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Stantec, Inc. (STN)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Stantec's Second 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 qualifications set out on slide 2, detailed in Stantec's Management's Discussion & Analysis and incorporated in full for the purposes 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 thanks to all of you for joining today's call. I'll begin the call today with an overview of our second quarter performance. Theresa will then provide details on our results. Following that, I'll review our operations. In the second quarter, robust revenue growth, gross margins in line with expectations, and very competitive EBITDA margins were overshadowed by higher than expected administrative and marketing expenses, primarily driven by excess labor costs. When we began the planning cycle for 2019, we recognized

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that we needed to be more aggressive in managing costs by reducing our higher level workforce that's typically less engaged in winning or executing on projects. This has caused our costs to creep up over the years.

So we initiated a process to improve utilization and reshape the organization to significantly reduce these excess labor costs. We want a greater proportion of employees to be actively engaged in client work, project execution and revenue generation. The expected cost savings from this initiative was incorporated into our 2020 guidance but it took us longer to plan, prepare and roll out than we anticipated. This resulted in excess labor cost in Q2 that were not in our earnings plan. It wasn't until after the second quarter that we were able to accelerate the reshaping of our workforce and that will translate to significant cost savings.

The actions we have taken to-date, will translate into approximately CAD 29 million to CAD 32 million in cost savings or CAD 0.19 to CAD 0.21 per share on an annualized basis. We intend to continue this process for the remainder of 2019 to further drive down costs by an additional CAD 11 million to CAD 13 million pre-tax or CAD 0.07 to CAD 0.08 per share on an annualized basis. So the expected annual run rate for cost savings is CAD 40 million to CAD 45 million or CAD 0.26 to CAD 0.29 per share.

Without the full year benefit we planned on, our 2019 earnings will likely be at the lower end of our guidance range. We expect cost savings in the second half of 2019 to be in the range of CAD 16 million to CAD 20 million pre-tax or CAD 0.11 to CAD 0.13 per share excluding severance. We do not expect severance costs to be material. And there are a couple of reasons for this. The primary factor is at-will employment in the U.S., where more than half of the affected employees were based. There were also a number of contractors in the mix. So the severance costs will not be as high as you might expect and we intend to exclude these costs from the determination of our adjusted EBITDA and adjusted net income metrics in Q3 and Q4.

Highly utilized people, actively executing project work are the engine of our business. We want a higher proportion of our people in those roles so we can convert our record backlog into revenue, continue to grow our business and drive stronger returns for our investors.

With that, I'll hand it over to Theresa.

Theresa B. Y. Jang

Chief Financial Officer & Executive Vice President, Stantec, Inc.

Thank you, Gord. [ph] As with (00:03:52) last quarter, for the purposes of this call, we presented Q2 2019 results both before and after the adoption of IFRS 16. We've provided a reconciliation of our Q2 statements in our MD&A and the appendix of the slide presentation as well as posted as supplemental information in the Investors section of our website.

Although our Q2 results did not meet our expectations, the core of our business did perform well, generating solid revenue growth and gross margin that was in line with our expectations. We reported adjusted net income of CAD 56.1 million or CAD 0.50 per diluted share, decreases of 9.5% and 7.4% respectively compared to Q2 2018. This is largely due to increased admin and marketing expenses, with excess labor costs negatively impacting after-tax earnings by CAD 11 million or CAD 0.10 per share. Adjusted net income represented 5.9% of net revenue. Net revenue was CAD 953.6 million, reflecting the growth of 10.5%, with increases across all business units. We generated organic growth of 2.3% and acquisition growth of 6.4%.

Gross margin was CAD 517.5 million, reflecting a 10% growth and at 54.3% of net revenue, a consistent margin relative to last year. Admin and marketing costs were CAD 372.4 million, 39.1% of net revenue. Excluding the

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impact of IFRS 16, these costs represented 42.8% of net revenue, a 12.8% increase over Q2 2018. The increase was mainly due to lower utilization, which drove labor costs to be significantly higher than anticipated.

Adjusted EBITDA was CAD 145.4 million, representing 15.2% of net revenue. And the adoption of IFRS 16 reduced our Q2 net income by approximately CAD 1 million or CAD 0.01 on a diluted per share basis, which is in line with our expectation.

In terms of our year-to-date results, other than gross margin, our results for the first half of the year were outside of our annual target ranges. This again is attributable to excess labor costs and since the end of Q2 we have taken meaningful steps to address these costs.

As Gord mentioned, we're continuing to reshape our workforce toward the levels that are more highly utilized and billable. These actions will significantly reduce admin and marketing cost for the second half of this year, so we're maintaining our previously established earnings target ranges for the full year 2019. However, having carried those excess cost for the first half of this year, we're expecting to be at the upper end of our range for admin and marketing as a percentage of net revenue and at the lower end of our ranges for adjusted EBITDA and adjusted net income.

We've amended our previously expected quarterly earnings pattern of 40% in the first and last quarters and 60% in the second and third quarters. While this is our typical earnings pattern, we're expecting the pattern to be slightly different in 2019 due to our reshaping initiative. We anticipate approximately 45% of annual earnings to be generated in the first and last quarters and 55% generated in the second and third quarters.

And so this brings me to our day sales outstanding, our DSO was a 104 days at June 30, 91 days including deferred revenue, and this was unchanged from March 31, 1 day higher than the 103 days at the end of 2018. Our DSO has historically been under 100 days averaging 94 and 95 days in 2016 and 2017 respectively. In 2018, we saw a marked increase to an average of 104 days, mainly due to our expansion beyond North America, where factors such as milestone-based contracts and clients with long payment approval processes have impacted our consolidated DSO.

In North America, where DSO is 99 days, 82 days including deferred revenue, we're undertaking an increasing number of larger, more complex projects, where we are not the prime consultant or are part of a consortium where we're subject to pay when paid terms and these create additional delays. We're striving the reduce DSO across all geographies through increased scrutiny of our invoicing processes and by targeting collection of receivables outstanding for more than 60 days. Our efforts have yielded positive results in certain geographies in the interim quarter months, but we're not yet seeing a sustained reduction at the consolidated level.

