11-Nov-2022

Stantec, Inc. (STN)

Q3 2022 Earnings Call

CORPORATE PARTICIPANTS

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

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

OTHER PARTICIPANTS

Yuri Lynk
Analyst, Canaccord Genuity Corp.

Devin Dodge
Analyst, BMO Capital Markets Corp. (Canada)

Jacob Bout
Analyst, CIBC World Markets, Inc.

Chris Murray
Analyst, ATB Capital Markets, Inc.

Sabahat Khan
Analyst, RBC Dominion Securities, Inc.

Maxim Sytchev
Analyst, National Bank Financial, Inc.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Michael Tupholme
Analyst, TD Securities, Inc.

Ian B. Gillies
Analyst, Stifel Nicolaus Canada, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Stantec's Third Quarter 2022 Earnings Results Conference Call. Leading the call here are Gord Johnston, President and Chief Executive Officer, and Theresa Jang, Executive Vice President and Chief Financial Officer.

Stantec invites those dialing-in to view the slide presentation, which is available in the Investors section at stantec.com. Today's call is also webcast. Please be advised that if you have dialed-in while also viewing the webcast, you should mute your computer as there is a delay between the call and the webcast.

All information provided during this conference call is subject to the forward-looking statement qualification set out on slide 2, detailed in Stantec's Management Discussion & Analysis and incorporated in full for the purposes of today's call. Unless otherwise noted, dollar amounts discussed in today's call are expressed in Canadian dollars and are generally rounded.

With that, I am 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 today. I'm very pleased to report record third quarter results that delivered in line with our expectations. Our results reflect strong operational performance and the ongoing solid execution of our strategic plan, delivering both top and bottom line growth. We generated a 24% increase in net revenue, reaching approximately CAD 1.2 billion, propelled by the key drivers that we've noted over the course of this year. Aging infrastructure, climate change and sustainability and the reshoring of domestic production.

Net revenue was driven by double-digit organic growth of 11% and acquisition growth of 13%. We continue to drive organic growth in each of our geographic regions and business units. Notably, Water and Energy & Resources delivered 16% and 17% organic growth respectively, and Environmental Services continues to have a very strong year, with over 9% organic growth and a 47% net revenue increase overall.

Water and Environmental Services continue to account for 40% of our business, which speaks to the strong weighting of our business towards addressing climate change and sustainability challenges. We achieved solid project and EBITDA margins of 54.1% and 16.7%, respectively. And this performance translated into adjusted diluted earnings per share of CAD 0.86 for the quarter.

Looking at our results by region. Our activity level in the US continues to increase, driven by momentum in both public and private investment. We grew net revenue by almost 29% overall, with 12% organic growth, 13% acquisition growth and 4% from the stronger US dollar. Organic growth in Water was driven by the ramp up of public sector and industrial projects, including advanced manufacturing projects, as well as our work on large-scale water security projects, addressing water scarcity risks in the Western US.

We also delivered solid organic growth in Infrastructure from work on projects in transportation, as well as in industrial and residential land development activities. And we continue to see activity levels recover in Buildings, with investments still flowing into healthcare and science and technology. Of note, our US Environmental Services business has now grown to match the net revenue generation of our US Infrastructure business. Our results reflect how well aligned our US business is to continue to capture the wave of opportunities and funding being made available to address the key drivers and developing trends.

Canada continued to perform very well. Net revenues were up 7% in the quarter, all attributed to organic growth. Similar to the US, both private and public spending remains robust in Canada. We saw the strongest growth in Environmental Services with continued high demand for permitting work in archaeological services and in Energy & Resources or power transmission and distribution, and energy transition work generated continued opportunities.

We also grew our Infrastructure revenues with ongoing work in community development through the housing market, bridge work in Quebec, and the continued recovery efforts in British Columbia from last year's flooding. Work on public healthcare and private commercial projects drove growth in our Building segment.

And our Global region continues to lead with 38% net revenue growth for the quarter or 44% on a constant currency basis. Global also continued to have the highest organic growth at just over 14%. The strength of our acquisition programs generated additional net revenue growth of 30%.

Our Water business continues to be a significant pillar for us to capture long term framework opportunities in both the UK and New Zealand. And we also continue to see strong demand for our services in community development and in mining. So you can see that the themes we've been discussing continue to play out across all of our regions.

With that, I'll turn the call over to Theresa to review our Q3 financial results in more detail.

Theresa B. Y. Jang

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

Thank you, Gord, and good morning, everyone. As Gord stated, Q3 was a very solid quarter for us. We grew gross revenue by 26% and net revenue by 24%. Project margin was also up 24%, driven by strong net revenue growth. As a percentage of net revenue, project margin was very solid at 54.1% in line with our expectations. Our project margin reflects our continued discipline in project execution, our ability to increase rates on certain projects to mitigate the impact of wage inflation, and increased selectivity in project pursuit. Consistent with the increase in our project margins, we also delivered adjusted EBITDA growth of 24% and through solid execution across the business, adjusted EBITDA margin was 16.7%, directly in line with Q3 2021.

