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Stantec, Inc. (STN)

Q1 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Stantec's First Quarter 2017 Earnings Results Call. With us today from Stantec management are Bob Gomes, President and Chief Executive Officer; and Dan Lefaivre, Executive Vice President and Chief Financial Officer.

At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer period. [Operator Instructions] Please allow time for everyone to ask a question.

Today is May 11, 2017, and this conference call will be recorded and broadcast live over the Internet. It will be archived for future references at stantec.com under the Investors section. Any members of the media, who are joining us are in a listen-only mode and who would like to quote anyone other than Mr. Gomes or Mr. Lefaivre must ask permission from the individual concerned.

Stantec management would like to caution you that this call will include forward-looking statements and forward-looking information within the meaning of applicable U.S. and Canadian securities laws. By their very nature, forward-looking statements require Stantec management to make assumptions and are subject to inherent risks and uncertainties. Stantec management would also like to mention non-IFRS measures.

I would now like to introduce your host, Mr. Bob Gomes. Please go ahead.

Robert J. Gomes

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

Thank you. Good afternoon, everyone and thank you for joining us for Stantec's first quarter 2017 earnings conference call.

For those of you following the slideshow, we are not on slide three. I'll open the call with some introductory comments and then Dan will provide a more detailed summary for the quarter's results. After Dan provides his commentary, I'll offer some brief operational highlights, and our outlook for the remainder of 2017. Following that, I'll ask our operator to open the call for questions.

Please note that a copy of the slideshow is posted on stantec.com and it will be archived in the Investors section of the website.

Today, we released the results of Stantec's operations for the first quarter of 2017. Stantec had good operating results in the quarter, led by acquisitions completed in 2016 and organic growth in our Water and Infrastructure business operating units, which together make up nearly half of Stantec's gross revenue.

Operations in the United States also experienced organic revenue growth. We are also pleased to see that the rate of organic revenue retraction we've experienced in some areas of our business is trending in a positive direction. Retraction decreased from 4.4% in the fourth quarter of 2016 to 2.4% in Q1 2017.

Growth of our new Construction Services business segment is meeting expectations, driven mainly by large project wins in the United States. Earlier this month, we finalized the sale of Innovyze, Inc., the software, water software solution firm that was part of our acquisition of MWH, for growth proceeds of $270 million.

Selling Innovyze was the correct strategic choice, as there were no synergy that could be applied to our core business, and this sale allows both companies to prosper with the best available resources and support. This transaction results in a reduction of goodwill, intangible assets and debt.

Unfortunately, the way we required to record this transaction has a negative impact on our reported financial results. Our operational results paint a truer picture of Stantec's performance this quarter, which are in line with our expectations and which are trending in the right direction for 2017. Even these adjusted operational results were impacted by the continued full integration efforts of MWH and the investment in that strategy. Those impacts will dissipate over the second half of this year.

Now Dan will review our financial results for this quarter and explain the impact of the Innovyze sale in a little bit more detail. Dan?

Daniel J. Lefaivre

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

Thanks, Bob. Hello, everyone. This afternoon, I'll start with our Q1 results. As Bob just pointed out, it's been a good quarter, notwithstanding the impact of the Innovyze sale, which is a positive move for the long term that will have some impacts in our reported results through 2017. These impacts will make it necessary for us to report adjusted results, something that we said we were not going to do for the rest of 2017.

We are doing this, however, in the interest of providing clarity and transparency, so investors get a true picture of our core operating results. Gross revenue increased 69% to over CAD 1.2 billion, this was mainly due to

acquisition growth in Q1 2016. Revenue was also impacted partially by organic gross revenue retraction in some of our business operating units and the strengthening of the Canadian dollar.

Gross margin increased a 54.1% in Q1 2017, mainly due to the mix of projects. EBITDA rose to CAD 89.8 million this quarter, an increase of 35%. Administrative and marketing expenses increased slightly as a percentage of net revenue of 43.6% in Q1 2017. This increase was due to higher marketing and business development labor cost and a continuing integration of MWH in large part related to IT costs.

