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Stantec, Inc. (STN)

Q3 2019 Earnings Call

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Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

OTHER PARTICIPANTS

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Derek Spronck
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Chris Murray
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Analyst, National Bank Financial, Inc.

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Stantec's Third Quarter 2019 Earnings Results Conference Call. Leading the call today are Gord Johnston, President and Chief Executive Officer; and Theresa Jang, Executive Vice President and Chief Financial Officer.

Today's call is webcast and Stantec invites those dialing-in to view the slide presentation, which is available in the Investors sections at stantec.com. All information provided during this conference call is subject to the forward-looking statement qualification set out in slide 2, detailed in Stantec's management's discussion and analysis and incorporated in full for the purpose of today's call.

With that, I'm pleased to turn the call over to Mr. Gord Johnston.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

Good morning, and thank you for joining us.

I'll begin our call today with an overview of our third quarter performance. Theresa will then provide details on our results. Following that, I'll review our operations in more detail.

In Q3, we drove a 12.4% year-over-year increase in net revenue, with 7.4% representing organic growth across all geographies. In particular, we saw major contributions from the United States and our global operations. Environmental Services and Infrastructure generated double digit organic growth and Water and Buildings delivered strong growth of 7.4% and 4.5%, respectively. Energy & Resources, by contrast, experienced a modest contraction again this quarter, mostly due to major projects nearing completion, but it should be noted that comparative figures for last year were very high. Acquisitions delivered a 4.8% increase in net revenue, primarily in our global Buildings business.

Gross margin, which is a reflection of project mix and the quality of our execution, increased by 13.4%. And at September 30, our consolidated contract backlog remains at a record high, CAD 4.4 billion, that's up 5.4% from the end of 2018 and represents approximately 11 months of work. We've made very good progress on our organizational reshaping initiative and continue to focus on driving efficiency. We've reduced administrative and marketing costs and improved utilization compared to the first half of this year.

Importantly, as demonstrated by the results delivered this quarter, our reshaping initiative has not impacted our ability to achieve organic growth, execute projects or build backlog. In fact, we've won a number of major projects in the back half of this year, and we're actively hiring in regions and businesses with strong organic growth. We're also on track to deliver annualized cost savings of approximately CAD 40 million to CAD 45 million or CAD 0.26 to CAD 0.29 per share, consistent with our estimate in Q2.

And with that, I'll hand it over to Theresa.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

Thanks, Gord.

As we've done throughout this year, we've presented Q3 2019 results both before and after the adoption of IFRS 16. And you'll find the reconciliation of our Q3 2019 statements in our MD&A, in the appendix of the slide presentations and in the supplemental information posted to the Investors section of our website.

Adjusted net income for the quarter increased 29.5% to CAD 66.3 million and adjusted earnings per share increased 31.1% to CAD 0.59 per share. This was largely due to net revenue growth, which increased 12.4% to CAD 952.6 million in the quarter. As Gord outlined earlier, 7.4% of that increase was organic growth and 4.8% was acquisition growth. Gross margins for the quarter increased 13.4% to CAD 516.1 million. As a percentage of net revenue, gross margin increased from 53.7% to 54.2% and this reflects our continued focuses on improving project execution and our diverse mix of projects.

Admin and marketing costs were CAD 355.6 million, representing 37.5% of net revenue and that includes a 0.3% impact from severances associated with our reshaping initiatives. If we exclude severance, admin and marketing as a percentage of net revenue was consistent with the prior year on a pre-IFRS 16 basis, which is indicative of our normal cycle. Adjusted EBITDA increased 46.9% to CAD 159.1 million, representing 16.7% of net revenue.

Looking at our year-to-date result, we're within our target ranges for all our measures. I do want to remind you that we typically see a slowdown in activity in the fourth quarter as deals were closed in northern climate and as we approach the holiday season, resulting in higher admin and marketing costs as a percentage of net revenue compared to the third quarter. So for the full year, we expect our key financial metrics will be within our target ranges and will materially change from where they features at the end of Q3.

Our DSO remained unchanged from Q2 at 104 days or 91 days including deferred revenue. We have placed a major effort on reducing this metric and it remains a priority for us. Having said that, our analysis indicate that the return we generate on our working capital is comparable to that of our peers and relatively consistent with prior years. So in other words on the whole, we are being compensated with a longer period of time it takes to invoice and collect our receivables, but nevertheless, we can strengthen this return by reducing the number of days outstanding.

