03-Dec-2019

Stantec, Inc. (STN)

CORPORATE PARTICIPANTS

Since that time, the company has grown substantially including our global presence outside of North America. And I'd just like to pause for a moment to thank Scott Murray for his leadership and the many significant contributions he's made to Stantec over the years. He has truly helped shape Stantec into the company it is today. And we wish him all the best in his upcoming retirement.

We recognize that our North American and global operations have unique requirements. And for that reason, we've decided to split the COO role into two; with one CEO focus on North America, and the other with a specific mandate for our global operations. Stu Lerner, currently the business leader for our ± for Infrastructure will become our COO for North America; and Cath Schefer, currently the Regional Operating Unit Leader for our global operations outside North America will become our COO for global; and Scott will work closely with Stu and Cath to ensure a smooth transition.

We'll also be adding a new role to the C-suite to help drive our innovation initiatives forward. Marshall Davert, currently the business leader for Water will take the new role of Chief Innovation Officer. He'll lead the commercial development of services and digital solutions to improve our long-term competitiveness. Marshall will also focus on driving value from our industry partnerships and create competitive advantage from our creativity and innovation programs. Theresa Jang, Tino DiManno, Steve Fleck, Emree Siaroff and I will remain in our current C-

be an acquirer of choice. We're committed to doing what we're good at, focusing on small to medium sized acquisitions. We will not grow the via acquisitions just for the sake of growth, and we will only pursue those targets that meet our strict minimum requirements. That is, they must be accretive to earnings and have a risk adjusted internal rate of return in excess of our weighted average cost of capital. The earnings potential of the merged organization must be greater than the parts, resulting in long-term total shareholder return. We must be able to achieve earnings synergies, resulting in improved margins by placing the acquired company on our global back office and marketing platforms. The firm must fit our risk profile. And finally there needs to be a strong business and cultural fit.

I'll now turn the call over to Theresa to describe our capital allocation strategy, 2022 targets and our guidance for 2020.

Thanks Gord. As you've heard throughout this presentation, we've evolved our approach to capital allocation towards increasing capital return to our shareholders. While our share buyback program has been in place for a number of years, there was really only in the last half of 2018 when we really ramped up our share repurchases, spending about CAD 75 million. So far this year we've used an additional CAD 32 million of our capital to buy back shares representing over 30% of year-to-date cash flow.

And our dividend introduced in 2012 has increased steadily each year. Over the next three years, our dividend payout ratio should be in the range of 25% to 30%. Under our new three-year plan, we're committed to maintaining our rigorous approach to allocating capital. This is reinforced in our moderated net revenue growth target and in our commitment to only pursuing small-to-medium sized acquisitions. Against this backdrop, we've taken other steps to create greater alignment with shareholders by discontinuing dilutive stock options and by adopting total shareholder return as a metric in our long-term incentive program.

Central to my mandate is to ensure that we have a value-focused approach to capital allocation with a clear than 10%, an adjusted EBITDA margin as a percentage of net revenue of 16% to 17%, an adjusted earnings per share CAGR of greater than 11% and a return on invested capital of greater than 10%.

Having set out our financial targets for 2022, let me spend a little bit of time focusing on what we expect for next year. Consistent with our three-year plan, our 2020 targets are focused on three key measures. Our target for

Q

Okay. And then if you turn to slide 23, you talked about growth across all business lines, but less of a focus on Infrastructure versus Buildings, Water and Environmental, should we be reading much into that?

A

No. In fact, what we were trying to illustrate there is, currently, Infrastructure makes up 28% of our overall net revenue. And so the thought there was that, I think I mentioned that we see outsized growth in Buildings and Water, and that's only because illustratively, those Buildings and Water are both below 25% now. And we see over time those big three for us of Infrastructure, Buildings and Water all being in that 25% equal range. So, no, we're not taking our foot off the gas in any way from Infrastructure and we see great opportunities there, just that we want to continue to focus on Buildings and Water to kind of increase their percentage of overall revenue generation.

I think these are good solid targets for us.

Q

Okay, okay. And you had one metric around customer satisfaction. I'm just curious as to how do you track that and what is that metric and kind of where are you today within that metric?

A

Yeah, we have Derek ± Gordon here, we have a robust program of client engagement. We conduct regular client surveys. We ask that each of our project managers and everyone who's engaged with clients to conduct certain number of these on an annual basis. And so we work through everything from, were you satisfied with the project manager? Were you satisfied with the product that was delivered? How is the pricing schedule? All of those forms of engagement. And then at the end, we have a question that just says, are you satisfied or would you hire the

Q

Okay. Yeah. I just want to double check. That's it for me. Thank you very much.