Turning to our earnings. Net income in the quarter was CAD 68 million or CAD 0.61 per share. This was down slightly compared to Q3 2021, primarily driven by acquisition-related expenses. Our adjusted net income for the third quarter was CAD 95 million or CAD 0.86 per share, an increase of 18% and 19%, respectively, over Q3 2021, reflecting our focus on delivering both top line and bottom line growth.

Looking at our liquidity and capital resources, operating cash flows in the quarter were CAD 93 million. DSO was 86 days, largely resulting from the Cardno integration and 2 days from the effect of foreign exchange and net debt-to-adjusted EBITDA was at 1.9 times. As we approach completion of the Cardno financial migration, cash flows are beginning to normalize and we continue to expect cash flows, DSO and leverage to be at more typical levels by the end of the year. However, the disruption during the financial migration has led to our average debt level for the year being slightly higher than anticipated, and this will impact 2022 adjusted ROIC.

With that, I'll turn the call back over to Gord.

Gordon Allan Johnston

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

Thank you, Theresa. We continue to see very strong activity across our business. This is clearly evident in our backlog, which has grown organically by 15% since the beginning of the year and has reached an all-time high of CAD 6.2 billion, representing 14 months of work. As expected, increases in backlog were particularly strong in the US, where we had almost 21% organic growth, followed by 10% organic growth in Canada. The project's been recorded in backlog are largely following the themes that we've been discussing throughout the year, driving 20-plus-percent organic growth in our backlog for Infrastructure, Buildings and Energy & Resources.

Turning to some of our major project wins in the quarter. In the US, we were awarded a Bridge & Structures project through the Colorado Department of Transportation for construction management, construction inspection and materials testing. And we're also very active with project awards for our water programs around the country. These include the design of an alternative water source program in Illinois, project management and a biological review for underground and systems hardening in California and projects for water quality and dam improvements in the Western US.

Turning to Canada, in British Columbia, we were selected as the prime consultant for the Cape Horn Pump Station No. 3 for our client, Metro Vancouver. And in Toronto, we won a continuing services and funding contract with Metrolinx in the Greater Toronto area. In our Global region, we are excited to be contributing to the development of the transport corridors in the Horn of Africa. This project will enable increased mobility and trade within Africa and within Europe. And we've been awarded our – and we've been awarded project management services for an airport expansion project in Asia, our first in the region.

These highlighted project wins are reflective of the robust funding being directed towards addressing a significant, multifaceted challenges being faced around the world. As we engage with our clients, we continue to see strong advancement of projects despite some of the economic headwind fears. The message remains the same that the need to address these imperatives continues to outweigh the risk of cost increases and recession concerns.

So as we look towards the rest of the year with the strong performance that we've delivered year-to-date, we are confident in our ability to achieve our 2022 financial targets for adjusted diluted EPS growth, net revenue growth, adjusted EBITDA margin and adjusted net income margin. As Theresa indicated, we now anticipate delivering adjusted ROIC of greater than 10% for 2022 compared to our previous guidance of greater than 10.5%. Our execution has been solid and I'm very pleased with the continued growth that we're seeing in all our regions and businesses. We expect this dynamic to continue into next year and to the years to come.

In the US, public funding from The IIJA, The CHIPS Act and The Inflation Reduction Act is starting to accelerate and provide more opportunities in these critical areas. Similarly, in the UK, early procurement for AMP 8 services is already underway. Spend levels for AMP 8 are expected to be higher than AMP 7 as they seek to address severe drought conditions that we haven't seen in decades and the continuing need to harden critical water infrastructure.

And in Canada, the need for environmental services and energy transition continues to grow at an unprecedented pace. Stantec is very well-positioned to capture many of these opportunities, integrate significant value for all of our stakeholders. As we move into 2023, the last year of our strategic plan, we will remain focused on execution and excellence to deliver on the targets that we've set.

And with that, let me turn the call back to the operator.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Yuri Lynk with Canaccord Genuity. Your line is open.

Yuri Lynk
Analyst, Canaccord Genuity Corp.
Q

Good morning, Gord. Good morning, Theresa.

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

Good morning.

Yuri Lynk
Analyst, Canaccord Genuity Corp.
Q

Getting towards the end of the year here, so I thought I'd take a stab at just any update on your 2023 goals, particularly around 16% to 17% margin and 11% EPS growth. Just wondering if the inflationary environment, including higher rates, is kind of weighing on your ability to achieve those targets?

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

A

I think we're confident that our 2023 targets are in sight for us. We're working hard towards achieving that. We will formally roll out our outlook for 2023 in February. But there are always going to be pressures and wage inflation is one of them. But we continue to find ways to manage them to maintain our project margins to operate more efficiently. So overall, we're confident that those targets that we set for 2023 will be achieved.

