, and indeed, could see further opportunities. But on a quarterly basis, we've got a bit of movement from one to the next.

Sabahat Khan:
If I could squeeze in one just on the organic growth. The numbers last year have been north of 20%. Very good. Was this cadence of backlog burn sort of expected based on timelines, or how, what should we think about as we go into kind of '24 and onwards, because your numbers are very strong, I was just wondering if there was some acceleration of work, new sort of book and burn type of business, or just what kind of drove these numbers relative to recent quarters?

Ian Edwards:
Well, I'd probably refer back to the question on where we're positioned in the Company and how the demand for our services within that positioning of the Company, both from a geographical and a service line and end market of energy transition, transport, defence, water. They contribute to all that. Now, clearly, when we set out into the year, where the growth guidance that was much lower than where we've landed in the first half, year-to-date, 14% growth, if you put the two quarters together, really pleased. We felt it was necessary to extend that through to the rest of the year, because we see a fairly

consistent kind of pipeline for the second half of this year than we've seen in the first half and that's quite easy to predict.

Obviously, we are focused on growth, and we would hope to see growth '24 and beyond. But whether they're at this level, I mean, this is pretty exceptional, and I would probably temper down a little bit until we get further towards the end of the year where we could see the pipeline and we can see the specific opportunities and obviously we will guide at that point at the end of the year.

Sabahat Khan:
Thanks very much for all the colour.

Ian Edwards:
Thank you.

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

Benoit Poirier:
Yes, good morning, Jeff, Ian and congratulations for the strong results.

Ian Edwards:
Thank you.

Benoit Poirier:
Yes. Just to come back on the organic growth question, obviously, strong performance in the first half, 16%. You're now guiding for 12% to 15%. Does it signal some softness or return to more normalized levels in the second half, or are you being conservative right now?

Ian Edwards:
Well, we're looking at year-to-date for the H1, which is 14%. We had a great quarter in Q2. I mean, no doubt, right? I mean, really pleased. The work went into machineand the position that we've talked about has really played for us. But we're taking a H1 view, 14%. We see that that's in the pipeline. We see the visibility, the supports, that sort of range of growth between 12% and 15%.

So, I don't think it's conservative. I think it's accurate. It's obviously done from an analysis of the work we see ahead. So that's why we're fixed on that range.

Benoit Poirier:
Okay. Just in terms of operating margin, you were about to achieve 8.5% in the second quarter comparable to last year despite the strong organic growth. You added about 2,400 people in the first half. I was wondering about the—what kind of headcount addition we should expect in the second half. But also the question is around the operating leverage, the room for margin improvement, especially as you deliver on the organic growth side.

Ian Edwards:
Yes. Okay. So, let me answer the time question, and Jeff can go to the margin question. Our goal this year was to kind of have a cadence of headcount improvement of around the thousand person mark per quarter. That's an improvement on '22. Twenty two, if you'll remember, we're at 3,000 over the year. I think Q2 is pretty exceptional, of 1,400. There are some seasonal effects on the recruitment, because obviously we have big graduate programs as well and we have big intern programs. So, there is some effect. We expect that we will get to where we set out around the 4,000 increase in people during the course of the year.

So, we wouldn't see this sort of cadence of 1,400 for the next two quarters. I think that'd be a little bit too ambitious.

Jeff Bell:
Yes. Maybe to chat a bit further about the operating margin profile. As we've seen in previous years, the second half tends to be a bit stronger than the first half, as we work through our backlog and we tend to have slightly better and a stronger utilization in the second half. But I would also say overall, we continue to kind of see that as we deliver on our cost transformation activities. We've talked previously about the common sets of tools and systems and standardized processes that we're driving through the organization. We continue to improve and rationalize our real estate footprint and will continue to look to drive those sorts of cost opportunities as well.

So, I think we expect to continue to see as we have in previous years, a stronger second half on operating margins than the first half.

Benoit Poirier:
Okay. Would it be fair, Jeff, to say that all those efforts will likely pay off beyond 2023 and 2024, it will take a few quarters before we see that on the margin side? Right?