So moving on to liquidity and capital resources, operating cash flow from continuing operations increased 115.8% from CAD 64.4 million to CAD 139 million. This is mainly attributed to increased cash receipts from clients and IFRS 16, partly offset by higher supplier and employee costs related to acquisition growth. This brings year-to-date operating cash flows to an inflow of CAD 212.8 million.

Looking at our uses of capital for investing activities, we used CAD 29.9 million in the quarter, which includes payments of CAD 14.8 million related to past acquisitions and our typical spend on property and equipment. Cash used for investing activities was CAD 165.5 million for the year-to-date. We used CAD 54.7 million for net financing activities and this includes CAD 26 million in payments on a revolving credit facility, CAD 15.2 million for dividends and CAD 12.2 million in share repurchases. For the year-to-date, we've used CAD 56.7 million of cash refinancing activities.

We continue to strengthen our balance sheet as we progress through the year with net debt to adjusted EBITDA on a trailing 12-month basis at 1.6 times at the end of the quarter, well within our internal target of less than 2 times. So our liquidity remains strong. At the end of the quarter, we had approximately CAD 160 million in undrawn capacity on our credit facility. The July amendment to our credit facilities resulted in improved terms such as lowering our interest spread and increasing our access to additional funds from CAD 400 million to CAD 600 million, while extending the maturity date of the revolving facility by one year.

And with that, I'll turn the call back to Gord for highlights from operations.

Gordon Allan Johnston

President, Chief Executive Officer & Director, Stantec, Inc.

Thank you, Theresa.

In Canada, results continue to be in line with expectations with slower economic growth. Net revenue increased 2.9% in the quarter, 2.2% of which was organic growth. Our Environmental Services, Mining and Transportation businesses led growth in the quarter. Our work on LNG projects and in the midstream oil and gas sector drove growth in Environmental Services. Progress on major projects in the Prairie provinces drove growth in mining. And growth in Transportation was largely due to continued work on large light rail transit projects. Energy & Resources retracted as several power and oil and gas projects wrapped up or near completion. So we continue to work on Trans Mountain and LNG projects and anticipate ramping up our efforts there.

As for key wins in the quarter, our team will complete preliminary design and environmental assessment for a road-widening project along the 401 in Ontario, and we are also retained by one of Canada's largest telecom providers to deliver design improvements at up to 1,300 locations across North America. In the United States, project opportunities remain strong. Net revenue grew 12.1% in the quarter and that's almost entirely organic growth, with double-digit growth in Transportation, Environmental Services and Water. Our Transportation projects continues to be driven by work on major rail and transit projects, work on renewables and hydro power led growth in our Environmental Services and in Water, our efforts to expand market share in California and Texas are proving successful.

And from a sector perspective, we're seeing increased opportunities in conveyance and wastewater work. Key projects in the US include a three-year master services agreement for environmental and permitting services at solar power sites across the country, and we are also awarded construction and capacity improvements to one of the Florida's Turnpike routes.

We achieved strong growth in our global business. Net revenue was up 34.8% in the quarter. A large portion of that growth is due to acquisitions, mostly Wood & Grieve in Australia and Peter Brett in the UK, which both strengthened our global buildings and infrastructure practices. We also achieved 6% organic growth. All our global businesses grew organically with the exception of the WaterPower & Dams sector with some major projects neared completion.

Our mining export business continues to perform well, as doing our water and buildings practices in the Middle East. We also want a sizable project for the City of Gold Coast, Australia, a partnership we involved in was selected to deliver new and improved planning design and management of water and wastewater infrastructure.

And before we start the Q&A, I'll add that Theresa and I will share our 2020 strategic plan publicly in early December. We'll offer insights into our growth opportunities and provide additional details on our 2020 guidance and our targets through to 2023.

And with that, I'll hand it back to our operator for the Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first question from Mark Neville with Scotiabank.

Mark Neville
Analyst, Scotia Capital, Inc. Q

Hi, good morning. Maybe just want to talk about the workforce reshaping. So I'm just sort of curious sort of where you're at, what's left to do? Maybe to just start there.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc. A

Great. Thanks, Mark. Good question. So our workforce reshaping initiative, the lion share of that is complete. We got a jump on that really early and hard at the beginning of Q3, and we believe that we're on track to achieve that CAD 40 million to CAD 45 million in annualized cost savings that we spoke about in Q2.