A

Okay. Thank you.

A

Thanks, Max.

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

Q

Thank you. Good morning.

A

Good morning.

A

Good morning, Michael.

Q

First question is about the revenue mix and the suggestion that you expect Buildings and Water to achieve outsized growth and targeting 85% or higher from non-cyclical industries. Is the growth in the areas that you expect to show higher than average growth or oc h2 1 29224(th)-7(an)4( )-10(q48.6 47(0.2 ,Is)-2(th)-7(0(areas)-4(CID94 313.0

to take us ± I think we've mentioned in the prepared comments, this is going to take longer than just 2022. And we won't forego a good infrastructure acquisition to get ± to wait for a Water one. We'll do the right things. And what we're trying to really indicate on this slide is just in general we're looking for that, the big three for us is Infrastructure, Buildings and Water being each about a quarter of our business and about 85% or more of our revenue generated from these non-cyclic industries.

execution. So everything has to go really well in order for us to be able to believe that we can achieve the upper-end of that range. And so that's what we're going to strive to do. And we'll see how it goes over the course of the year. But it really is a number of moving parts that need to align in order to achieve that upper-end.

end.(LP.5llng)-76 Tm6 1 4(257.45 g C0T 0(wi oeT f5(s) gE)-.5x 7 22Tm6 1 7 4(6(t4(iy)]0Te(6( )1 47(T f5(s)e 3c)]0Te(6(W* n45 g&)-.545 gE)-.545ir eTm6 1 7 22((s)-4(W* n457.4

A

Good morning.

Q

I don't want to diminish the value of what you've done this morning and the messaging has been helpful. It sounds to me that it's more of a clarification and a fine tuning of a strategy than a reinvention of one. I mean, for example, wasn't disciplined acquisition not paying too much. Weren't those all part of what you did before? And if so what ± my question would be what would be the main message you want to get across as to what's different here about what you're trying to do. Is it do you feel like you were perhaps in the past too focused on growth? Were you undisciplined about capital allocation or what you paid for acquisitions or beyond a few narrowing of targets, what exactly is ±

Q

Thanks. Good morning. Just maybe ± Gord, if you want to just maybe explain this a little bit better. You alluded to in your organic growth, some of it coming from some of the international financial partners. Can you talk a little bit about the types of projects you're going to get into? And I guess what I am trying to understand is, does that draw you into more developing countries and some of the challenges you may have around that?

A

Sure. So, we already do a lot of work for the international financial institutions. What ± we have an office in that focuses specifically on this and we've worked for groups like the European Bank of Reconstruction and Development, working on development type work. And the nice thing about, as you say, does that lead you into some developing countries? And absolutely, it does. But the reason that we're comfortable with it, Chris, is that the selection process is run by the European Bank for Reconstruction and Development, the payment is done by them. So, we're ± while we're working in, sometimes in countries that may be a little bit lower on the Transparency International scale, the procurement and the execution of the project is run in accordance with the international financial institutions procedures. So, we're very comfortable with that. So, we already, for example, last year we worked in half of the countries in Africa. We're currently doing work for the Millennium Challenge Corporation putting in a large power line in Nepal. So, that's ± that is just sort of good, solid, base load type work, the funding sources seem to be reasonably ± reasonably secure. There's always a talk that it will go up or down, but, this is a good business for us. It's also a business that a lot of our employees like to be engaged in. So, a good stable business with good stable clients. And so, that's an area of continued focus for us.

Q

Okay. Thank you. And then Theresa, the comment ± the interesting comment, I go back to the slide looking at capital allocation, but, I mean, the key phrase I think really comes back to risk adjusted returns. And it really is that risk adjusted piece that may be open to an interpretation. Can you explain how you think about this, because when I think about the lowest risk for basically the returns ± basically you're aiming for a better than 11% CAGR on your net income. You know, that's ± that almost seems like a pretty high hurdle rate, not to be buying back more stock which ± can you just think ± explain how you think about that risk adjusted piece of that phrase?

A

Sure. Any time you are engaged in the M&A activity and you are evaluating an acquisition target, it is so ± it's so critical to do a fulsome risk analysis. And so, it's ± whether it's identified ± I guess, no need to explain to you all the different risks that we might examine. But, for me, it's really about evaluating the whole picture and ensuring that we are taking a measured approach and recognizing within that particular acquisition what the risks might be.