Jeff Bell:
Yes, I think we have talked about previously, Benoit, is that over the medium term, we do see the opportunity to continue to realize improvements in operating margins for those factors I've talked about and as we continue to grow the business and manage our utilization. There's no question, as Ian said, with such a strong revenue growth in the second quarter, there's a bit more of the business development expenses and we continue to drive that higher backlog, but we would expect that to continue to normalize itself out and for us to be in a stronger position in the medium to long term from that combination of cost transformation activities and the strategic review where we'll look to exit lower margin businesses.

Overall, when we look at our business, we see it either currently at a level or in the short to medium term an ability to reach peer comparable operating margins.

Benoit Poirier:
Okay. Okay, that's great colour. On the 407, obviously, a jewel. If we look at the traffic growth, it's been recovering very nicely. But you also announced the recent refinancing at 4.86%. So, was just wondering how it impacted the cost of debt and whether the traffic growth is kind of offsetting the higher refinancing cost and how it impacted the valuation as you might consider a potential divestiture longer term?

Jeff Bell:
Yes. I think from a valuation perspective, Benoit, that business is continuing to operate strongly, as you've said. We continue to see improvements in the traffic growth, I think in line with our expectations as traffic improves in the Greater Toronto area, as more workers are coming back to the office and more organizations are asking their employees to come back.

So, we certainly continue to see and believe that the demographics of the Greater Toronto area and the working arrangements in that area very much support getting to the long-term traffic levels that we would expect in terms of the valuation.

I think the second piece would be, from a cost of capital perspective, any of that debt, further debt that's been renewed, very much in line with what we see as the long-term assumptions around cost of debt and the weighted average cost of capital for that business.

So, we, frankly, see it from a valuation perspective, to continue to be a very valuable asset and not dissimilar in terms of its valuation to what we've seen in the past.

Benoit Poirier:
Okay, that's great colour. Last one on the nuclear side. The Ontario Government announced that they are starting pre development work at Bruce Power but also planning to construct three additional SMRs at Darlington. So, just wondering how large of an opportunity could this represent to the backlog in the longer term.

Ian Edwards:
Well, we're part, as the announcement showed, of the SMR program with GE and Hitachi, and those are—that work there at Darlington is likely to run through several units. So, that's a significant opportunity for us. The ramp to that is pre-engineering and engineering. So you'll see even now revenues flow through and those revenues will start increasing in '24 and beyond.

Bruce, obviously, we want to be part of the development of new nuclear. We believe the Canadian technology that we have the sole rights to should be the right technology to complement all of the existing reactors that are there at Bruce. And if that is the case, ultimately that will be a very, very significant opportunity for SNC-Lavalin.

Benoit Poirier:
Okay, that's great colour. Thank you very much for the time and congrats again.

Ian Edwards:
Thank you.

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

Michael Tupholme:
Thank you. Good morning. You put in place an NCIB earlier this year. Considering your expectations for positive cash from operations in the second half of the year and considering the stock's still depressed valuation versus peers, can you just talk about how you think about the NCIB and your appetite for making use of that going forward?

Jeff Bell:
Yes, sure. It's Jeff. Why don't I take that. I think, Michael, you heard us earlier. In line with our capital allocation strategy, as we said back in Q4, we wanted to make sure that we had all elements of that capital allocation strategy available to us going forward.

Notwithstanding that, clearly, our priority remains the balance sheet and that would be the first call on surplus cash flow. But we did want to have the opportunity in terms of returns to shareholders and that's why the NCIB is in place. I think we would very much agree with you, we continue to see the value of the Company is undervalued versus what we think its fundamental value is, and when we get to that point where we see positive cash flow or the expectation of it, then we think there's an opportunity to take advantage of that. We're just not there yet.

Michael Tupholme:
Yes, understanding that the expectation is for cash from operations to be more weighted toward Q4 than Q3, so understand that we're not yet in Q4. But do you need to see leverage come down to a certain level before you would consider using the NCIB or is this something you could do sort of concurrently once you're in a positive cash generating position?