Mark Neville
Analyst, Scotia Capital, Inc. Q

Okay. And sort of on that CAD 40 million to CAD 45 million, is there any way maybe a ballpark sort of how much has hit the P&L at this point, if any, sort of just kind of think sort of what's incremental to 2020 and sort of what – sort of already been reflected in the numbers if you can do that?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc. A

Yeah. So Mark, we had estimated that for the second half of the year, we would achieve savings in that CAD 16 million to CAD 20 million range the forecast and before severance. And so I'd say that we are on track for that and because the initiatives [indiscernible] (00:13:08) a little bit later in the year that's why [indiscernible] (00:13:11) doubling when we get to the CAD 40 million to CAD 45 million for next year. But we are on track for the second half of this year to be in that CAD 18 million to CAD 20 million range.

Mark Neville
Analyst, Scotia Capital, Inc.

Q

Okay. But I guess, just by math and so the progress, there wouldn't be much in Q3. You see more of a – in Q4 and probably a bigger chunk sort of next year at least in the P&L, am I thinking about that right?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yes. That's right.

Mark Neville
Analyst, Scotia Capital, Inc.

Q

Okay. Again, just maybe just on the organic growth, you touched on or you said you'd talk about plans for 2020, I guess, next month. But just I'm just curious if you're seeing sort of anything that would sort of materially change either up or down sort of what the business is doing sort of now into next year?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

We're feeling good about the backlog that we've had all year, which is still at record levels. So as we move into next year, I think we're still looking at that low- to mid-single digits.

Mark Neville
Analyst, Scotia Capital, Inc.

Q

Okay. I'll leave it there. I'll get back in queue, but thank you.

Operator: [Operator Instructions] We'll take our next question from Derek Spronck with RBC.

Derek Spronck
Analyst, RBC Capital Markets

Q

Okay. Thanks, guys, and congratulations on the nice quarter there. Just on the A&M front, actually we're thinking about the range next year. Should we continue to see that lower as a percent of sales and any color around where that could be? I'm assuming mathematically we could kind of reverse engineer it but.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yeah. So I appreciate the question, Derek, and it might not be the most satisfying answer, but what we really want to do when it comes to 2020 is provide that commentary when we're on our strategic plan. I think it will be important for us to put some context around what we're expecting for those financial metrics and so if you don't mind holding off that and you're right you can do some backwards math and probably come up with something, but really from our perspective, we'd like to hold off on commenting until December when we roll out the strategic plan.

Derek Spronck
Analyst, RBC Capital Markets

Q

Okay. Fair enough. Just you had a nice pickup in organic growth. Was that just pent-up demand that was released or have you seen more sustainable higher organic growth trends here?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

We saw, as you say, pretty good organic growth certainly in all of our geographies, good organic growth this quarter and in all of our business lines with the exception of Energy & Resources. As we look at a couple of the sectors, in Environmental Services we saw strong growth across all the geographies. Will that mute a little bit going into 2020? I would think it probably would a little bit. In Infrastructure we saw great pickup in our Transportation factors this year – this quarter, sorry, double digit in all of our geographies.

And so as we talked about over the last little while, we've had some strong backlog generation in Transportation, we've talked about some of the large projects we're working on and those are all in the midst of heavy design at this point. I think the one that we are most pleased with this quarter would be the Water organic growth. We've talked for several quarters that while we're generating good backlog in Water, we felt that we haven't seen that translate into organic growth yet. Certainly, we did see that in Q3 where 7.4% overall with really strong growth in the United States, really as a pickup to a number of those projects that we've been focusing on in California and in Florida.

Derek Spronck
Analyst, RBC Capital Markets

Q

Okay. That's great. Thanks, Gord. Just maybe one last one from myself, are you seeing any sort of negative headwinds from the divestiture of the construction in Water? Or is it still feeling relatively bifurcated between the design and construction side on the Water side?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Sure. Good point. And just before I answer that the operator just ask if I could say everyone who is in queue for some reason those people who are in the queue have been dropped from the queue. So it looks like Mark is in the queue again. There is Jacob now. So if you need to have yourself back to the queue please do so. Okay.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

I knew it...

[indiscernible] (00:18:01)

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. That's true. Okay, there. Now we see it's great. Thanks, everyone, for that. So as to your question with regards to constructors. In fact, Theresa and I are in the UK this week and meeting with a number of our clients and staff here. And certainly one of the questions that we've talked about quite a bit was the impact of the divestiture of construction here. Certainly, we have not seen that, but in fact we still work with our construction business here when it makes sense, and we have recently won an AMP7 recompete with them for one of the clients here. So where it makes sense, we'll work together with them. But neither in North America nor here we've seen a significant negative headwind as a result of that divestiture.

Derek Spronck
Analyst, RBC Capital Markets

Q

Okay. That's great. I'll turn it over.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Thanks, Derek.