In terms of our liquidity and capital resources, in Q2 we generated CAD 162.3 million of cash from continuing operations, bringing year-to-date operating cash inflow of CAD 73.8 million. For investing activities, we used CAD 31.4 million in the quarter and CAD 135.6 million for the year-to-date, largely reflecting our Q1 acquisition of Wood & Grieve Engineers and our typical spend on property and equipment. And we used CAD 70.2 million for financing activities in the quarter, primarily reflecting the repayments of CAD 30.6 million on a revolving credit facility and CAD 16.2 million for dividends. Year-to-date cash flows from financing activities were essentially neutral.

As mentioned, our leverage decreased this quarter, net debt to adjusted EBITDA on a trailing 12-month basis was 1.8 times, an improvement from 2.0 times at Q1 2019 and within our internal target range of 1 times to 2 times. At the end of the quarter, we had approximately CAD 133 million in undrawn capacity on our credit facilities, so our

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liquidity is in a good spot and we anticipate continuing to drive leverage down over the balance of the year and should be comfortably within our target range. I will also mention that subsequent to the quarter, we extended the term with our revolving credit facility by one year, such that it now matures in June 2024. As part of the extension, we negotiated an increase to our accordion feature from CAD 400 to CAD 600 million giving us further flexibility to fund growth as the right opportunities arise.

And now, 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 are in line with our expectation for slower economic growth in 2019. Net revenue decreased by 1% in the second quarter with acquisition growth of 2.6% offset by organic net retraction of 3.6%. Slower economic conditions drove retraction in a number of our markets, particularly in industrial buildings, healthcare, major water and wastewater treatment plants and housing and we're also up against some tougher comps in some businesses mainly buildings, power and water where major projects that were in full swing last year are now completed or nearing completion. Despite these retractions, we saw a growth in our Mining, Transportation and Oil & Gas sectors. Our Environmental Services business continues to perform well and is actively recruiting to execute contracted backlog and a growing amount of expected work, particularly for projects associated with LNG and pipeline activity in Western Canada. We secured a major win for our Buildings group with a CAD 500 million BMO Convention Center expansion in Calgary and we've won a number of significant strategic infrastructure pursuits that are contributing to our growing backlog. One of the ways we mitigate lower utilization in Canada is by engaging our Canadian teams and project work outside the country with relatively lower fringe benefit costs in Canada and favorable foreign exchange rates, we've been successful in leveraging our Canadian teams to support U.S. operations. In the United States, the economy is strong and that's reflected in our results. We generated solid net revenue growth of 8.7% in the quarter with 4.9% representing organic growth and the balance primarily representing a favorable change in foreign exchange.

Growth was particularly solid in our Transportation business with work beginning on the Chicago Transit Authority modernization project and steady work on the CAD 1 billion Long Island railroad project. We've recently added some significant projects to our slate of transportation work, including the Loyola Drive interchange project in Louisiana. Also of note, our Environmental Services business exceeded growth expectations in the U.S., and our efforts to position with key clients in California, Texas and Northwest water markets boosted growth in our U.S. water business.

In fact, we're close to obtaining notice to proceed for a new water treatment plant in California and we look forward to announcing a major federal win in Texas and upcoming work on a new water treatment plant assignment in the Northwest. Reduced activity in Mining and Water Power & Dams, led to retraction at our U.S. Energy & Resources business. However, we did secure a key win for a large Mine Remediation Project in U.S. West region. As was the case in Q1, growth was strongest in our Global business. Net revenue exceeded 44% growth. This was primarily due to contributions from recent strategic acquisition, but did include a healthy 6.3% organic growth. Organic growth was widespread occurring in all Global businesses with particular emphasis on Mining, Buildings and Water. Looking at Mining specifically, our export business – that's where our North American teams performed work on projects physically located outside North America is performing quite well, with growth driven by new and extended projects. And in our Global Water business, the transition from AMP 6 to AMP 7 is still in work with some clients. But we continue to see a steady flow of work with Scottish Water, Yorkshire and new water projects also drove growth in the Middle East.

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Moving on to backlog, at June 30 contract backlog was CAD 4.3 billion representing roughly 11 months of work. Backlog has increased 3.5% since the end of 2018. And as you can see from the list of major Q2 project wins on the slide, we continue to steadily build on what is a record level of backlog.

In the past few years, we've made concerted efforts to sharpen our approach to project pursuits. We've implemented strategies to identify and prioritize our most critical clients, pursuits and markets. Today we're looking at significant potential revenue parsed out into more than a dozen high priority opportunity that we call our corporate campaigns. We are well-positioned with majority of these projects and are channeling resources to ensure we are successful in these pursuits.

We're also working hard to improve how we deliver projects, ensuring our people have the tools and systems in place to provide consistently exceptional project execution, and those of you, who are participated in our Investor Day in June will recall that we're on the leading edge of using technology and innovation to improve the kinds of services we provide clients and how we provide those services.

We're working to deliver improved shareholder value on multiple fronts. In addition to top-line growth and strong gross margin generation, cost savings and operational efficiency are all part of this drive. Being an efficient and nimble organization is necessary ingredient for our success and we recognize that we can do better in the delivery of value to our shareholders. We've taken meaningful steps to operate as a lean, agile organization and I'm confident our ongoing reshaping initiatives will position us for future success.

Now, I'll hand it back to the operator for Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Benoit Poirier of Desjardins Capital Markets.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Yeah. Thank you very much and good morning everyone. Could you – Gord, could you talk a little bit about the mechanism that you're putting in place right now to make sure that you're managing costs properly going forward, given the action plan that you're putting right now to address the admin and marketing expense?

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

A

Great question, Benoit and good morning. The action that we've done, you see that we split it into, we wanted to clearly show you that we've taken significant action already and that's why we've shown, what we've done already and yet what's yet to come. So, from a perspective of going forward, this is a leaning out of the higher-level staff that we've been planning since the beginning of the year. So as we continue to execute on that, our plan going forward is to – we're looking at everything Benoit from the perspective of – as we move people into these more senior roles ensuring that they – we've always had but really ensuring that they have specific deliverables and metrics that we expect them to achieve. And we'll be following up on those on a quarterly basis just to ensure that people are achieving the metrics that they require -- that they're required to deliver. And if they're not, we'll either have to ensure that they get to that – those locations or we'll have to make further adjustments to our leadership.