Labor expenses will fluctuate due to lower utilization in the winter months and the mix of clients and projects along with a number of acquisitions completed in each quarter. We are continuing to report adjusted diluted earnings per share this quarter, and we're also reporting adjusted net income since legally these measures better explain our operating results. Net income was impacted by a CAD 90.4 million tax charge stemming from the recently completed sale of Innovyze. MWH is a water software solution company as Bob had mentioned in his opening remarks. Note that the divestiture amounts reported are subject to change due to balance sheet adjustments and foreign exchange fluctuations as we finalize the accounting in Q2 2017. Excluding the tax impact from the sale, our net income for Q1 2017 would have increased 5.9% over Q1 2016 to CAD 32.4 million. Adjusted diluted earnings per share stable at CAD 0.40.

Moving to slide number seven, the impact of the Innovyze sale, the CAD 90 million deferred tax charge decreased our diluted earnings per share by CAD 0.79 in Q1 2017. We've also provided additional information reflecting the estimated pro forma impact the Innovyze sale will have on our Q2 and 2017 year-to-date earnings.

The net proceeds of the sale will allow us to reduce an estimated CAD 290 million of goodwill, and intangible assets pay down about CAD 200 million of our debt and results in a pre tax accounting gain of about CAD 53 million. The tax charge does not impact our liquidity, our cash flows from operating activities or debt covenants this quarter. You can review all of this information on page M29 of our Q1 MD&A.

Our 2017 targets – we're on slide number eight now, remain as outlined in our 2016 annual report. At the end of Q1 in 2017, we met our target the gross margin as a percentage of net revenue at 54.1%. EBITDA as a percentage of net revenue is at 10.3% below our targeted range of between 11% and 13%. However, we do expect to achieve this targeted range by the end of the year. Administrative and marketing expenses as a percentage of net revenue are at 43.6%, just above our target of between 41% and 42%. This is typical in Q1 as seasonality has an impact primarily related to lower stock utilization in the winter months and as we noted the integration related costs.

We reported a loss as a percentage of net revenue this quarter of 6.6% again because of the tax impact from the Innovyze sale. Without the deferred tax impact, adjusted net income as a percentage of net revenue was 3.7%. A cash dividend of CAD 0.1250 per share was declared to shareholders of record on June 30, 2017. It will be paid on July 13, 2017. We believe that we will meet our 2017 annual targets given our robust work backlog, anticipated revenue growth and reduction in admin and marketing expenses.

With that, I'll hand things back to Bob for some operational highlights. For those of you that are following along on the slide show, we're moving to slide number nine.

Robert J. Gomes

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

Thanks, Dan. The takeaway for this quarter is that we've achieved good operating results and are trending in the right direction in accordance with our expectations. It was a good start to the year and we expect our results to

improve throughout 2017. As I mentioned previously, we are seeing overall organic retraction at reduced rate and we expect this rate of improvement to continue throughout the rest of the 2017.

As you can see on slide 10, our Infrastructure and Water business operating units performed very well this quarter. Together, they make up nearly half of our total business. Infrastructure achieved organic gross revenue growth of 2.3% over Q1 2016. This was due to strong organic growth in the United States transportation sector and stability in the Canadian transportation activities. We're in good shape for continued growth in this sector, thanks to our strategic market position in Bridge Inspection, bridge projects, program management, roadways and light-rail transit.

Overall, our Transportation business is benefiting on both sides of the border from the continuing interest and attention to investments in infrastructure. Stantec's Water business operating unit achieved organic gross revenue growth of 2.2% over Q1 2016, with growth occurring in both Canada and the United States.

On to slide 11 for those of you following along. Our Environmental Services business operating unit had stable organic revenue in Q1, 2017, compared to Q1, 2016. This business operating unit continues to be impacted by low commodity prices and reduced capital spending, leading to project delays and cancellations. We're seeing more request for proposals though and because of our strong client relationships and expertise, we're continuing to win a stream of generally smaller projects in North America.