Operator: We'll take our next question from Mark Neville with Scotiabank.

Mark Neville
Analyst, Scotia Capital, Inc.

Q

Hi. Sorry, I guess I didn't want to steal the questions here, but I guess since I'm on the line. I guess just on M&A, it's been a bit quieter in the last few quarters. So I'm just curious if that's sort of related to the workforce reshaping or if there's sort of something else happening or just sort of just coincidence I guess, I mean...

[indiscernible] (00:19:20)

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. Certainly, the slowdown in M&A this year was not intentional in any way. We did close Wood & Grieve Engineers in March and it has been quite since then. But as we always are, we're always involved in numerous discussions and really we're just waiting for one to hit. We just haven't had the right mix of cultural fit in opportunities yet. But there's been no change to our M&A program.

Mark Neville
Analyst, Scotia Capital, Inc.

Q

Okay. Thanks. I'll leave there. Thanks.

Operator: We'll take our next question from Devin Dodge with BMO Capital Markets.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Operator, still there?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Hello?

Q

Hi, can you hear me?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Hello?

Q

Hi Gord, can you hear me?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Gordon and Theresa are here, but we can't hear you at this point.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Of course, they've lost you, but they can hear, Chris.

Q

I can hear you guys. I'm not sure if you can hear me though.

[Technical Difficulty] (00:20:31-00:20:50)

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Can you hear us now?

Q

I can hear you. Can you hear me?

Operator: We can hear you.

Q

Okay, great. Okay.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

We seem to have a technical difficulty here. Perhaps I'll dial in again using a different phone line.

Q

So if you can hear me, I'll just go ahead and ask my question.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Okay. So you can hear us.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

We're going to disconnect and dial again. Our apologies.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Okay. I apologize. We'll connect with you again right away.

[Technical Difficulty] (00:21:21-00:21:30)

A

Chris, I don't know if you heard that, but Theresa and Gord are recalling in.

[Technical Difficulty] (00:21:35-00:23:23)

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Hello, it's Gord Johnston here. Can you hear us?

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Hi Gord, I'm here. This is Devin from BMO. Can you hear me?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Devin, I'm so sorry for that. I don't know what happened, but yes, we can hear you. Thank you.

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Okay.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Sorry, I apologize for the IT issue.

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

That's okay. I just wanted to come back to the organic growth in Q3. I just want to get a sense for what was the driver, I think you addressed what verticals and where that strength came from, but just trying to understand whether it was like project-specific revenue recognition changes or a higher head count or utilization or and what was driving that outsized organic growth in Q3?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Certainly, a number of the projects that we've been waiting to, to fully engage in really kicked into high gear. There is certainly a seasonality component in Q3 as well as we have more people out in the field and those programs are growing a bit stronger. So it really wasn't due to any one of those issues. But pretty broad based across all the geographies, and we felt good about the quarter.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

And just to confirm, we did not change any of our revenue recognition approach for the quarter, so there wasn't anything from an accounting perspective that caused that. I think it's probably a bit of that feeling that we would – we have commented that we were still getting out to the field this year because of the cold, the winter and so on, and we saw that in our results in the first and the second quarters. So I think there is some respect as well because of the pent up ability to move forward. And it was more pronounced in the third quarter because of that.

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Okay. Okay. Makes sense. To maybe just kind of continue on that theme, but organic growth in the Canadian business was positive in Q3, it remains lower or a bit lower on a year-to-date basis. Just with what you see in the backlog, what you're seeing in the bid pipeline, just wondering how we should be thinking about the pace of organic growth in Canada over the next say two to four quarters?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

As we look at Canadian organic growth going forward, this quarter we were at, just about 2%. We sort of see it in a similar number going over the next couple of quarters. If we – that will bring the year end reasonably flat, and I think that's sort of in line with our expectations for Canada this year. Next year, I would see it going forward in a similar number to that; slightly positive organic growth, but not huge, certainly not in the high numbers.

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Okay. And maybe just one last one for Theresa. But just DSO reduction progress, I mean I think we're stuck at 104 days. It just seems like that target of 98 days is becoming maybe less likely. What is – how should we be thinking about reasonable target by the end of the year?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Sure. So the target at 98 days that we said at the start of the year, I would agree with you that's increasingly unlikely that we will achieve that by the end of the year. I, from the work that we've done and there has been a tremendous effort put towards this. It would indicate to us that maybe a day or two improvement at best over the – to the end of the year. The reason is the same is as I pointed out in earlier calls, a lot of that centers around our operations outside of North America and for some of it is, just meeting some of those contracts to roll off. Certainly, as we go forward, and as Gordon mentioned, we're in the UK, we're talking with our global leaders, and as we're entering into new contract, there is a very keen focus on payment terms as we enter into new work, but it's just going to take a lot of those other contract to roll off.