Yuri Lynk
Analyst, Canaccord Genuity Corp.

Q

Okay. And on the margin front, is it just some of the cost synergies coming through and better absorption of your SG&A rather than gross profit improvement?

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

A

It's really all of the above. All of those things that we look towards in driving to EBITDA margin. Looking for, as I mentioned in my comments, being selective on the projects that we take on with the pricing and acceptance of margins, the pursuit of rate increases to capture the higher wages that we've seen and synergies of course. But again, continuing to operate as efficiently as we can throughout our organization. We've seen a continued uptick in the use and the build out of our delivery center in Pune and now in Manila as well. And that's an important part of our overall cost strategy. And as we move into 2023, again, some specific targets around how we intend to continue to grow the use of those services. So it's kind of a – it's – there's not one major thing, it's just lots and lots of things.

Yuri Lynk
Analyst, Canaccord Genuity Corp.

Q

Okay, that's fair. I'll leave it there. Congrats on a nice quarter.

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

A

Thanks.

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

A

Yeah, thank you.

Operator: One moment for our next question. The next question comes from Devin Dodge with BMO. Your line is open.

Devin Dodge
Analyst, BMO Capital Markets Corp. (Canada)

Q

Yeah. Thanks. Good morning. There continues to be good development in the backlog. It's great to see but can you comment on the efforts to expand the workforce? Just wondering if you've seen net additions in Q3 and should we expect head count to push higher again into Q4?

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

Yeah. We definitely have seen continued head count development and an increase in Q3. We've seen our voluntary turnover rate sort of stabilize. They were up a little bit in Q2. Q3 was remained the same. But I think in Q3, we actually had some of the highest number of new hires that we've had in history, really. So we're bringing on a lot of new people. So absolutely the head count continues to increase.

Now, when you look – you talked about Q4, we'll continue to hire people in Q4, but seasonally, our workforce sometimes comes down in Q4 depending on how soon winter hits for us here in Canada. So some of our field programs may start to wrap up depending on cold and snow and so on. So we'll absolutely continue to be hiring. But seasonally our workforce does come down in Q4 typically.

Devin Dodge
Analyst, BMO Capital Markets Corp. (Canada)
Q

Okay. So in the outlook there was mentioned that year-to-date figures were near the upper end of the guidance ranges, but I think you're expecting Q4 will bring them down closer to the midpoint. So, given the seasonality you just mentioned, I think that makes sense for EBITDA margins and net income margin. But does that comment also apply for net revenue growth, either organically or just overall net revenue growth?

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

Yeah. I mean net revenue for Q4 should continue to be very strong. And we do expect to continue to see good growth in Q4. And of course, because so much of our business is weighted towards the US, we're getting a nice tailwind from exchange rates as well. So net revenue will push past the upper bound of our range possibly. But overall, I think we want to draw attention to our overall profitability, whether that be EBITDA margin or EPS. And we do expect that to be within the range.

Devin Dodge
Analyst, BMO Capital Markets Corp. (Canada)
Q

Okay. Makes sense. And if I just sneak one more in question for you, Theresa. In the cash flow statement, I think there was about CAD 100 million usage for investments held for self-insured liabilities in the quarter. Looking back, I don't believe we've seen anything close to that magnitude. Just can you give some color for the drivers behind that cash outflow?

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

Yeah, for sure. So over the course of this year, actually, we changed the management of our portfolio for our self-insured liabilities, equities I should say. And so we did have a big outflow, as you note, in the quarter of about CAD 100 million for purchase. But if you look at the line below that on the cash flow statement, you'll see that a corresponding almost purchase of CAD 75 million. And then further for the year-to-date, the purchases were an outflow of CAD 144 million. But then there was a sale of CAD 179 million. So it has moved around a little bit. The numbers on a gross basis are higher than you would typically see because of the movement in sale and transfer of these investments. But net-net, the impact isn't that significant.

Devin Dodge
Analyst, BMO Capital Markets Corp. (Canada)

Q

Okay. Thank you. I'll turn it over.

Operator: One moment for our next question. Our next question comes from Jacob Bout with CIBC. Your line is open.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Good morning.

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

A

Good morning, Jacob.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

So strong backlog and organic revenue growth in this quarter. Can you talk geographically if you're seeing any signs of weakness? It seems like Canada lagged a bit, US and Global [ph] and do you think improving Canada (00:19:02)?

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

A

Yeah. I think we're feeling pretty good about our operations in each of these locations. The US is kind of unfolding the way that we had thought. As you recall, as we were kind of coming through the last part of last year, it was getting a little bit – it was slower to rebound. Canada rebounded quicker, coming out of last year than the US. So that's why when you look at our Canadian organic growth is against the higher comp from last year, whereas the US is really unfolding as we thought. A lot of these projects started to come in the Buildings group in particular, a lot of the big healthcare projects were coming. And so, the backlogs are up, the organic growth is up. So we're feeling really good about that. And then Global, the same. Great growth in Global and it really has been all year. And we continue to see that – well, that will continue into next year as well.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Are you seeing any change in customer behavior as you move through 2023?