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But certainly, it is our intention that once we've gone through this leaning out of the organization, that it will not grow again.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. And Gord, is there an opportunity to maybe do a little bit more, assuming that you see a softness in the overall market environment at one point in time. Is there more room to cut on the expense side?

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

A

We're always looking at it, Benoit, And this is where we think we'll get to in this initial phase of where we're going from an organizational reshaping perspective and I should clarify when I say leaning out of the organization, we're really leaning at out at the higher level of our staff. We are continuing to grow and with the engine at the junior intermediate staff, that the folks that we need to deliver the projects and to – those are typically the higher gross margin generating staff, many of them. So, we're going to keep working there. But certainly, we're continuing to monitor this on a monthly and a quarterly basis. So, are there are additional opportunities? There could be. But, really what we're looking to do is, get ourselves down to where we believe we're agile and nimble and so if we need to make slight adjustments going forward, we'll do so. But, I think this will -- this is the majority of the work, the heavy lifting we need to do now.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. And could you talk about how the action plan impacts your M&A strategy right now, because when we look at the pace so far this year, it's been slower than last year. So just wondering if the action plan is putting a pause on the M&A or anything has changed on this side?

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

A

Right. Yeah. No change on our M&A strategy and the two activities are separate initiatives. Certainly, this reshaping initiative and our M&A programs are separate and we have different teams working on them. So from an M&A perspective, as you know, it's always been lumpy and we did close Wood & Grieve Engineers in Q1 of this year. The pipeline is still full, but we're disciplined and we're just waiting for the right opportunity to come along and then we would move forward.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. And looking at the Energy & Resources, Gord, there's been a retraction and completion of large projects. So what makes you confident that the growth in the Energy & Resources will come back in the quarters to come?

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

A

Yeah. So our Energy & Resources business is divided into several different business lines, Mining, Oil & Gas and Power and so on. We're comfortable with that Energy & Resources in general. By the end of the year, we'll be on budget both from a net revenue and a profitability perspective. The issue that we saw in Q1 from an Energy & Resources side, two comments there. First, while there was retraction in Energy & Resources of roughly 4.9% in Q2. It's coming off of really high comp. Q2 2018, we had over 32% organic growth in Energy & Resources. So the

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retraction in Energy & Resources in Q2 was primarily due to the completion of a couple of very large Power projects, where they were run through our Power group in Canada. So they were industrial facilities, one was a potato processing plants in Alberta, the other was a tissue manufacturing facility in the United States. So those projects have completed. So that's where we saw the retraction really in Oil – sorry, in Energy & Resources in Q2 was from that. Our actually -- our Oil & Gas grew in Q2, mining in Canada grew in Q2. So the other components of Energy & Resources were positive, it really was just Power in Canada due to the completion of those couple of projects and we've rightsized the staff as a result of those being completed now.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay, perfect. And maybe one question for Theresa. In terms of DSO, what makes you confident that you can improve from 104 days to 98 days by the end of the year? And also, could you remind us what is the sensitivity or the positive implication we should expect from the working capital standpoint assuming that you improve your DSOs by six-day by year-end? Thanks.

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

A

Sure. So, as we look at what our target is for DSO at the 98 days that's the target that we established at the start of the year. It's what our board is holding us accountable for internally, what we're working toward. So it has proven to be quite stubborn where we've seen some improvements in certain geographies, it's challenging in others. So we [ph] moved up (00:23:07) our target at 98 days. Our confidence level in there is certainly not as strong as it was at the start of the year, but we're continuing to work toward it. We didn't feel that we should change the target in spite of where our confidence level is because that is the target. So, we're working toward this. We do expect to see some improvement, whether we'll achieve the 98 day remains to be seen and I think it is proving to be one of those longer-term exercise, as we've really dug underneath the structure of contracts and so on. In certain geographies where we are now focused on recognizing some of the contracts may require some renegotiation in terms of payment terms, in other cases, it's what we have delivered which means that as we go forward, our new contract, in fact, this will have to be much more focused on what those payment terms are. So it's a bit of a longer answer to the question you asked but I think that context is important. In terms of our working capital and the improvement, I mean, we roughly think about the day of our DSO is translating to something in CAD 12 million to CAD 15 million range and so, a day's shift or movement is significant. So that's roughly the metric that we use when we think about how to – how do we bringing our DSO down, the impact it has on our cash flows, and so again, we're just going to keep working on it, we have pretty material exercise around it. Everyone is focused on us and we do believe over the long term, we will be able to bring this number down.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. Thanks for the time. I'll get back in queue.

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

A

Okay. Thank you.

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

A

Thanks.

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Operator: Thank you. Our next question comes from Jacob Bout of CIBC.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Hi. 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 wanted to go back to the reshaping of the workforce and is it concentrated in specific geographies or end markets and maybe as a follow on there, does it impact your competitiveness in those areas?

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

A

Yeah. So, great question Jacob. No, when we got into it, we found that it's really primarily focused in North America, where that percentage of our more higher-level staff has grown over time. And so, as we look at it really was throughout geographies and really throughout our business lines. It was a little high – more heavily weighted to the United States and Canada. But we – and that's one of the reasons to your second question, that's one of the reasons why this took a little time is because we wanted to be sure of that as individuals exited the organization, that we weren't about to receive a large project award that required there – that was primarily due to their involvement or that there wasn't a significant project, they were currently delivering that would be at risk. So that's why it took us some time to put the list together, then we had to work certainly with our HR departments and with the appropriate legislation to ensure that we did this properly. So, we don't believe that it will have any impact on either securing or delivering work going forward.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

And what type of reduction in head count, do you expect when this is all done and maybe talk a bit about your ability to repurpose individuals?

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

A

Yeah. So, the order of magnitude is certainly in the hundreds of people, it's not in the thousands of people. And so, that's sort of roughly where we find ourselves. And sorry, the second question, I couldn't get. Second part of your question I couldn't quite hear.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Yeah. Just the ability to repurpose individuals?