Devin Dodge
Analyst, BMO Capital Markets (Canada)
Q

Okay. So a day or two by year end and there is – it sounds like there's a little bit more room to go maybe in 2020 is that fair?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

We're to keep trying. And I think DSO is clearly one of the things that every organization, particularly as a professional services company, should be working on to reduce. I made the comment earlier around the work we've done on looking at our return on working capital. And that would indicate to us that over the last couple of years even when DSO has moved up and by a fair number of days that we're still the return we're generating has been consistent.

So I don't want to downplay the issue. I don't want to say that we're not going to focus on any more because we certainly are. But I would also say that given the return is good that it's important for us to bring the number down, but it's more important for us to focus on generating profitable earnings and that moves the metric, moves the return far more than saving a day or two off our DSO. If that makes sense to you. So still important to us, but from a more broad perspective, the metric that matters to me a lot around our return that number is in good shape.

Devin Dodge
Analyst, BMO Capital Markets (Canada)
Q

Okay. That's helpful. Congrats on the good quarter. I'll turn it over.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Thanks very much.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Thank you.

Operator: And we'll take our next question from Chris Murray with AltaCorp Capital.

Chris Murray
Analyst, AltaCorp Capital, Inc.
Q

Thanks, folks. Just Gord, just turning back into growth and in the Canadian business, Energy & Resources, I mean, we've kind of had a bit of a recovery now kind of looking a little concerned about what's going on. So I was wondering, can you maybe talk about how we should be thinking about that business? And as well, can you give us any updates on how you guys are progressing [indiscernible] (00:29:33) pipeline? So I'm just hearing different stories about pacing on things like [indiscernible] (00:29:38) and Coastal GasLink and some of the challenges, I was wondering if you can share any color on that from your perspective?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Sure. No, absolutely, and great question. So Energy & Resources, you're right, we were down 2.7% in Q3. But again, that's coming off a comp of just above 26% in Q3 2018, so it's a pretty high comp. But to your point specifically about some of the pipeline hereof, on Coastal Gas, in addition to the environmental work we've been doing for some time, we've also – we've just recently been engaged on some compression type projects there and on TMX, we continue to support that project, the Trans Mountain expansion project, we continue to support it going forward, we have had a number of spread kickoff meetings to get going, and so right now, we continue to work on detailed engineering. We're working on project management, construction monitoring and inspection and permitting work on key MVP. So pretty busy there and as that job or as those jobs continue to increase the pace, our involvement will increase as well.

Chris Murray
Analyst, AltaCorp Capital, Inc.

Q

Okay. Are you seeing anything unusual in the regulatory environment because I know you guys – like you're sort of at the front end of that. We've just been hearing like there's been a lot of issues around getting some of the construction actually going.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. I think that's – we're pushing forward with our clients as far as we can, but I don't see anything unusual there at this point.

Chris Murray
Analyst, AltaCorp Capital, Inc.

Q

Okay. Fair enough. And then just turning back, I get asked about 2020 organic question. But I guess you guys – I'll hold up, but just for expectations, can you just give us some more color on what your plan is on releasing your strategic forecast? Are we expecting there is a press release and a conference call or a mini Investor Day and any kind of more granularity on exactly when you expect to release this would be great?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah, yeah. Great question. We are just checking some schedules, and we expect to do that in early in December. And we thought it would be a webcast type of an event, where we just would lay out our three-year vision for the company, where we're planning to take the firm as well as the financial metrics, both for 2020 but also where we see we might be able to take some of those metrics moving forward over the three-year period.

Chris Murray
Analyst, AltaCorp Capital, Inc.

Q

Okay. Fair, thank you. Thanks, guys. I'll turn it over.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Great. Thank you.

Operator: We'll take our next question from Jacob Bout with CIBC.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Good morning

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Good morning.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Good morning, Jacob.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Yeah, I had a few questions on the Water business. It sounds like you're executing on the backlog. We talked about the issue of the staff shortages in the US. I know you were talking about utilizing Canadian staff and India delivery center, have some of those issues been resolved?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. We certainly, while we've always been working on using our staff in a cross-border way and taking advantage of even folks in the Water business from Australia or from the UK, in addition to our Pune, India operations, we've really ramped that up over the last couple of quarters. So certainly, that did help us as we continue – as was the project is launched that did help us to get the resources that we needed to continue to drive them forward.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

And then obviously strong organic growth in the quarter, but it sounds like it might start to average down as you go forward, but do you think you're going to get back to where the industry is growing at kind of 4% to 5%?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

From Water in particular?