Energy & Resources continue to retract because of weakness in the oil and gas sector in Canada and the Middle East. That being said, oil and gas sector within Energy & Resources and Environmental Services now represents just 6% of Stantec's overall gross revenue and the pace of retraction has definitely slowed. We continue to see signs but stabilizing environment in our oil and gas and mining sectors, which is good news after the last three years of retraction. Our position in these sectors provides us a market leading opportunity to advantage of a future recovery.

Our Buildings business operating unit experienced organic revenue retraction compared to Q1 2016, but it should be noted the Q1 2016 was a very robust quarter for Buildings. The retraction is again due to continued weakness in the Canadian and Middle East oil and gas sectors, which affected public and private spending. Also we pursued and won a number of P3 projects and in Buildings recently, but those won't start generating revenue until later this year.

As Dan noted, the tax implications of the Innovyze sale will have a negative impact on our results for the rest of 2017, but the sale remains the correct strategic choice. The software business is very different than the Consulting business. We also didn't want to divert management attention and capital to growing the software business. It's not our field of expertise, so it make means strategy sense to divest.

In the end, the sale will allow both companies to prosper with the best available resources, and it provides us with an opportunity to reduce debt by about CAD 200 million. By divesting the now Stantec takes full advantage of the outstanding performance of Innovyze, and the current market value of this firm. We have unlocked that value for the benefit of Stantec shareholders.

As noted on slide 13, this quarter, we made substantial progress towards integrating MWH projects and financials into Stantec Systems, and we've very pleased with our progress to-date. We've integrated items such as the benefits plan, payroll, IT, insurance and business networks. We've migrated 15,000 MWH projects into our Oracle system, and we're in the process of harmonizing our policies and practices. We expect full integration of MWH to be complete in 2018, except for Construction Services, which will continue to be operated as a separate business.

However, even though the construction business will not be fully integrated, we continue to explore and execute on the synergies of bundling our Consulting and Construction Services on projects and with clients that benefit from that strategy.

It's also – it's always difficult when you merge two large organizations, but so far, we're seeing that it's a very good fit, and staff are working well together. We're very happy about and how the integration is going. We should be on track for achieving the $15 million in cost synergies by the end of the year, and we're indentifying opportunities and winning more together. We expect to achieve our revenue synergies over the next year.

To review our outlook for the remainder of 2017, there have been no material changes to the expectation outlined at the end of 2016. We expect to achieve a long-term annual compound growth rate for gross revenue at 15% through a combination of acquisition and organic growth. For 2017, we anticipate continued economic improvements in the United States, increased Infrastructure spending in both Canada and the United States, increased spending in the water and waste water sector, and strong spending growth in the U.S. transportation sector, especially at the state level.

We expect a modest improvement in the Energy & Resource sectors compared to 2016, continued support for P3s in Canada with increasing opportunities for APD in the United States, and modest economic, global economic growth. Overall, 2017 continues to look better than 2016, but the clear majority of our business poised for growth with stability. And a small minority that may need more time to move into organic growth. As we progress through the second half of 2017, we expect the efforts of the full integration of MWH to have less of an impact on our SG&A costs.

As you can certainly see on slide 15, we have a strengthening backlog of significant projects across a wide variety of sectors and geographies. The projects listed represent just the small sampling of the work we have in our strong backlog.

To sum up, this quarter shows that consistent performance is the result of strategic acquisitions and the strategy of complete integration, and effective management and delivery of a wide range of services across a larger global platform. We built our business to adapt the changing market conditions, industry drivers and client needs, and are seeing the benefits of that strategy.

One final note, we recently published our Annual Sustainability Report, which reports on our ongoing commitment to social, environmental and economic sustainability, our sustainability performance for 2016 and our plans for this year. I invite listeners to read the report on our website at stantec.com.