And then as we ± as we look to how we would adjust an IRR that we would be looking to achieve from that acquisition target. That's ± that's obviously where it's going to flux. And so, can't give you specific examples of getting into the details of what degree to which we flux that risk adjustment, but it's just ± it's a really important part of that process. So, identifying the risk, stress testing them and then understanding to the extent we choose to accept a particular risk profile, what are the mitigates and goods charged with ensuring that those risks are

Q

Okay. And then, I guess, my last question is, thinking about total shareholder return. And, I mean, I appreciate your chart, you've shown us about your buybacks versus dividends some whole bit. But, when we start thinking about available free cash flow, I mean, I'm operating on the assumption that we shouldn't expect anything in your capital spending requirements to change over the next few years? There's always a difference, as you alluded to, in some leasing versus buying certain capital assets or facilities; but if we think about it, I mean, you just renewed your normal course issuer bid, for up to 5% of your shares, which, in my mind anyway if you're going to be turning to that feels maybe a bit light because when we think about, folks are kind of aggressive on buybacks, they've got at least a 10% limit. So, I guess, like a couple of questions on this. I mean, how flexible are you in being more aggressive on share repurchases even to the extent that that would probably increase your leverage a little bit? And then, any thoughts or did you guys discuss accelerating the NCIB or did you even talk about substantial issuer bids?

A

Yeah. So, as far as the NCIB program goes, let's start with the 5%, You'll know that the [ph] GSX (01:04:56) is pretty rigorous in terms of what they allow you to establish as your target. And, as we as a company historically has a NCIBs, a number of years ago we weren't using it. And so, Gord [ph] took forward the GSX (01:05:10) and said, okay, like, you can't do this anymore, we're not going to allow you to have an allocation for NCIB because you're not actually using it. When we started ± when we came back ± and again forgive me I don't know exactly what the year was. But set the program at 2.5%, [indiscernible] (01:05:26) give us a little bit of room here because we were serious this time. We're really going to use it. And so we got that approval for 2.5% and so that's where you'll see in the 2018 program ± November 2018, that was initially what we were allowed to set the threshold, that was 2.5%. And we started to approach that limit really into the first quarter of this year.

So, we went back to see [indiscernible] (01:05:56) okay, like that we've shown you, we're using ± we're using this actively. We'd like to increase our number to 5% and that's where we got approval to do so. So, 10% would be a real stretch for us both from a capital deployment standpoint and from the perspective I believe of the regulators to say ± to say that we would actually be successful in setting a limit beyond 5%, so it kind of start there.

As far as, how we'll deploy the capital between share buybacks and acquisitions and where I'm comfortable with the leverage. It is something that we actively manage. And so, you'll see like in the second quarter when our share price ± we can considerably ± we were very active in that space and in buying shares back. And so it's a valuable tool for us. And I completely agree with you, it's very low risk because we know our company. And so it's really just on balances, managing all of the pieces, trust ability for acquisitions, where is our leverage ± I won't ± I think part of it too from a leverage perspective is, it's been important for us to reestablish our commitment to the strength of our balance sheet because the leverage was really high at the start of this year like all for good reason. But there was ± I got a considerable amount of pushback and feedback externally for where our leverage was. So, I think we're now in a position where we've built some credibility to say, listen, we're going to be prudent, we're going to be careful, it might flex above it, if it does so, it will be for a good reason. But we're going to bring it back in line. So those are all the pieces that I'm going to try and manage as we go forward.

Q

Okay. And just ±

A

No, it's ± that's not really something on my radar at this point.

Q

All right. Thank you very much.

A

Thank you.

Operator: Thank you. Our next question comes from Yuri Lynk with Canaccord Genuity.

Q

Hey, good morning.

A

Good morning, Yuri.

A

Hi.

A

Good morning.

Q

Just going back to the M&A question, I understand the pipeline for M&A is strong and I believe it has remained strong for some time now. Can you comment on the quality of this pipeline? And is that one of the reason that 2019 was muted, maybe there are a lot of options out there but limited good option?

A

No, I think the quality there is very solid for us, one of the things that we have talked about is, there is a number of

Operator

Great. Well, we'd just like to thank everyone for taking the time out of your day to

Operator

Di7claimer anit(er to)ea0(5..1TD 16>B4(a] TJETQ EMC P MCID 21>BDC q53.16 103.34 50c[1 189.98 27.63 2Wnu37MCIDn)8( )-12(

So thanks very much. Scott Alan Johnston