Jeff Bell:
I think it's really about—I think we can continue to do that concurrently. As we get closer to that point later in the year, see where our cash flow is turning out, then we'd look to make those decisions at that time. I just think at this point we're probably a bit too early for that.

Michael Tupholme:

Okay. I appreciate that. Earlier you were asked to talk about sort of what you're seeing in the U.K. versus Canada and the U.S. and I think you provided some good detail about the U.K. But can you just talk in a little bit more detail about Engineering Services and growth in Canada versus the U.S.? Obviously, U.S. backlog is again a record level, so presumably, there's a lot of good growth coming out of the U.S. But if you could just kind of compare and contrast what you're seeing in Canada versus the U.S., that'd be helpful, and in Engineering Services?

Ian Edwards:

Yes, for sure, for sure. Very significant growth opportunity for us is the U.S. We're rated in the top 20 for our Engineering Services business, and we have an aspiration of being in the top 10 in the medium term.

The market is very strong and the services that we sell, which is being fuelled by the Infrastructure Investment Jobs Act and the IRA, both from the energy transition side and also the replacement of aging infrastructure, road and bridge, water, industrials around the energy transition and potentially services work on energy distribution, and all of that outside the nuclear opportunity, all within the Engineering Service opportunity are presenting great, great kind of markets for us.

And just to repeat our strategy here, I mean, very, very strong play into Tier 1 and in some southern states opened new opportunities - California, Washington State and the Washington, DC, New York corridor, where we see significant investment in new infrastructure. And those opportunities are now bringing work in, and obviously, revenues.

So, the plan's working, the market's strong and we will keep pushing, and obviously, add to that within organic when the time is right.

In Canada, pretty story too. With the provinces committed to new transport, clean energy transport solutions, and metros and replacement of aging infrastructure also in the road sector, we are seeing good, strong pipelines of work. Our business, obviously, it's where our home is, and we offer ambitions to grow in Canada also and in line with all of our other businesses.

So, from what we see going forward and the commitments that are being made, even outside of any party changes, political changes, we see the replacement in the energy transition will fuel them.

Michael Tupholme:
Great. That's great. Thank you.

Ian Edwards:
Thank you.

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

Frederic Bastien:
Good morning and congrats on the solid results.

Ian Edwards:
Thank you. Good morning.

Frederic Bastien:
Thanks. I was wondering if you could drill down on the successes you've had with recruiting. Was wondering if the new hires are weighted towards graduate students or whether you've had also successes recruiting more seasoned professionals? Likewise, are you seeing growth in specific segments or was that broad-based?

Ian Edwards:
Yes. That's a good question. The way I think about this is that there is a talent war. Obviously, the engineering sector is a busy sector. We're not alone. But we've really been hard at work for quite a long time now looking at our employee value proposition, the purpose of the Company to engineer a better future for the planet and its people, the culture. We have the development and flexibility we've put in place and all of those things are working for us.

So, we are able to reduce our attrition, which obviously, keeping the employees that we already have is key, really pleased that the attrition rate now is below pre-pandemic. But we're also able to attract and we're actually able to attract across the board. I mean, we have enhanced our graduate recruitment process. We've always had a really strong process in the U.K. and we've established similar processes now in Canada and the U.S. and we feel that that is a really good asset to the Company as we grow those graduates into the Company. But also, across the board, really, in multiple professions and multi-locations as well, multi-geographies, which obviously is needed to fuel the growth.

So, all in all, it's not something that we can be complacent about in any way whatsoever. But we're pleased with the success that we've got and it is helping drive our growth.

Frederic Bastien:
Thanks again. My second question about the government measures that are being implemented in the U.S. Just wondering if SNC's best positioned to—or more excited about the opportunities related to the Infrastructure Bill, the IRA or the CHIPs Act, or are you indifferent on like all these themes?