[indiscernible] (00:20:11)

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

A

Yeah. We've been talking to all of our business leaders and the people who are closest to the clients. Are we seeing projects get delayed, an increase of projects that might be getting canceled. And we're really not seeing that in any of our business units or in any of our geographies. And our customers have not been telegraphing concern for Q4, haven't been telegraphing concern for 2023 either. So I think we feel pretty good about the backlog that's there, that is valid and that we'll be drawing upon it as we move forward.

Jacob Bout
Analyst, CIBC World Markets, Inc.
Q

And strategically, as we think a bit longer-term, as far as geographic mix, I think in the quarter, it was roughly 50% US and then 25% each for net revenue Global and Canada, is that kind of the right geographic mix strategically? Or what do you think the year would be offside there?

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

We've talked a little bit about overall from an M&A perspective, where we might be looking to deploy capital and to continue to grow. So, certainly there are continued opportunities for us to grow head count through M&A activity in the United States, but also a lot of opportunity. If you look at the UK, things are a little challenged there right now, certainly. But we continue to look for good long-term opportunities there. I think we could double or triple our size in the UK. We're still looking at, as we've been messaging, consistently looking up into the Nordics and Scandinavian countries. They continue to look for opportunities there because we really aren't present in those geographies. And then additional opportunities down in Australia. So I think the mix in general is comfortable, but I think you'll see a change in over the years to come based on these acquisition growth opportunities.

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

Thanks, Jacob.

Operator: One moment for our next question. The next question comes from Chris Murray with ATB Capital Markets.

Chris Murray
Analyst, ATB Capital Markets, Inc.
Q

Yeah. Thanks, folks. Good morning. Maybe following on my question, I was curious about, if you guys could spend some time maybe talking about the UK business a little bit more. It's certainly been through kind of a bunch of changes in governments and delays. Gord, I think you mentioned AMP 8 is coming. But we go back a couple of years and historically you've been pretty much a water focused firm in the UK. But there was some talk about bridging into maybe other areas.

Can you just maybe give us some more thoughts around how you're seeing the UK market evolve? And I think you alluded to the fact that you think you could double or triple through M&A in that market. Is all this disruption that it's going through right now, is that creating opportunities for you and maybe accelerate that plan?

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

Yeah. So as we look at the UK in particular, we've talked before that we're the number one water firm there, and we continue to be so. So that work is stable, not impacted by the – some of the inflation and the economic challenges that we're seeing there. Water work continues, AMP 8 as we've talked about should be even a higher spend just because of some of the drought and so on.

But I think one of the things that we have been talking about is our move into planning. So, Peter Brett Associates had a very, very strong planning group. But with the acquisition of Barton Willmore earlier this year, we're the number one planner in the UK. And certainly, I was there just last week or the week before, still continued discussion about a shortage of housing, shortage of affordable housing in particular, the various housing authorities around the UK continue to search for ways to move that forward. So we're active on a number of those large scale planning schemes. So that's good work for us because we do the planning work and then in many cases we can do – go ahead and do the actual new community design work as well. So that continues to support that.

And then we've talked about the building side and certainly, Peter Brett Associates had a very strong buildings and infrastructure group as well as planning. So you've seen we've talked a little bit in previous quarters about some transportation, some highway projects that we've received that, we wouldn't have gone without the addition of the folks who joined us from Peter Brett. So I think we're building a really good, solid, multi-sector business in the UK.

And so to your point about this – some of this inflation and economic challenge presents some opportunities. The firms that we're talking to are really solid Tier 1 players. And so, while we've been talking about multiple compression and so on, I think they understand that multiple compression on M&A activity is coming, but it seems to be lagging just a little bit because these are good firms who have been through downturns before and come back again. So, we'll just stay close to them. And when the timing is right, then we'll act.

Chris Murray
Analyst, ATB Capital Markets, Inc.

Q

Okay. That's helpful. Thanks. My next question, maybe more for Theresa. Theresa as regards to your Q3 reporting, a number of companies have talked about changes in taxes, I guess, there's been a lot of changes in US regulations. The UK has been whipping around tax rates. Maybe early days, anything to think about cash flows? Is there any potential for like one-timers that we should be thinking about? Or any material change to tax rates or cash taxes next year that we should maybe be aware of?