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Correct.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah, absolutely. The backlog of projects is there and a number of the projects that we're just beginning to engage with our large multiyear projects. So once they get rolling, we feel confident in that that type of a range going forward about 4% to 5%.

Jacob Bout
Analyst, CIBC World Markets, Inc.
Q

And then maybe just on the US. So seeing some outsized growth there, it sounds like a pretty big step up in transportation environmental. You've got a couple of projects here the Long Island, the Red, Purple Line. How are those projects? When are they expected? And how are you thinking about the continued growth in the US?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Yeah, yeah, and a good question. We have – those projects are certainly in the midst of full design. We have resources from – throughout the United States and Canada working on them, but they are a large projects. So those will certainly be going for the next couple of quarters. And in the case of Long Island and in terms of full flat out design and for Chicago even longer than that. But as that winds down, we talked about during the prepared comments the railway project in Florida comes on, and we have other like rail projects that we're working on in Canada. So we see good backlog in transportation, overall.

Jacob Bout
Analyst, CIBC World Markets, Inc.
Q

I'll leave it there. Thank you.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Great. Thank you.

Operator: We'll take our next question from Benoit Poirier with Desjardins Capital Markets.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Yeah. Good morning, Gordon, Theresa, and congrats for the good quarter. First question on Energy & Resources, I mean when we look at Q4 last year, the growth was more pronounced. So would it be fair that you could probably turn the corner in Q4 and show some positive organic growth for Energy & Resources?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Our Energy & Resources group is made up of a number of different components, one of which of course is oil and gas. So if those pipeline projects get engaged in a larger way, certainly, we'll see an uptick in that type of work in Canada. Our mining space is also within our Energy & Resources group, and we're seeing good growth in mining in Canada and Australia in particular as a result of our involvement in both gold, but also some of the battery metals. So that feels good going forward over the next little bit as well. So I don't see Energy & Resources having a significant change to the positive in Q4, but I think we're hoping to see some good growth there going forward.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. And for Environmental Services, you already provided some color, but if you look at organic growth it's been in the double-digit over the last two quarter. Would you still – or is it reasonable to expect double-digit in Q4 again, but maybe kind of a more moderate growth for 2020 in the mid- to high? Or how should we be thinking about the 2020 for Environmental Services?

Gordon Allan Johnston A
President, Chief Executive Officer & Director, Stantec, Inc.

Yeah. I would expect to see that growth to moderate 17% from this quarter was very high. So I would expect to see that that growth to moderate. We're still hope for a double-digit growth going forward, but certainly it will moderate from that number.

Benoit Poirier Q
Analyst, Desjardins Capital Markets

Okay. Perfect. And if we look at the Province of Ontario, they recently released the market – the P3 Market Update. They highlighted about CAD 65 billion of opportunity. So could you provide some color on the potential upside for Stantec? And whether it could boost the growth prospects in Canada for Stantec for the years to come, Gord?

Gordon Allan Johnston A
President, Chief Executive Officer & Director, Stantec, Inc.

Yeah, certainly some great projects were identified on that list in Ontario. And so for a number of them, we have begun working on teaming discussions already. And certainly, we believe we've got some strong positioning for those. So we believe that that will bode well for us into the future. But like the industry in general, we're waiting for these projects to come to market, and we're looking forward to competing for them.

Benoit Poirier Q
Analyst, Desjardins Capital Markets

Okay. Perfect. And for Theresa, maybe question about the DSO. You mentioned already some color, but on what we should expect by year end, but when we'll be looking at the next three years, is it fair to assume that 98 it's still a number that could come out and be part of the plan or given the focus on profitability it's less the end goal?

Theresa B. Y. Jang A
Chief Financial Officer & Executive Vice President, Stantec, Inc.

The number for the three years notice is something that we'll share when we roll out our strategic plan in December.

Benoit Poirier Q
Analyst, Desjardins Capital Markets

Okay. Okay. That's great. And for free cash flow conversion in Q4, anything unusual we should expect? Or it will be kind of normal seasonality here, Theresa?

Theresa B. Y. Jang A
Chief Financial Officer & Executive Vice President, Stantec, Inc.