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

A

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So we certainly whenever possible, we want to repurpose individuals and use those individuals wherever we can. A lot of people – a lot of our individuals who have moved into these more senior business developments or more administrative type leadership roles are typically have been very, very, very talented engineers and project managers. So wherever possible, we certainly are looking for opportunities to repurpose those individuals sort of back onto more client-facing work whether it's delivering work, whether it's managing those projects, so wherever possible we certainly have looked for opportunities to repurpose those individuals where we could.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

And where do you think the cost come in and when will this can be completed?

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

A

Well, the first wave, Jacob, of work as Gord said is largely done. And we have more to do through the balance of this year, and then, I think we'll be in maintenance mode. So the cost savings that we have displayed on one of those early slides, is where we think we're going to be with an annualized run rate of CAD 40 million to CAD 45 million in labor costs, that we'll look to phase. And then from there, it will be about just maintaining, keeping a really close watch on, what our utilization rates are, what our admin and marketing costs look like relative to our net revenue and just staying on top of that.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Yeah. No, what I was asking, just on the cost side was just cost associated with the head count reduction.

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

A

Oh, from a severance perspective.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Correct. Yeah.

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

A

Oh, yeah, okay, sorry. From the severance – so yeah, I think as we – as Gord mentioned in his remarks, the severance costs will not be material. We already incurred a little bit in the second quarter. It was very small, and it will be not material for the balance of this year because of the reasons that Gord laid out around ample employment in U.S. and the number of contractors that don't have a kind of severance built into their work arrangements.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Last question here just on the Water industry. I see the organic growth rate in the quarter was 1.3% still lagging industry or what your comps would be doing. Just talk a bit about what's going on there? And when do you expect it to get into that kind of 4% plus organic growth rate in the Water business?

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

Yeah. So we did have either positive or flat organic growth in the majority of our regions, Canada, U.S. and Global. We have low retraction in Canada. What's interesting there from the Water side, we've been generating the backlogs are high and we continue to win great, great project, when those of you who were at our Investor Day, we heard from Cath Schefer and we look at the UK what's going on with the AMP programs there and we've already, of course, announced we won Yorkshire and Southern AMP 7. We've also recently won from an AMP 7 perspective some framework in Severn Trent in with United Utilities. So we're replacing that AMP 7 work. In North America, we've got several very significant awards on the Water side – a water plant in California that is very innovative. We'll be hopefully, will be able to talk about shortly a very large several federal project in Texas that once we get the go-ahead from the client, we'll be able to chat about. So the backlog is there. It's really now just working hard to turn it into revenue and we have the people that are ready to go there, our utilization in Water is not maxed out. So we have capability to continue to generate additional revenue there. It's really just as I believe the timing issue of working with our clients to get these projects rolling. The backlog is there, and from a utilization perspective, we have people to do it.

Jacob Bout
Analyst, CIBC World Markets, Inc.
Q

Thank you.

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

Thank you.

Operator: Our next question comes from Yuri Lynk of Canaccord.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.
Q

Hey. Good morning. Gord...

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

Good morning, Yuri.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.
Q

Hi, Gord, so I just want to dig in with this realignment of labor force. I don't understand how labor costs kind of -- it sounds like they almost crept up on you guys. And you've got record backlog, there's labor shortages in the U.S. and you're laying off hundreds of senior people. So just maybe just back up a little bit and when did this start to be a problem? And why does it appear like it's something that was kind of crept up in the last couple of quarters?

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

This is -- this is something that Yuri I think has crept up on us slowly for years -- likely a decade or more. We have senior staff, high-level staff that join us through acquisitions, that have good client connectivity, good connectivity

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with the staff. We -- they come into the -- our organization and are they adding value? Certainly. But, I think over time we've seen that the number of these folks and our overall shape of our organization was trending more to be a bit more heavily weighted than it needed to be from a -- when you look at how – where companies like ours generate the gross margin, typically it's at the junior and intermediate staff level, and the more senior-level generates less from a margin perspective. So, I think over time, we've just seen our curve move a little bit higher and so really what this is all about, this initiative that we've been working on really from the beginning of the year is to reshape that curve and to reduce those more that higher-level staff that are typically have -- command a higher salary and are less utilized and we're hiring at the junior to intermediate levels where we generate the gross margin and that's really where a lot of the project execution work is done.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.

Q

Okay.

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

A

So, it's not something that crept up over the last couple of quarters, it's been something that has been developing over probably a decade and we're just taking action to get it back on track now?

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.

Q

Okay. I guess, I mean what's changed that it's – I mean because we didn't hear anything about this in the first quarter or the quarter before that, I mean and now the numbers were okay in Q1 and now they're weak because of this. So I mean what's changed to make this a more pressing issue, I guess, than it was might have been previously.

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

A

So maybe I'll answer that for you, Yuri. I mean it's – I think the urgency that maybe came across in the way we talked about it in our press release was really because when we started the year, we kind of had a mindset around how long it would take to get all of this done and that's a bit why it wasn't specifically called out. It was baked into our guidance that we manage our admin and marketing costs, back to being within the range of 37% to 39% and so that was the assumption and that implies that those costs would've been eliminated at the start of this year. And so, because of the time that it took, it's widened to the savings in Q2 and it wasn't really like – it wasn't a rush to action but it was reaching a point where we completed the work and we were able to make those excess happen post Q2 and before today's call, and that was just, it is kind of the way that happened all at the same time, given the steps we had to take to get the work done. So, it wasn't a rush to action, it was been in the plan, it was intended to be sort of orderly and executed well through the first half of the year and as I said it just took longer than we expected in the kind of the [ph] wage (00:36:10) yet.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.

Q

Okay. Last one from me on just the cost savings that you've called out for the back half of the year, are they going to be half in Q3, half in Q4 or would they be mostly felt in the fourth quarter?

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

I can't be really precise about it, but I would expect that it will be more in Q4 that you – it's probably not true, it's probably going to be about half and half, because a lot of it represents the exits that have already occurred and then there's a smaller portion yet to be done in Q3 and Q4 that you won't see those statements until Q4. So it's probably closer to evenly split.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.
Q

I'll turn it over. Thanks.