Thank you. That concludes our presentation. I will now turn it back to the operator to begin the Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll go first to Yuri Lynk with Canaccord Genuity.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.

Q

Hey, good afternoon, guys.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Hi, Yuri.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.

Q

Yeah. Can you provide some additional color on the G&A in the quarter, and I guess going forward, specifically as it relates to the impact, the MWH integration activities had – it doesn't look or sound like there was – these are necessarily costs or maybe it's more in efficiencies, but just what's going on there and what happens in the back half to make, to provide some better leverage on the G&A?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yeah. I think there is two things Yuri, and we can't understate the utilization impacts in the first quarter. That is really the impact on the rest of our business were driven – really driven by the MWH or the Water business. So areas like certainly our Middle East was a little weak, still. The Buildings practice still a little weak or again a lot of time spent in [ph] MNBD (18:19) and our Environmental Services, which is a largely field work; again have some lower utilization in the winter months.

So on the top of that, the work that we are going to integrate MWH, I expect that we will still see some utilization impacts in the second quarter, as we – as Bob mentioned, we migrated all the projects and everything, now it's getting them ramped up and learning the new process or new tools and new systems in order to be effective.

So we'll see receive a bit of that impact still in Q2. The other thing is that there were some IT-related costs, we moved all of our ITs or all of our staff certainly in the North America and then across the number of the other geographies around the globe on to our single domain. So there is some additional IT costs related in getting those people all up on to our same platforms.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.

Q

Okay. I mean, I'm just trying to square the – that the commentary on the quarter with the results vis-à-vis the targets. So I just want to understand, I understand the targets correctly like I thought the low end of your targets would kind of account for seasonally weak quarters like the first quarter and vise versa. So was the quarter in line with what you were expecting at the onset of the year, or was there some additional weakness somewhere?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

I think there is a little bit of additional weakness in utilization generally, as I described earlier, but if you look at our EBITDA percentage in Q1 of 2016, it was only slightly weaker in Q1 of 2016, and we do expect that to improve as we get through into Q2, in particular Q3.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.

Q

Okay. Okay. I'll turn it over and I'll hop back in the queue. Thanks.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Thanks, Yuri.

Operator: And we'll go next to Mona Nazir with Laurentian Bank.

Mona Nazir
Analyst, Laurentian Bank Securities

Q

Good afternoon, and thank you for taking my questions. I believe at the Analyst Day last June, you stated that you were allowed for some pricing concessions in the energy and environment sector, and in the quarter, we saw these pricing pressures kind of persist. I'm wondering the timing that you initially put through some of these rate discounts. And can you speak about the contract structure and your ability to increase pricing? Is there a certain time period where prices are locked in or you're flexible, so that if there is recovery that could then help you guys?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

So some of those pricing cuts, pressures certainly continued into Q1 of this year. Actually in some cases we had written agreements for some of our clients that extended into 2017. We do see that dissipating now. So there is going to be less of an impact on some of those pricing considerations we gave.

We do have some long-term MSAs with some of our clients that also had pricing considerations in there. However, most of those contracts are salary multiplier contracts, that then we have the capability of going in and getting salary increases to get the multipliers up. We've also got other methodologies of getting increases, that business is very volatile; it is cyclical and our clients understand that. So the good news is, when things do get busy then that we definitely have that capability of going back and getting some of that back.

Mona Nazir
Analyst, Laurentian Bank Securities

Q

Okay. That's helpful. And just, it's almost a year now since MWH was first announced. I was just wondering, looking back, what's kind of the biggest positive surprise that you've taken from the transaction, and as you continue to work, what's an area that you'd have to put pour a little bit more energy into than you previously factored in?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Certainly, the positive surprise and maybe it's not a surprise because we anticipated that it's just their presence in that global water space and their position in that global water space. They do truly have a, number one, water position in number of geographies and certainly North America, certainly in the UK, but we're seeing that their capabilities would really allow us now to bid on just about any water project. We feel that we have the capabilities to and we have enough of a status and top tier position to be able to do that.