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

A

Yeah. I mean taxes, particularly, when you operate on a global scale like we do. It's always tricky because there's so many moving parts to it. At this stage, I would not say that there is anything in particular that I'm aware of that will require an unusual cash outflow. We will have better guidance for you in February, but there's always going to be kind of puts and takes. This global minimum tax of 15% that has been discussed, we don't – there's two pillars under it and I won't go into the details, I'm sure you're familiar with it. But with the first pillar, we don't expect we'll have much of an impact on us. The second, may. But we don't think that it'll be material. So there are all things that we monitor very, very closely. And as I said in February, we'll give as much clarity as we can on that. But nothing that I see on the horizon that will be kind of a big material cash outflow.

Chris Murray
Analyst, ATB Capital Markets, Inc.

Q

All right. That's helpful. Thank you.

Operator: One moment for our next question. Our next question comes from Sabahat Khan with RBC. Your line is open.

Sabahat Khan
Analyst, RBC Dominion Securities, Inc.

Q

Hey, great. Thanks and good morning. Gord, I think earlier in the conversation, you talked about the kind of the backlog build in the US, one of your US peers provided some early commentary on the 2023 outlook there, with one kind of the IIJs expected to kind of flow through. I guess at this point, what is the I guess funding that's driving some of the demand? Because it feels like some of the bigger bills probably come through in 2023, but the backlog on the US side is building up quite a bit.

But can you maybe just walk through kind of what's driving that? What kind of – which end markets are you seeing more funding in? And then, also maybe your thoughts on when some of the bigger US bills, they are exposed to, will start to flow through? Kind of the impression we got yesterday was more kind of calendar Q2 onwards. But want to get your thoughts.

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

A

Yeah. So I would agree with that, that a lot of the big IIJ funding and some of the IRA funding, I think we'll see coming in the – we're starting – we have some of that in backlog. Now, we're generating a little bit of backlog, but really nothing material. Just some early releases. I do think we'll see more of that coming sort of Q2, Q3 of next year and that'll just continue to build on our already strong backlog in the US.

But when I look at the US overall, we've had backlog growth in each one of our business units, in particular, we've seen great backlog growth in our Building segment. And we've talked about some of the healthcare projects and some of the logistics center work and things that we've been doing big backlog there. The largest backlog growth actually is in our Energy & Resources group, a lot of transitioning to renewable energy and these things. So we saw great growth there as well as in Infrastructure overall.

But again, we saw backlog growth in each one of our business units in the US. And I do think that's just going to continue and even strengthen as we move into 2023.

Sabahat Khan
Analyst, RBC Dominion Securities, Inc.

Q

All right. Great. Thanks for that. And then, as we kind of look over the next year, I think you talked about kind of the margin profile a little bit earlier on. I guess, how you're thinking about kind of drivers of this margin improvement? Do you think it's going to be sort of the largest scale post-Cardno kind of the end market [indiscernible] (00:29:53)? Can you just maybe walk us through how you think about your margin progression over the next few years kind of post-Cardno.

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

A

Yes. I mean Cardno's business is very similar to ours. We've talked about having achieved synergies already. And of course, we'll continue to look toward continuing to look for efficiencies amongst the businesses as we combine them. But it's really, as I noted earlier, Sabahat, that the levers that we have available to us on our EBITDA margin largely centered around good project selection, good project execution, ensuring that we are growing our use of our delivery centers in India and the Philippines.

And we spent – we – this year, I had talked earlier about investments in our back-office systems and so on. And again, it will be bringing to bear sort of the efficiencies that have come from that investment, continuing to drive and draw on our innovation to do things efficiently. So it's all of those things.

And as we look toward next year, the 16% to 17% margin target is in sight, and it is what we're driving toward. And beyond that, as we enter the next stage of our strategic planning for the next cycle, we'll start to consider where there may be a general kind of step-change opportunities. But again, in our business, it's largely these incremental improvements that we're able to make as opposed to one big button that we can push.

Sabahat Khan
Analyst, RBC Dominion Securities, Inc.
Q

Okay. And then just one last quick one. I think there was some discussion earlier on kind of some of the tax changes. And I think we heard from your peers that there was a US tax change around expensing R&D. So maybe we could take this offline, but I guess for you guys, that wasn't an impact in the quarter, I guess? And I guess maybe you don't do a lot of R&D in the US. Just trying to understand if there was any impact from that change in tax policy in the US side.

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

Yeah. So it did affect us because we do have a healthy R&D program. For us, for the year-to-date, I think it's led to incremental cash taxes around CAD 20 million. And we would expect maybe another CAD 10 million for the rest of this year. But having said that, as I noted earlier, there's always puts and takes. And so when we looked at our overall cash flow as it related to our taxable income – our US tax income in particular, they were offset. And so really didn't feel like we needed to call it out.

Sabahat Khan
Analyst, RBC Dominion Securities, Inc.
Q

Perfect. Thanks so much for the color.

Operator: One moment for our next question. Our next question comes from Maxim Sytchev with National Bank Financial. Your line is open.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

Hi. Good morning.