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

Thanks, Yuri.

Operator: Thank you. Our next question comes from Derek Spronck of RBC Capital.

Derek Spronck
Analyst, RBC Capital Markets
Q

Thank you for taking my questions. Just around the cadence of major projects rolling off, major projects starting in kind of your bid pipeline, I know it's still pretty early, but how is 2020 shaping up, as you see it today in the context of your project backlog and bid opportunity?

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

Yeah. We haven't seen really any slowing of the proposal or the opportunity pipeline that we're processing. Some good general baseload projects, but also some very, very large projects and we've had a couple of really large project wins over the last quarter that our clients haven't given us authorization to press release yet, but hopefully, within the next month or so, we'll put those out on the street, and those are multi-year project toward some of these larger pursuits. So, while we see on the small to medium size projects, good cadence there, but the backlog or the pipeline of opportunities remains full. A number of these larger projects that are multi-year in duration, we see them still coming and we have some good success [ph] from them (00:38:30) in the quarter as they say, we look forward to press releasing those over the next month or so as we get client approval.

Derek Spronck
Analyst, RBC Capital Markets
Q

Okay. Any concern around hard Brexit and is there anything you can do to kind of mitigate if there is any issues with that?

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

From a Brexit perspective, a lot of the work that we do in the UK is by staff residents in the U.K. So, and that the largest part of the work that we do there is in the Water space. And so, the Water work is done, it's been put together over these long-term cycles driven by regulatory requirements. They – in AMP 7 the capital spend is

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10% to 12% higher than in AMP 6. So that's work that will need to be done regardless of a hard or soft Brexit. So we feel good about that type of work.

Some of the large infrastructure projects that we've been working on, we still feel good that those will continue. We certainly are looking at what the impact might be. Roughly 5% of our workforce in the UK are EU nationals. So depending what happens there from a – if there were a hard Brexit, there were hard immigration or residency control put in place, that would all take some time, and we'd have to work through it and we do the best we could working with our staff to get the appropriate permits for them to stay. But if there were any issues that would represent roughly 5% of our staff, so those are people and we'll do everything that we can but it's not a significant portion of our workforce in the UK.

Derek Spronck
Analyst, RBC Capital Markets

Q

Okay. Thanks. That's helpful. And maybe one last one for myself before I turn it over. Any implications from SNC getting out of fixed bid projects as it relates to Stantec?

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

A

Yeah. Yeah. So we have a number of projects where Stantec and SNC do overlap a little bit. One of them is on the REM project in Montreal. We're part of the SNC engineering team there for REM, but SNC has committed to completing that project. So, we don't see any impact there. We're the owner's engineer on the Broadway project in Vancouver. So, SNC did withdraw there, but we still have two bidding teams, and so we don't see any impact to Stantec on that project as well because again we're owner's engineer.

The one where SNC's withdrawal from fixed fee turnkey projects does have some impact on Stantec was the Valley Line West LRT project here in Edmonton. So, we were part of the SNC team there. With SNC withdrawing, the city now only has a single bidding team. So in late July, the city announced it was temporarily pausing the procurement, they had to reassess the market interest to see if they want to relaunch that. Now, they only have a single bidder. So, we've been contacted by a number of interested parties. So, if they were to proceed with [ph] re-procuring (00:41:59), we're quite confident that we would be on another team. So we'll just have to see how that one plays out. But that's the only – of the existing projects, we see no impact. That's the only pursuit that we had in place with SNC. And if we do have an opportunity to propose again on that, we're confident that we will be on a team.

Derek Spronck
Analyst, RBC Capital Markets

Q

Do you think that it allows you or eventually the market structure will change such that these fixed bid projects may – you'll have a easier time bidding that more rationally and perhaps get better pricing in the future because of, I guess, the lower competition/general malaise of some of these fixed bid projects?

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

A

That will be an overall industry macro trend. It does seem that the more and more of the risk is being transferred from the owners to the proponent teams and you can see that perhaps that risk reward has got a little bit out of shape and so you can see that from a number of our competitors who have either taken significant charges or withdrawn from that market altogether. So, I wonder if over time the pendulum will swing back to some sort of a more balanced risk reward profile, [ph] which teams (00:43:23) – proponent teams and owners. And so that work

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– because we're not typically in the top box, we don't take that long-term fixed fee risk. We haven't been impacted as much by these, that's one of the reasons of course why we divested [ph] our constructors (00:43:39) last year. And maybe we're just a bit ahead of the market in doing that. But, yeah, I do see, my gut says that this whole area of work will likely – I would hope and others in the industry that we talk to, see that swinging back a little bit more towards a more balanced risk reward profile for proponent teams.

Derek Spronck
Analyst, RBC Capital Markets

Q

That's great. Thanks for the additional color, Gord.

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

A

Thanks Derek.

Operator: Thank you. Our next question comes from Michael Tupholme of TD Securities.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Thanks. Good morning.

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

A

Good morning, Michael.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Good morning. With respect to the cost savings initiatives, and I'm not sure if you touched on this or not, but were any of the people that are going to be leaving the company, were they engaged in any sort of business development activity or were these primarily people involved in execution of projects?

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

A

These were people, Michael, who – everybody is engaged in some activities whether it's working with a particular client or pursuit or in some way on a project. But we view that these individuals over time had lower utilization and have become less connected to clients and business development. And so, in making these changes, we viewed it was the right thing to do for the organization. We don't see it hurting us going forward from a business development or a project delivery perspective. But you can't accept several hundred people and say there'll be absolutely no impact. But I think we've – on balance, we view that transitioning these individuals from the organization and allowing others to step up into those shoes is healthy for our overall organization and for the development of our staff moving forward.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Okay. All right. Thanks for that. Just shifting gears, can you talk, Gord, a little bit about the organic growth outlook for your Canadian business? Organic net revenue growth was negative 3.6% in the quarter. And if I'm not mistaken I think I heard you suggest in your prepared remarks that that was in line with expectation. So, I guess,

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my question would be how do you see that trending going forward? At what point would you expect that to get back into positive territory and what causes that to happen?