Ian Edwards:
No. I think the IIJA is actually where seeing funds flow through the states into infrastructure work, and our strongest capability in the U.S. is really transport, both in rail and road and bridge. We are developing our water capability because we see quite a bit of that IIJA flowing into new water, both the dealing with flood water and also the movement of drinkable, potable water.

So, we do see good opportunity around there. I mean, the IRA's really aimed at the development of energy assets and we support customers in that space. But I would say that for ourselves, specifically, and our own capability, that's probably having less effect than the IIJA.

Frederic Bastien:
Okay, that's helpful. Thank you.

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

Maxim Sytchev:
Good morning gentlemen.

Ian Edwards:
Good morning.

Maxim Sytchev:
Ian, just a couple of quick questions in terms of the margin profile. The first one is when it comes to the Engineering business I think in the past you've alluded that there was some geographical discrepancy when it comes to sort of the profitability. Is the role of kind of like of LSTK work, should that help Canada on a prospective basis or how should we think about this? Thanks.

Ian Edwards:
I don't think so. The Engineering Services business as a whole has regions that are operating very, very strongly at peer level. As I said, geographies such as Scandinavian were not, and they're dragging the whole down. So, we need to deal with that and we need to deal with those on a one-by-one basis. I don't think the LSTK and the work that we were doing in engineering specifically really has an effect on that.

Jeff, I don't know if you would add any further colour?

Jeff Bell:
Yes, I think the only thing I'd add is, as Ian has said, we do see strong margins in the different geographies where we're not, like Scandinavian, exiting that business, and that will help our margin improvement. There are, as we've said, there are a few other geographies or sub geographies where we are on a margin improvement plan. Part of that is around cost, part of that is around realizing our full pricing capability. And that does take a bit of time to roll off through the backlog.

So what I would say is that the business we're selling now and the margins we're selling now into the backlog, we think are absolutely at peer levels, but in some business units or sub geographies, it may take some time over the six to nine months to roll off some of the sort of lower margins we've seen. It is why we see over time the opportunity to continue to drive improved operating margins as that works its way through the backlog.

Maxim Sytchev:

Yes, makes sense. Just kind of circling very quickly to the Nuclear margin year-on-year compression, because as you're doing more precede work on some of sort of the potential new builds, wouldn't that be kind of high end margin? Or do you mind maybe just providing any colour in terms of why the margin came down year-on-year? Thanks.

Jeff Bell:

Yes. So as I said, Max, it does depend a little bit. There is a range of margin within that Nuclear business. all very strong. I think you can see on average, it's a business that attracts premium margins, even over the good business we see in Engineering Services. But it does a bit depend on the mix of how much of that is Services, sometimes we're doing some procurement of material for different life extensions or other waste commissioning work that we're working on, depends on the level of equity pickup that we're getting in the waste management business in the U.S.

So that does—that business mix fluctuates around a bit quarter by quarter. But very confident that we remain well within our 13% to 15% EBIT margins within that business, which are real premium margins, and it moves a bit quarter by quarter, Max. But don't see any fundamental reason why we wouldn't continue to deliver over the medium term the sorts of margins we've delivered in the past.

Maxim Sytchev:

Yes, for sure. In terms of the risk profile on prospective projects, I mean, everything is going to be done on a cost-plus basis, right, or an approximation of such?

Jeff Bell:

Sorry Max. Was the question around the lump sum projects?

Maxim Sytchev:

No, no. The future nuclear projects, like on the new-build stuff. It's all going to be cost-plus, basically, right?

Ian Edwards:

Oh yes. Yes, yes, yes. I mean, the engineering contracts on the prefeasibility studies, the engineering studies, are all Engineering Services type, and then if we get into the delivery of the asset, absolutely, where we don't take the risk on the cost on these things.

Maxim Sytchev:

Okay. Okay, excellent. Thank you so much and yes, strong quarter. Thank you.

Ian Edwards:

Thank you.

Operator:

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

Denis Jasmin:

Thank you very much for joining us this morning. As usual, if you have any more questions, please don't hesitate to contact me directly. Thank you very much and have a good day everyone. Bye-bye.

Operator:

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