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

Good morning.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

Theresa, maybe the first question for you, if I may. When we talk about working capital sort of free up normalization in Q4, can you provide maybe directionally the quantum of that improvement that we should expect for Q4?

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

Sure. We're actually just putting the finishing touches on our October monthly results, and we have seen positive movement in our working capital as DSO now down up a couple of days from the end of September and moving closer towards our target of 80 days. So we're seeing things unfold as we expected, and so that's positive. And of course, you can't ever take the pressure off. We need to keep driving that to achieve our typical 80-day target.

And so that is sort of the movement that we are working towards for the end of the year is to get back to where we generally are in that 80-day range. And it's really – we've talked a lot about Cardno and the impact of the financial migration. I do want to note that, when you look at our revenue growth, that also has an impact because these are the same people that are managing – accounting for managing the projects, managing the growth that are also supporting in some shape or form the Cardno migration. So like overall levels of activity are much higher than usual, and that leads to things taking a little bit longer on the invoicing side, on the collection side and so on.

So it's a number of things that have driven our working capital to where it is all, I think, quite typical given levels of activity. And – but as I said, we are seeing movements in a positive direction, and we expect that to continue through to the end of the year.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

Okay. So do you think it's going to be possible to get leverage maybe down to, I don't know, like [ph] 1.6 times (00:35:11), something around that because, again, like some of the stuff is one-off free-ups?

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

Yeah, for sure. For us, that's our goal to be somewhere around about [ph] 1.5 times, 1.6 times (00:35:27) range, it is absolutely possible, and we're doing everything we can to push towards that.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

Okay. Thank you very much for clarifying. And then another question for Gord, if I may. I think in the past, we spoke about semiconductor opportunities. One of the things that I'm more sort of curious about is I guess if you can attach sort of any materiality to those things and maybe talk about sort of the attach rates of additional services that you're able to introduce to those, I presume, new clients? So maybe just any color on that vertical, please?.

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

Yeah, absolutely. And so I think we mentioned last quarter that we're currently working with 5 of top 10 manufacturers around the world. And in addition to the work that we have on going, Max, we have in our opportunity, our sales pipeline, we have CAD 1 billion in fees for opportunities there. Now, we're not going to get all of that, to be sure. But this is a huge opportunity for us, not just in the United States, but we're also seeing opportunities in Europe and in other locations with these clients will often take you with them to these different locations.

So in terms of the types of services that we offer, it's typically everything from zoning and – site selection, zoning, water, transportation, master planning, those sorts of things. We do a lot of advanced water and wastewater treatment for these locations. And that actually truly is often our way in the door is on the water and wastewater. But then once you're in there, there's a lot of, we call it, balance of plant. So there'd be – there's parking lots, there's office buildings, there's site security, all these sorts of things. So it really touches almost all of our business lines when we look at a big facility like that. And I think that's why you've seen – or as I mentioned, like our fees and our opportunity pipeline are roughly CAD 1 billion. Now, again, want to concern that's not backlog, and we're not going to win it all, but it's a huge opportunity.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

All right. And then in terms of talking to some of the stuff in Europe, I mean like is this more of a, I don't know, 2024 sort of timeframe? Or how should we think about in terms of timing?

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

Yeah. As we're talking with the firms, we are looking for sites now and these things. So – you're probably right. It's probably that material revenue generation would likely be sometime in – some in 2023, but it would likely be a bit of 2024 as well.

Maxim Sytchev
Analyst, National Bank Financial, Inc.
Q

Okay. Excellent. Thank you so much. That's it from me.

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

Great. Thanks, Max.

Operator: One moment for our next question. Our next question comes from Benoit Poirier with Desjardins. Your line is open.

Benoit Poirier
Analyst, Desjardins Securities, Inc.
Q

Hey. Good morning, Gord. Good morning, Theresa.

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

Yeah. Good morning.

Benoit Poirier
Analyst, Desjardins Securities, Inc.
Q

Yeah. Gord, you provided great color about the impact that we've seen so far with the US Infrastructure Bill, obviously unfolding the way you thought. You'll be finishing the year with strong organic growth. I was wondering if you could, based on your comments about the timing for the US Infrastructure Bill, whether it would be fair to expect an acceleration in organic growth in 2023? Or it's too early to look at the organic growth expectation?

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

A

We haven't really – as you know, of course, we haven't put out our guidance yet for next year. But I think if you were to look at the macro environment, certainly, the speed and the number of projects that we'll see coming out of IIJA, particularly in the infrastructure space, we'll look to accelerate. Now, we're going to be coming off a higher comp as well. But certainly, I do think that there's going to be some great opportunities coming for us in 2023 in the US infrastructure space, absolutely.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. Perfect. And on the Water side, you provide some color about the upcoming AMP program 8. Could you provide an update on the AMP 7 program so far? And maybe more color about the expectation for the forthcoming AMP program and maybe the timing?