So, it's maybe not a surprise, but maybe a confirmation of why we did this, we're seeing that come to fruition. Certainly their position in the UK is an outstanding position in the Water business, and again, that's maybe just on a validation of what we had originally thought. Certainly some of the global operations, they have a strong mining group in South America, that is certainly an area that's under stress at the moment, because of the mining business.

But yeah, it's about 300 people, I think we've now all together we've rationalized the staff down there, and we're in a good solid position based on the work backlog that they have. And they have operations in Australia, New Zealand that certainly will benefit from our diversification strategy, because today, they really rely upon a water sector business.

So overall, we're very happy, the Innovyze sale was, we believe a very strategic opportunity we saw right out of the gate, but it took us some time to position that business to be able to sell it, and going through that, I think was – it makes the overall transaction, we're very good now. When you go back a year ago and look at the metrics associated with what we did with MWH, now add in some metrics of the CAD 270 million sale of Innovyze, doing the math it looks pretty good.

Mona Nazir
Analyst, Laurentian Bank Securities

Q

Okay. Thank you for that.

Operator: And we'll go next to Sean Eastman with KeyBanc Capital Markets.

Sean D. Eastman
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi, gentlemen. First question from me just kind of a high level; I noticed in the MD&A that your kind of framework within your outlook is predicated on a moderate slowdown in the Canadian housing markets. So I guess my question is just given that this topic has been in the news lately with some of the moves in Ontario, if you could just kind of discuss your direct exposure and indirect exposure to the Canadian housing market, and how a more severe slowdown might impact the business?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

So our residential exposure – our exposure in our Community Development group, is really in a greenfield master plan communities, mainly in Western Canada, and I put that into Manitoba, Saskatchewan and Alberta, but probably the majority of that being in Alberta, we have a residential, again, master plan community exposure in Ontario. Those are really not the areas that are probably being impacted in Toronto and Vancouver specifically. Where we're seeing the slowdown is mainly here in Alberta, just due to the slow growth in oil and gas, and the fires in Fort McMurray last year and sort of just put everything on hold for a while.

We've see that actually – we thought at the beginning and the year being slow, we anticipated the year was going to be, but I think we're starting to see signs, is not going to be as bad as we thought. It is a business that has matured, I'd say over the last couple of decades, so point of not getting over built and are a little easier than to respond to some of the fluctuations in the housing market.

So we're always cautious, because that housing market responds quickly to the ups and downs, but we don't see it as being a major concern right now. I think we've adjusted forward and now it's a matter of waiting for how that market is going to recover as oil and gas prices recover in Western Canada. So really it's more of a Western Canada play than an Ontario play. Dan?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

And maybe just to add a bit more context Sean, the Community Development business, it's a little less than 10% of our overall revenues and you can consider probably a little bit less than half of that is Canadian. So you're thinking about it as probably less than 5% our overall revenues is exposed to the Community Development markets in Canada.

Sean D. Eastman
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Thanks. And second question is, it's good to see a little pop in backlog this quarter, and it sounded like you did have a couple of lumpy awards in the Buildings segment. So I'm just wondering kind of how you're thinking about the backlog trajectory through the year, and maybe if you could provide some context with sort of the bidding activity you're seeing and whether there is some kind of incremental lumpy big awards that could hit backlog in the next few quarters?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

I would say the overall and sounds like a maybe a too positive of a statement, but overall this – for everyone of our businesses right now are seeing an increase in opportunities, that includes our oil and gas business and mining business.

So we're the only one that were a lot of concerned about our opportunities this Environmental Services, it's sort of lagging behind, but certainly everyone of our other businesses are seeing more opportunities, are seeing increase in backlog and an increase in backlog per FTE, full-time employee.

So all those metrics point towards good signs for us. You have to still win those opportunities obviously and you have to still execute the backlog well, so those are the – certainly aren't givens, but we are also very happy to see the backlog increase and also very happy to see the opportunities.