Yeah, I expect it to be pretty normal. As you know, Q3 tends to be at the high point for us, generated really solid cash from operating activities and free cash flow for the quarter and for the year-to-date and really strong conversion of cash from operating activities to net income. So it should moderate some as we go into the fourth quarter, but I would expect that from a cash flow perspective and overall leverage perspective that those will both be in the good shape in the fourth quarter.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. Perfect. And depreciation of lease asset is CAD 29 million, CAD 30 million, a good number on a run rate basis. Or is the number should accelerate a little bit as you grow revenues, Theresa?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

I don't – yeah, I don't think it would be that far from the guidance that we gave at the start of the year.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. Okay. And last one for me, when we look at the strategic plan that you're going to be providing in December, I'm wondering whether how should we be thinking about management compensation and whether the compensation will be aligned with the plan?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

So I think that our management compensation has always been aligned with our plan. We have – from a LTIP long term incentive metric certainly are driven by – specifically by financial metrics in the plan. So I don't see that that would change going forward.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. Thank you very much for the time.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Great. Thank you.

Operator: We'll take our next question from Nauman Satti with Laurentian Bank.

Nauman Satti
Analyst, Laurentian Bank Securities, Inc.
Q

Hey, good morning, everyone.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Good morning.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Hi.

Nauman Satti
Analyst, Laurentian Bank Securities, Inc.

Q

So just on the M&A side, I understand that you're going through a workforce reshaping and then there is cost saving initiatives there as well. How comfortable are you from operational perspective to absorb M&A activity in the future?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Is your question around funding?

Nauman Satti
Analyst, Laurentian Bank Securities, Inc.

Q

From operational perspective, bringing those M&A new companies in and making sure that they are aligning with the rest of the business.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

[indiscernible] (00:41:42).

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

In fact, that's an area where we are very comfortable. Certainly, within North America, we have well-established operations. The biggest part for us was our – when we look for M&A firms to join us is cultural alignment. And so when we find firms that are very culturally aligned with Stantec, we do find that the – that integration flows fairly smoothly. But now that we've got here in the UK, where Theresa and I are, MWH has been with us for three years now. Peter Brett Associates, we're in their offices today, very good alignment and in fact that the team is really looking forward to having other firms to join and to continue to grow our presence here. So from an operational and integration perspective, we feel good about that. That would be a similar statement in Australia, New Zealand where [indiscernible] (00:42:39) where we continue to look. So yeah, we feel very comfortable from an operational perspective in terms of bringing new firms into the pool.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

And we have as well – although last year we completed our ERP system integration in Australia and New Zealand and in the process of integrating systems here in the UK and so again that just adds to our capacity and capabilities of being able to operationalize acquisitions and get them on the same systems.

Nauman Satti
Analyst, Laurentian Bank Securities, Inc.

Q

That's great. Thanks for that, and just if you could comment on the M&A pipeline, and if you've seen any changes to the valuation or the prices has gone up?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. I would see if the pipeline is still remains very robust in terms of both firms in North America, Australia, New Zealand, the UK, Western Europe, Nordics, we're always talking to the firms in these areas. From an overall valuation perspective, we're not seeing significant up creep in valuations from where we typically have seen over the last number of quarters, but it is a very active market, it is a very active market.

Nauman Satti
Analyst, Laurentian Bank Securities, Inc.
Q

Thank you.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Okay, thank you.

Operator: We'll take our next question from Maxim Sytchev with National Bank Financial.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

Hi, good morning.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Good morning, Max.

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Hi.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

I was wondering maybe if you can comment please about the UK, the operating environment. Some of the global peers have witnessed some slowdown in the market. Maybe any type of color you can provide, please?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.
A

Yeah, great question. And so as I said that's where we are this week, and so we've met with a number of the Water clients and I'll start with Water. And as we transition between M6 and M7, a number of those awards, as we've talked about before we've been awarded a number of M7 contracts already. But in general, as the industry transitions from M6 to M7, 2019 is seem to be sort of the lower year from an overall industry revenue generation perspective. And next year, we're looking to see an uptick. So our Water business was solid this year and we see that only continuing to improve next year and into M7 as that's gets rolling.

From a buildings perspective, we've met with a number of our property development clients here and there is no concern with regards to projects being or certainly we've heard none of projects being canceled. But there is a little bit of a let's just hold on for a bit and see what happens with Brexit. So we're seeing projects move to the right a little bit, still perhaps moving forward with a bit of planning and getting planning permissions and consent, but not moving into the next stage. So a little bit I think of trepidation a little bit of a wait and see on some of those properties or on the projects.