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

A

Yeah. So we're well into the 5-year AMP 7 program. Really, it's unfolding as we had expected with the work that we're doing for our clients really throughout the UK there. But some of them are – we're beginning to talk about re-procurement for AMP 8 already. And typically, the way that, that works is – not quite yet, but soon they'll put out their plans to the regulator in terms of their capital spend. And so when the regulator then reviews them. Because based on that capital spend is one of the things that would impact water rates to the user community.

So they'll be looking at drought resistance, leakage reduction, regulatory burden, overflows and what's the capital program that needs to be put in place in order to deal with these over the next the AMP 8 cycle. From that, then they work with the regulator, confirm what those are and get back to us. So we're not quite at that stage yet, but many of our clients are beginning to look at it. So the wisdom on the street is that the AMP 8 spend will be higher than AMP 7, but I couldn't quantify it quite yet.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

Okay. Perfect. And maybe last question for Theresa. You provided great color, great explanation about the 86 days for DSO. Obviously, outlook still very robust, looking at 2023. I'm just wondering whether the target of below 80 days is still achievable? Or you could back up – you could go back up above 80 days, let's say, looking forward beyond Q4 on the back of the strong market environment?

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

A

I – my personal preference is that we would stay at 80 days or below. And I do believe that, that's achievable. And so that is certainly what we're going to strive for. I'm not seeing any reason. Once we get past this big push in the fourth quarter and sort of get to a steady stage on Cardno, that we shouldn't be able to achieve by 80 days. And so I'd say for now, that's what we will be aiming for.

Benoit Poirier
Analyst, Desjardins Securities, Inc.

Q

That's great. Thank you for the time.

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

A

Thanks, Benoit.

Operator: One moment for our next question. Our next question comes from Michael Tupholme with TD Securities. Your line is open.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Thanks. Good morning.

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

A

Good morning.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Gord or Theresa, wondering if you can talk about your confidence in the outlook for your global geographic segment. And I guess, specifically, I'm looking at the change in organic backlog growth for Global this quarter. It does sound like you remain upbeat, but curious about the year-to-date organic backlog growth in that region moving down to 3.2% in Q3 from 13.4% in the second quarter?

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

A

Yeah. The one thing also – so firstly, just to say, we're not overly concerned with that backlog growth. There's a number of big pursuits that are in the pipeline. And so sometimes, these things are a bit lumpy. So we're not overly concerned with that. Also, Global had our highest organic growth at just roughly 14%. So we're chewing through. We're consuming a lot of that backlog as well. So I think when you kind of look at the overall growth, it's a combination of just some lumpiness in terms of when some of these awards will be made and that high organic growth consuming that backlog. So not overly concerned with it at this point.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Okay. Secondly, pleased to hear that you're not seeing any slowdown in overall activity to any degree, any material degree due to the rising rates environment and inflationary pressures. I think I can understand why that would be the case as it relates to public sector work. But on the private side, I guess, if you can just confirm that, that is, in fact, true? You're not seeing sort of anything on the private sector side either and why do you think that might be? Like how are clients – how are they dealing with the rising rate environment and higher costs for projects? Like how are they contending with that? Where are they finding additional funding if needed and so on and so forth?

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

A

Yeah. No – and so – to answer your first question, I think your statement is right. We – certainly, that is the case on public sector projects. But as we've queried our various business leaders, specifically about the private sector, we haven't seen any really uptick in projects being delayed or canceled. And so as to why that is, I just think that there's still a lot of underlying fundamentals. We've talked about some things like the big logistics center that we're working on in Southern California.

And so we've had interest in that, that facility is still very high. We see no indications of slowdown there or from other similar type projects. So if interest rates go longer – higher for longer, if the economy slows, perhaps we'll see something going forward, but we're really not at this point.

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

A

Yeah. I think the other thing that we're seeing, and this is specific to the US, Michael, but the IRA funding is helping to support private investments. So perhaps where project proponents would have maybe pulled back a little bit with this funding that's being made available to them, the IRA funding is what we're seeing driving pretty significant investment in energy transition. And so much of that work supported by the funding that's going to be available. And so these stimulus programs are working to drive investments the way that they were intended.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Okay. That's helpful. Thank you. And then lastly, just a question about the sustainability of the strength you're seeing in Energy Resources. It's been one of your better performing business units on a year-to-date basis, but was, I think, the best performing business unit from an organic growth perspective in the third quarter.

Gord, I think you mentioned some of that's being driven by renewables activity. And so I can appreciate there's probably a long tail on that type of work. But as it relates to the oil and gas piece, has that been a major contributor? And given that's a more cyclical area, how do you see that looking going forward? And again, just a question on the sustainability of that strength?

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

A

Yeah. No, no, great observation. So with the renewables side of it, absolutely. That has been growing, and I think – and that will continue to grow. We're also seeing, from a power perspective, a lot of work coming from grid hardening or the movement of taking above ground power lines, putting them underground. So there's a lot of power grid type work that's coming out of that power group as well.