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

Yeah. In Q2, we did have positive growth in Environmental Services and oil and gas, transportation and so on. The two major groups that had organic retraction, the first was the group that we spoke about there, they're working on industrial facilities and they rolled up into our Power group and that was the potato processing plant in Lethbridge, the tissue processing plant and our manufacturing plant in the United States. So we were heavy on that – those projects at this time last year. Now those projects have wound down. Organically we retracted and we've adjusted staff as a result of that.

So the other area where we had organic retraction in Canada was in our Billings group. And that's primarily because of some of the major healthcare projects that we were working on this time last year, [indiscernible] (00:47:17) project, healthcare projects in Toronto. However, as we've mentioned – messaged in the Buildings group, great project win with BMO Centre in Calgary. We've also had a larger project win with a Canadian federal government agency that once the client give us approval, we'll press release that. So, those are both multi-year projects that we think are – will turn the corner on that Buildings group. So, going forward, we see continued growth in Environmental Services, certainly oil and gas. We are active on Trans Mountain. We hope to get the go ahead as publicly has been stated, in the next month or so. We've had positive growth in the quarter in oil and gas. We only see that improving. So, I do see us, from my perspective, I see us swinging to positive organic growth in Canada, certainly in the latter half of this year...

Michael Tupholme
Analyst, TD Securities, Inc.
Q

Okay.

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

...on a quarterly basis.

Michael Tupholme
Analyst, TD Securities, Inc.
Q

Right. Okay. And then, just in terms of Environmental Services, very strong growth there in the quarter, is and it's – you sounded upbeat about it when you answered the last question. But is that rate of growth we saw this quarter, is that something you think you can maintain for the foreseeable future or is there something sort of anomalous about what you saw this quarter there?

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

Well, I think what we're seeing in the Environmental group is just solid growth hitting on a number of different sectors. In Canada, that group will be active on construction monitoring work, assuming Trans Mountain gets the go ahead. That group is currently working on some of the marine offloading facilities that are associated with LNG Canada, they're doing work related to Coastal GasLink. We've got a proposal in LNG Canada to continue our Environmental work during the construction phase, [ph] it was just a (00:49:20) proposal at this stage. So we see pretty broad based work support of the Environmental group going forward.

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Michael Tupholme
Analyst, TD Securities, Inc.

Q

Okay. And then just lastly when we look at the backlog up 8% year-over-year relative to consulting services in the prior-year period. Part of that, I guess, is driven by acquisitions. Do you happen to have the organic, how much of that growth would have been organically driven?

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

A

When we look at the growth, I can tell you relative to where we were at the end of the year, the change from organic growth was actually bigger than the total change in total. It was offset a little bit by negative change in foreign exchange. So, really solid contribution from organic growth as well as growth from acquisitions from the of Wood & Grieve acquisition. So those two positives in acquisition and organic growth offset slightly by change in foreign exchange, so pretty solid contribution.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Okay. Thank you.

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

A

Thanks, Michael.

Operator: Our next question comes from Chris Murray of AltaCorp Capital.

Chris Murray
Analyst, AltaCorp Capital, Inc.

Q

Thanks, folks. Good morning. Just going back to the cuts you're going to make in some of your SG&A, so, I guess, a couple parts to this. I mean it sounds like part of this has been your acquisition evaluation over time and maybe having too many higher end folks around. So, I guess, I'm curious about two parts to this, one, how do you think that this changes your approach to acquisitions in terms of even trying to retain some senior folks as you go through those transitions and what this may do to your attractiveness as an acquirer if maybe you need less of the senior folks as you buy different companies.

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

A

Yeah. Great question. The individuals – the higher level individuals that come with these acquisitions, we want them to stay as long as they're continuing to be engaged with clients, bringing in work, helping us execute work. But what we don't want is individuals that over time may become more disconnected from client and get more involved in administrative type activities. And so, we're a company that's focused on clients, on growing our work, on delivering the work. And those are things that are important to us.

So, I think that we as we continue to look at our companies that join us, it's that fire in the belly that makes those people have their own company, it's the opportunities to bring that to Stantec that I think is important and attractive to them as well. But we've been very clear with these people that when Stantec acquires you, we don't want that fire in your belly to be extinguished. We need that continued entrepreneurial drive and that spirit to keep moving us forward.

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And all of these people that we've talked about, that have exited the organization, they didn't all come from acquisitions. These were people who have been with a company and grown with us over time, which is – and they were people who were all providing value. There's no one sitting there that's providing no value or they would have exited from the organization a long time ago. We're just really trying to lean out and ensure that the people that we have particularly at the higher levels in the organization are focused on our core objectives of client, winning work, delivering work and executing on it well. So, we're just refocusing and ensuring that the folks that we have, have that drive to continue to move us forward.

Chris Murray
Analyst, AltaCorp Capital, Inc.

Q

Okay. Do you think that has any impact over the way you approach project oversight and control, is it part of – like you talked – you referenced sort of admin and that kind of thing but I mean, I know, at the Investor Day, we talked a little bit about how your approach to project management and risk management, do you see any impact from some of these changes?

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

A

No. Not on that group. Chris, we've got a very robust risk evaluation process before we'll take on projects and we continue to work on how we [ph] win (00:54:14) our project oversight, project sponsorship. We continue to work at how we're evaluating project pursuits going or a project delivery going forward. So, no, I don't see significant downside risk from some of these changes that we've made.

Chris Murray
Analyst, AltaCorp Capital, Inc.

Q

Okay. Great. And then just if I can ask a quick question just on the seasonality. I know, I appreciate, just with, call it, some unusual things happening this year, you've adjusted your seasonality guidance. But should we still be thinking like 2020, we're going back to kind of the normal pattern, is that the best way to think about it?

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

A

Yeah. I think so.

Chris Murray
Analyst, AltaCorp Capital, Inc.

Q

Okay. Thanks, folks. Thant's all my questions.

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

A

Thanks, Chris.

Operator: Our next question comes from Ben Cherniavsky with Raymond James.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Good morning, guys.