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

Okay, that's fair enough. And the other question I had was just in terms of capital allocation priorities, do you have any thoughts, incrementally speaking, in terms of deploying capital via M&A versus share buybacks? Just in terms of if you have evolved your thinking over the last little while, just maybe any thoughts there, please?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Sure and it's really pretty consistent, Max, from what I shared in the earlier part of the year. From our perspective, allocating capital to make accretive acquisitions is our biggest priority. It drives growth and drives returns and so that remains a priority. Having said that, so long as there are opportunities that present itself where our share price gets dislocated as it has been, and we've remained well within our leverage metrics and for me that is also a good use of capital. So we have been active in the NCIB market for this past year, which is – it's been an appropriate and valuable way for us to create shareholder value. But as I said, acquisitions are our priority. And so, at the moment, I'm not making one trade-off over another.

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

Okay. That's fair enough. That's it for me. Thank you very much.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Thanks, Max.

Operator: We'll take our next question from Ben Cherniavsky with Raymond James.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Hi guys, most of my questions have been answered and there have been a fair number of questions about organic growth. But if I could just maybe ask it in a different way, I mean, the confidence you have in the sustainability of the kind of growth you put up, it's sort of that odds with a lot of the leading indicators out there. I think Maxim asked about Brexit and the ABI index has been slowing. There have been other indicators not just in Alberta, but elsewhere that activity is slowing. And so what do you think explains your ability to sort of go against the grain with some of those trends?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

I do think that Q3 was a particularly good quarter for us. We had good seasonality, got people out in the field, a lot of the projects that we've been waiting to get going head-to-head got started. And so you can see that from a quarter-on-quarter basis throughout the year, organic growth increased significantly in Q3 over the previous quarters.

Our guidance I think is still in that low- to mid-single digits. So would we expect to see the type of growth that we saw this quarter in all of our quarters going forward, I don't think that that would be an accurate statement. I think our guidance would still be in the low- to mid-single digits as something that is sustainable in the long-term.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Yeah. Okay. That's helpful. And I mean there's no question that you guys have put up some good numbers here, and it's also no secret the last couple of quarters, if not the last couple of years, you've been a little beaten up on your results. So before expectations get too far ahead of themselves, what do you feel like this is a turning point for you guys that things just sort of – the work you've been doing have been – is coming together here? And beyond just a few projects getting released, what would you explain in – as this sort of – or where do you see this as an inflection point in your performance?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah, that's a good point, Ben. And you know that we've been focused on a number of things for some time. Certainly, the divestiture of constructors was important for us working through the reshaping initiative, working on some of the other internal efficiency type things that we've been working for building backlog. We do feel like that we're ready to continue forward with more sustainable delivery not spiking up, but not spiking in a negative direction either. We do feel like we've turned the corner really certainly added a lot of focus from all of our leadership and employee base on that – just that long term sustainable delivery.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

But can you point to a couple of things that – if there are any catalysts or anything in particular that that's been working for you lately, you feel better about? Or is it a bunch of whole – a whole bunch of little things that have – that are projects you've been focused on that are coming together?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. It's a combination. It certainly is any number of – a number of small things, but we certainly have seen that there are reshaping initiatives. In addition to achieving that CAD 40 million to CAD 45 million of annualized cost savings that we've talked about, it also has reenergized the organization to a large degree. There's been a number of people who now are stepped out into the sunlight sort of for lack of a better word that have an opportunity to really shine and show us what they can do, and we've seen really a number of people step up to do that. So I think that while that was something we needed to do from a cost efficiency perspective, I think from an organizational perspective, it was also very positive.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

And what work remains to be done? What are you guys focused on? I mean, I guess we'll hear more about this in the strategic plan, but what's occupying your focus right now, Gord?

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

For now, we're continuing to focus on getting ready to roll out our strategic plan to both internally and externally in early December, where we're continuing to focus on the M&A pipeline and spending a lot of time there. And then just overall, working with the teams to ensure that that long-term efficiency, long-term operating ability is there.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Okay. Great. Thanks very much.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

A

Okay. Thanks, Ben.

Operator: We apologize for the technical difficulties and thank everyone for their patience. There are no more questions in the queue at this time. I would like to turn that back over to today's speakers for closing remarks.

Gordon Allan Johnston
President, Chief Executive Officer & Director, Stantec, Inc.

Great. Well, thank you, everyone, for taking the time to join our call today. We look forward to providing you with some additional information in the near future about the timing and the date for our – when we roll out our strategic plan to you in early December. So thank you very much.