We're also seeing strength in the mining sector. While we've seen a little bit of softening recently in copper and iron ore, a lot of the investment decisions have been made and those projects that we're working on are still continuing to move forward. So renewables are strong. Power in general is strong. Mining is strong. From an oil and gas perspective, we've seen that those fees as a percentage of our overall net revenue have sort of continued to decline over the last several years.

Recall that for us, our oil and gas is really a midstream pipelining work business. And so we're still active on a number of those. But as those projects continue to wind down, I think we've seen the oil and gas work sort of being – the percentage of that reflecting in our backlog continues to sort of trend downwards. The one thing that we are, though, supporting a number of our oil and gas clients is with some transitional type work.

We're looking at a pipeline, for the most part, is a pipeline, whether it's carbon sequestration or natural gas. So we're talking to clients about sort of moving in those directions. So the question will be going forward, is that still called oil and gas because it's an oil and gas client, even though it's a carbon sequestration pipeline. So, yeah, those are some of the things that we're working through there. So no, I think we're seeing good long-term tailwinds for that business.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Okay. That's helpful. Thank you.

Operator: One moment for our next question. Our next question comes from Ian Gillies with Stifel. Your line is open.

Ian B. Gillies
Analyst, Stifel Nicolaus Canada, Inc.

Q

Good morning, everyone.

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

A

Good morning.

Ian B. Gillies
Analyst, Stifel Nicolaus Canada, Inc.

Q

It's obviously been a very challenging hurricane season in the US. And I know Stantec has a long history of disaster recovery work in helping there. Can you maybe remind us of how long work like this typically tends to show up in the backlog? And if you – and whether it tends to be material or not to the growth profile?

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

A

Yeah. So absolutely, after some of the recent hurricanes that have come through, we have crews that are on the ground virtually immediately assessing damage. As an example, would be in Puerto Rico with some of the electrical grid issues that we had there. I think we had 14 or 18 crews out in different areas of Puerto Rico looking – assessing damage and then coming up with remediation plans.

Similarly, in the mainland of the United States, there's drainage pump stations, sewage lift stations that are knocked out. So we're typically involved in working with some of those things. In terms of it being material, we haven't – it can be significant, but we don't see it really being material to our overall portfolio. But one thing to note is, is the length of time that some of these projects take. We've talked previously about the big lift station, the PCCP lift station that we put in in New Orleans following Hurricane Katrina. And we commissioned that pump station roughly 10 years after Katrina.

So first, there was the hurricane and the flooding, then there's the recovery from that. Then there's the design of the new pump station, the construction and the commissioning. So a lot of these projects take multiple years as we work through them. Now 10 years for Katrina, that was probably a bit on the long side, but it's not particularly – it wouldn't be completely unusual that we see that sort of thing. So absolutely short-term recovery work, but then long-term design and commissioning work also.

Ian B. Gillies
Analyst, Stifel Nicolaus Canada, Inc.

Q

Okay. That's helpful. And then the backlog is obviously very, very healthy. You're adding head count. But Gord, is there any increased level of concern that you're not going to be add – be able to add people quick enough and you could end up with some disappointing customers just because you can't quite get to the volume of work?

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

A

Yeah. That's something that we look at all the – on every pursuit that we chase, and that if we can't deliver it in – with the quality that we want, along with the timeline that we've promised, then we'll either look for partners who can help us get it done, look for sending additional work to our delivery centers, either in India or Manila, look for other ways to make it happen. But yeah, we specifically though, Ian, we won't go and take projects if we don't have a clear sight to how we could deliver it on time.

Ian B. Gillies
Analyst, Stifel Nicolaus Canada, Inc.

Q

Okay. Maybe if I could sneak in a quick follow-up to a point you just made. Is there any intention – are there any plans to add additional delivery centers in international jurisdictions in 2023?

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

A

I think what we'll really be focusing on is continue to grow our existing. We've – over the last year or so, we've added a touch over 20% in terms of head count to our delivery center in Pune, India. And we're still – it's early days for us with our delivery center in Manila. But by all account, a good group there. So I think what we'll be doing is focusing on how to grow those existing centers before we would be looking to add additional centers.

Ian B. Gillies
Analyst, Stifel Nicolaus Canada, Inc.

Q

Okay. You know, that's helpful color. Thanks very much. I'll turn the call back over.

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

A

Great. Thanks, Ian.

Operator: And I'm not showing any further questions at this time. I turn the call over to Gord for any closing remarks.

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

Okay. Well, thanks. I'd like to thank everyone for joining us today, and I look forward to engaging with many of you throughout the quarter. So if you have any follow-up questions, please feel to reach out to Jess, our Vice President of Investor Relations. And have a great day, everyone.

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

Thanks, everyone.

Operator: Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.