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SNC posts above consensus 2Q 2023 results; raises full-year organic revenue growth target to 12%-15% (from 5%-7%); fair value increased to \$43 per share (from \$38.50 per share)

- This morning, before the market open, SNC reported 2Q 2023 consolidated sales up 13.9% to \$2.13 billion (vs. consensus of \$1.88 billion), including ~22% growth to \$2.0 billion in the core SNCL Services business. Total adjusted EBITDA increased ~39.5% to \$183.9 million (vs. consensus of ~\$152 million) with professional services & project management (PS&PM, which includes SNCL Services) posting ~30.5% growth to ~\$167 million (compared with ~\$128 million in 2Q 2022).
- Importantly, the backlog on its legacy LSTK Projects business declined ~\$96 million sequentially (i.e., versus 1Q 2023) to ~\$422 million and was down ~49% when compared with 2Q 2022. The segment adjusted EBIT loss improved to \$13 million in 2Q 2023 (as compared with a \$37 million loss in the prior year period). The company still expects to “hand over” 2 of the remaining 3 projects to the clients in 2023 (with the final project being completed in 2024); to that end, the company expects to generate positive free cash flow in 2H 2023.
- The company ended 2Q 2023 with net recourse & limited recourse debt of ~\$1.68 billion, including \$553 million in cash and \$2.22 billion of debt, and a net leverage ratio of 3.1x (compared with 2.9x at the end of 1Q 2023 and 2022). That said, as calculated by SNC’s credit agreement, the leverage ratio stood at 3.0x (compared with the company’s 3.75x covenant).
- In terms of 2023 guidance, the company increased its full-year outlook for organic revenue growth at SNCL Services to 12%-15% (from 5%-7%) while maintaining the remainder of its outlook, which calls for an adj. EBIT margin at SNCL Services of 8%-10% with adj. EBITDA margins at the Engineering Services subsegment (~60% of consolidated sales) of 14%-16%. Corporate SG&A and amortization expense continue to be projected at ~\$130 million and ~\$90 million, respectively. Based on an unchanged capital spending budget of \$80-\$100 million, SNC still expects to be cash flow positive in 2H 2023 (see Exhibit #1 on page 2).
- Additionally, the company maintained its longer-term (2022-2024E) guidance (see Exhibit 2 on page #2).
- Our fair value for SNC is increased to \$43 per share (from \$38.50), which assigns value of \$50 per share to SNCL Services, based on a blended multiple of ~9.5x, and \$10 per share for the Capital segment, wholly comprised of the estimated value of its stake in Highway 407, while accounting for future LSTK losses, corporate overhead and net debt (see Exhibit 3 on page #3).

UPDATE

SNC-Lavalin Group Inc.

TSE: SNC

Publication Date:
August 3, 2023

Price: C\$37.88/share

Market capitalization: ~C\$7.0B

SNCL Services: C\$50/share

Capital: C\$10/share

Corporate, LSTK Projects, Net Debt &
Other: (C\$17.50)/ share

SOTP: \$43 per share*

*SOTP may not add due to rounding; all figures in CAD unless otherwise noted

(See the report dated 11/14/2022 and updates from 3/3/202 and 5/9/2023 for more info.)

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Exhibit #1 SNC-Lavalin: Initial and Current 2023E Financial Guidance

(\$ in millions, except per share figures)

	<u>2022A</u>	<u>2023E Guidance</u>		
		<u>Initial</u>	<u>Previous</u>	<u>Current</u>
<u>SNCL Services:</u>				
SNCL Services organic growth	6.80%	5% - 7%	5% - 7%	12% - 15%
SNCL Services segment adj. EBIT margin	8.70%	8% - 10%	8% - 10%	8% - 10%
Segment adj. EBITDA margin - Engineering Services	14.60%	14% - 16%	14% - 16%	14% - 16%
<u>Consolidated:</u>				
Corporate SG&A	\$127 million	\$130 million	\$130 million	\$130 million
From PS&PM	\$99 million	~\$100 million	~\$100 million	~\$100 million
From Capital	\$28 million	~\$30 million	~\$30 million	~\$30 million
Amortization of intangible assets	\$84 million	~\$90 million	~\$90 million	~\$90 million
Net cash generated from operating activities	(\$246) millions	(-) 1H/ (+) 2H	(-) 1H/ (+) 2H	(-) 1H/ (+) 2H
Capital spending	\$110 million	\$80 - \$100 million	\$80 - \$100 million	\$80 - \$100 million

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Exhibit #2 SNC-Lavalin: Long-term Financial Targets (2022-2024E)

(\$ in millions, except per share figures)

	<u>2022E-2024E Targets</u>
<u>SNCL Services:</u>	
Annual organic revenue growth	4% - 6%
Segment adj. EBIT margin	8% - 10%
Engineering Services	8% - 10%
Nuclear	13% - 15%
Linxon	4% - 6%
O&M	5% - 7%
Segment adj. EBITDA margin - Engineering Services	14% - 16%
<u>Consolidated:</u>	
Free cash flow (FCF) conversion (by end of 2024)	80% - 90%
Net leverage ratio, ex. non-recourse debt (by end of 2024)	1.5x - 2.0x

Source: Company reports, Bloomberg, and Institutional Research Group estimates.

Exhibit #3 SNC-Lavalin: Sum-of-the-Parts Fair Value Estimate

(\$ in millions, except per share figures)

	<u>SNCL</u>			<u>Enterprise</u>	<u>Net Debt,</u> <u>LSTK</u>	
	<u>Services</u>	<u>Capital</u>	<u>Corporate</u>	<u>Value</u>	<u>Losses &</u> <u>Other</u>	<u>Market Cap</u>
2023E Revenue	\$7,479.0	\$125.0	-			
2024E Revenue	\$7,819.6	\$125.0	-			
2024E EBITDA	\$940.1	\$103.0	(\$130.0)		(\$1,854.4)	
Applied multiple	9.4x	16.8x	9.4x		1.0x	
Enterprise value	\$8,841.0	\$1,728.6	(\$1,222.6)	\$9,347.1	(\$1,854.4)	\$7,492.7
Diluted shares	<u>175.6</u>	<u>175.6</u>	<u>175.6</u>		<u>175.6</u>	<u>175.6</u>
Per share basis	\$50.36	\$9.85	(\$6.96)		(\$10.56)	\$42.68
Bull	\$55.72	\$15.18	(\$7.70)		(\$10.56)	\$52.63
Base	\$50.36	\$9.85	(\$6.96)		(\$10.56)	\$42.68
Bear	\$45.01	\$3.72	(\$6.22)		(\$10.56)	\$31.94

Source: Company reports, Bloomberg, and Institutional Research Group estimates.