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

A

Yeah. Good morning, Ben.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

At this stage, most of my questions have been answered, but I will take the opportunity just to go back to what Yuri was talking about because frankly I'm still struggling to understand what happened here and I think judging by the your stocks opened this morning, I think I don't think I'm alone. So, this is something that was, Gord, from your assessment, a little bit like the frog in the boiling pot of water slowly happening over time. You had some plans, according to what Theresa said, to deal with this earlier on and they didn't materialize as quickly as you expected. But how did it all show up in this quarter like this? I mean it seems like there is – as you pointed out, organic growth has been good, your gross margins performed well, so this sort of blindsided the market and there was no indication from you guys that there was even this kind of a problem, I know, Gord, you have talked, to be fair, you have talked about being leaner on costs, but I just don't see how this all of a sudden transpired in this quarter and nobody really saw it coming.

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

A

Yeah. I think the one thing around this, Ben, is that in the first quarter, I mean our earnings were good and admin and marketing cost as a percentage of net revenue were higher than they typically would be through the course of an average year. And we attributed that to seasonality, which was a part of it but embedded in that also was a component of these costs being too high. So it got massed a little bit I would say from expecting the cost to be seasonally a little bit higher than they would be through the rest of the year.

And then as we got into Q2, typically what you see in Q2 for our business is that admin and marketing costs actually comes down pretty significantly within our guidance range. And so that on a year-to-date basis, we are comfortably in a range, and that did not happen this year. And so, as you sort of look at the way the numbers rolled through the year, they were too high in Q1, we're expecting to bring them down, it didn't happen fast enough. And so, you have this bulge in the second quarter and that's really kind of the way that this showed up. I think historically they have been high as well but from a utilization perspective, again, with certain puts and takes in our admin and marketing costs, would have been less apparent. And so I think that's the explanation, and it does – it's called up pretty prominently. And if you look at our total admin and marketing costs, the piece that we pulled out around excess labor is bigger than the sort of aggregate variance in admin and labor, is because we've had other expenses that rolled into that total, came a little bit more favorably, so there's always things kind of offsetting these amounts, which make it more or less apparent. And so, that is as best as we can explain it, Ben.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

So, in short it was a misinterpretation early in the year, that some of the cost issues were seasonal when they weren't?

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

A

I think so, yeah.

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Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Historically Stantec always had sort of prided itself on being very much on top of utilization rates, having good visibility into projects, almost immediate visibility into projects and margins. But something changed in the processes of the systems that allowed this to happen in this way or like, this is, Gord, we've talked in the past about bringing back some sort of [ph] old (00:59:34) – the historical standards and practices or performance of Stantec and this is sort of very, to put it bluntly, anti-Stantec. So, what would explain the fact that this isn't the kind of stuff we used to see from Stantec?

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

A

Yeah. You know what, I think, Ben, what – in fact that the actions that we're taking are to get us to that – get us back to how we've always operated lean, and take these costs out of our SG&A. We do track utilization very closely as you mentioned. We are now – due to where we are now like in Canada as an example, our utilization rates are up about 3% from where they were a quarter ago. So we've got the season – we've got that, that seasonality is hit from a positive side, where the utilization values are up. So, I think, Ben, it's a bit of, as you've said, it's been the frog in the boiling water that – and that's been happening over – it hasn't happened over a quarter, it's more happened over a decade, but now we're taking action to get us back to where we need to be.

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

A

I think it is...

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

You think that – go ahead, Teresa.

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

A

I think, so having been with the company for now quite a year, but in observation, this whole area of having maybe slightly too high, maybe way too high admin and labor costs is the theme that I heard really from when I joined the company. So it's not like we woke up one day and realized that it was too high. There has actually been a theme and a discussion around the need to address this. I do believe, though, that last year there was so much focus on the construction business and how to write that shift, how to address that strategically and then work through the sale process that it did take attention away from getting after this piece.

And I think, as Gord said in his remarks, when we came into the planning for 2019 with construction behind us and we said, we know that Stantec is – we are a show-me story and what do we have to do to begin to put the markers back in place and get ourselves to the standards that we have always been known for. And this was kind of top of mind. And so, again, this is why if the cost savings were baked into our guidance and for the full intention of taking this line and moving forward.

So, we would have liked it to have happened faster, we would have liked for it not to bulge the way that it did this quarter and to meet our mark, it didn't happen. But again we've taken action now. It would have been better not to have to do it in a way that we did, but that's where we are. But it certainly has been with the purpose of reinvigorating getting back into that sort of top of the game that Stantec has been known for.

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Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Right. Yeah. Well, that was going to be one of my questions whether or not the construction issues were a distraction to the core business. So, thanks for answering that. Thanks guys.

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

A

Thanks, Ben.

Operator: Thank you. Our next question comes from Devin Dodge at BMO Capital Markets.

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Thanks. So, just coming back to the cost issues that you had, so if we look ahead to 2020, do you think the cost efficiencies from the organizational reshaping initiative, should that put admin and marketing expenses at the lower end of that 37% to 39% of net revenue range? Maybe another way to put it, if you look at the base business, assume a bit of organic growth, do you think admin and marketing expenses could be close to flat year-over-year in 2020 on a dollar basis?

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

A

So, I'll start by saying that we're in the early stages of the planning and the budget cycle for 2020. So, I can't answer your question with a lot of precision. I think certainly we believe this will put us in the middle of the range, all things being equal, and it would certainly be our desire to bring it towards the lower end of the range but having not actually really started being that far into our budget process, I can't say with a lot of precision but that certainly would be the goal.

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Okay. We noticed in the Q2 report there was a mention that Stantec remained committed to its long-term revenue growth target of 15%. At the Investor Day, it seemed like there was maybe a bit of softness related to that commitment. Just can you provide us an update how we should be thinking about revenue growth over the next three to five years?

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

A

Yeah. So we are in the midst of our strategic planning cycle right now. We have meetings with our board coming up. And certainly that number is something that we are evaluating, our 15% five-year CAGR. And we've heard from a lot of you that the law of large numbers catches up with someone and that while we're a disciplined acquirer, nobody wants us to go and do something that is outside that disciplined focus just to hit a target. So that is certainly something that we're looking at. We haven't confirmed a target with the board, but it is certainly something that we're looking at through the strategic planning process this year and with an understanding that that number is, while historically we've been there as we were a smaller firm, it is something that we're evaluating now that we're larger and more complex and global. So I can't tell you what the number will be because we haven't confirmed the long-term direction with the board yet, but certainly we will be doing that through the fall.

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Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Okay. That makes sense. And just you mentioned being disciplined in the [indiscernible] (01:06:32) M&A. Just can you remind us how you look at M&A targets in terms of multiple differentials or hurdle rates?

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

A

So, from a multiple perspective, we remain disciplined there. We used to be looking at the firms in our space in that [ph] 6 to 8 (01:06:55) range, now it's maybe [ph] 6.8 (01:06:57) something, but we're continuing to be focused on that. You can see some of the larger acquisitions are going for sometimes double digit multiples and that hasn't been a market that we've been active in, those larger groups. So we remain disciplined certainly as we see in the U.S. now, firms have been generating solid revenue for a number of years, so multiples there are very strong from what the potential sellers are looking for. But we remain focused on ensuring that whatever we do from an acquisition perspective will be accretive.

Devin Dodge
Analyst, BMO Capital Markets (Canada)

Q

Okay. Thank you.

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

A

Thanks, Devin.

Operator: Our next question comes from Maxim Sytchev of 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.

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

Just the question, as you guys do bigger projects, one of, I mean, obviously, issues is the DSOs, which seems to me, we're having a problem right now. And when you combine this with letting go some of the senior people, I'm just trying to see how you guys feel your comfort level around the execution. When I look at one of your partners [ph] Fluor (01:08:19) for example on Purple Line, there appears to be an issue, so I'm just trying to see how you're going to be able to manage and balance these sometimes conflicting dynamics. So, if you don't mind providing some color there, it would be helpful.

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

A

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Yeah. No, great perspective, Max. The – our senior staff, higher level staff that are engaged on projects, project management of these larger projects and execution of these larger projects and who are engaged with clients, those folks are – we're growing that percentage of our workforce. The individuals that we had to work with here as part of this reshaping initiative were those individuals that typically were not as highly utilized or engaged on project pursuits or delivery. So, in terms of, will this negatively impact our ability to manage projects large or small, we don't see that being the case.

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

And, again, I'm just – I don't want to belabor the point, but is there a push then to implement some sort of technological tools to make sure that there is no leakage of either cross-selling capability between different departments, because like I assume if you don't have 800 people helping kind of at the mid-level to manage all that stuff, like what is the exact substitute instead?

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

A

Yeah. From a project delivery perspective, we've always had good tools in place and we continue to strengthen them. From a cross-selling perspective, our account management programs are very robust and we've got – had seen significant growth in account management. So, no, Max, I don't – we do have all the technological tools from an account management perspective and a client opportunity management perspective, we do have all of those tools in place. You can never accept a number of people from an organization and say you'll have no impact. But, we – that's part of the reason why this took a little longer to get to where we were, because we spent a lot of time to ensure that as these individuals were transitioned, that the work that they were working on or the clients they were working with were also transitioned as best as possible. So we don't see any significant negative impacts from the work, the reshaping initiatives that we've done.

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

Okay. Fair enough. And then just last brief question for Theresa if it's possible. The leverage right now 2.4 ex-IFRS, is there a sense of maybe guidance you can provide by where we should expect this number to be by the end of the year?

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

A

We do think – so, Max, [indiscernible] (01:11:19) excluding IFRS 16 [indiscernible] (01:11:21).

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

Or whatever you think you're [indiscernible] (01:11:25)

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

A

Yeah. Well, so the former target was 1.5 to 2.5 times without IFRS 16 and so we expect to be [ph] solidly (01:11:34) in the middle of that by the end of the year...

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Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

Okay. All right. Thank you very much.

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

A

...or better.

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Q

That's it from me.

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

A

Yeah. Thanks Max.

Operator: Your final question comes from Benoit Poirier of Desjardins Capital Markets.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Yeah. Just to come back on the water opportunities, if we look at the AMP7 backlog, there was about, I think, at the Investor Day, about [ph] $75 million (01:12:01) book already with a much larger amount to be secure. So, you mentioned a couple projects, federal work in California, so, Gord, could you maybe give us more color about what is currently book with the AMP7 and the timeline with respect to securing the other [ph] chunk (01:12:24) that you were referring to at the Investor Day?

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

A

Yeah. No, a great question. When Cath Schefer at Investor Day talked about the AMP7 work that we had done, she talked this is what has been – this is contracted backlog and as well we're looking to – we have other pursuits in the pipeline that will then expand that backlog. And so as we mentioned, we did win the framework agreement for AMP7 with Severn Trent and with United Utilities, those are both new since Investor Day. We've previously announced that we won the AMP7, some components with Yorkshire and with Southern Water. So that – as best as you can see the future, the future of AMP7 is unfolding as we would hope. So that feels good there. And the work needs to be done and we talked a little bit about Brexit in or Brexit out, what happens there, that water infrastructure work needs to be done.

Back here in North America that backlog continues to increase as well with some really good awards over the last quarter that we'll be able to press release hopefully over the next month or so depending on when we get client approval, so we feel good about the water backlog, we feel good about the water group. It's just really getting that work out the door and we're working with our clients day in and day out to get these things moving.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. Thanks for the call...

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

A

So it's interesting – yeah. Great, Benoit. And not just in water, but across the company, backlogs are good, you can see the overall revenue generation is good, the project gross margin is good. And I appreciate all the questions [ph] from everyone (01:14:16) this quarter particularly was related to our reshaping initiatives, but we feel positive about where we're going in the future.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. Thanks.

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

A

Thanks, Benoit.

Operator: At this time, we have no further questions in queue.

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

Great. Well, thanks everyone for joining the call today. Look forward to chatting with you over the next weeks and months to come.

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

Thank you.

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

Thanks very much.

Operator: Thank you. Ladies and gentlemen, this concludes today's teleconference. You may now disconnect.

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