From a larger world perspective, I certainly think that Buildings is a group that probably it's had more of their share with some of the P3s, but that probably only makes up about 20% of our revenue in that Buildings operation. They still rely upon a lot of smaller projects at the local level, and I think that's again the strength of the company is probably 60%, 70% of our backlog and revenue comes from those sort of smaller, local projects, that just continue to feed the backlog and we're seeing those areas very strong.

Sean D. Eastman
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks very much. Very helpful.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Thank you.

Operator: And we'll go next to Jacob Bout with CIBC.

Jacob Bout
Analyst, CIBC World Markets, Inc.
Q

Good afternoon. Maybe just following on...

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Hi, Jacob.

Jacob Bout
Analyst, CIBC World Markets, Inc.
Q

...with a question on organic growth. Maybe just talk a bit about, when you think organic growth is going to turn positive, what that trajectory looks like? And then maybe talk a bit about the importance of Energy & Resources, Environmental Services in Buildings? And specifically what I'm getting at here is, how important is that the Canadian infra spend here in driving growth in particularly in Environmental Services and Buildings?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

So with regards to when, by the end of the year overall for the annualized basis we'll have positive organic growth and organic growth will improve in the second half of the year. So that'll give you some general guidelines with the organic growth. With regards to the impact that oil and gas and Environmental Services and Buildings will have on it and then the impact of the Canadian economy or the Canadian business on that, there is no doubt that's where the retraction has been, and the retractions has been in those areas. And we see the retraction slowing in those areas, specifically in the oil and gas and Environmental Services. Really the question will be as how much will they grow, the retraction will continue to be less. It's really how much lessened in comparison to the growth we get in other sectors.

Buildings is more of a timing issue and a some of the larger P3 projects, and also a comparison to what was the very strong quarter last year. So we see that improving maybe quicker and getting back to positive organic growth maybe quicker in the Buildings group. But certainly, those three will have an impact, because those are the three that are right now are having the negative impact. So they're obviously going to have an impact on the positive, turn for us into positive organic growth, which we're saying is going to be in the second half of the year.

Jacob Bout
Analyst, CIBC World Markets, Inc.
Q

Sorry, I should have specified, specifically the Canadian federal infrastructure spend. How important is that?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

I don't see that is being, something we need to turn things around. So let's put it this way, we're now looking for a significant bump in our – what I would call our Water business and our Transportation business in Canada to necessitate than a positive turn to organic growth. Right now our plans have, what we see in front of us, and the opportunities we see in front of us, really do not consider a huge spike in opportunities in the Canadian infrastructure business.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Maybe just – my second and last question here. The pause in acquisitions that we've seen over the past six months to nine months, is that a function of – the focus on the integration of MWH or is it just a function of things are just too expensive right now?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

No, definitely, it's a function of a pause for MWH. We knew we had to focus on taking that transaction. And because again, we fully integrate, you don't sit there in a way, you've got move very quickly. So, we decided to put all our efforts into that. Now, that being said, it doesn't mean that we did not continue to invest in developing some relationships, continuing on, I would say with our U.S. strategy. But certainly we weren't in a hurry, with any of those and we would allow those to sort of evolve and didn't push them. But certainly, we now see the opportunities in U.S. continuing. We really haven't seen any change in pricing or multiples, there are always really – they are always there, so I don't see a change significantly in that.

Excuse me, now we are also seeing opportunities for us in the UK and Australia, and that was the other thing that we took some time to start focusing on those markets, take the time to understand what our opportunities are there, which sectors we wanted to focus on, what relationships did we need to investigate. And so we're working on that as well. We've done small little acquisitions and we'll continue to do that throughout this year, and with the hope again, that we could expand that into the UK and Australia also by the end of the year.

Jacob Bout
Analyst, CIBC World Markets, Inc.

Q

Thank you.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

You're welcome.

Operator: And we'll go next to Benoit Poirier with Desjardins Capital Markets.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Yeah. Good afternoon, Dan. Good afternoon, Bob. Just to come back on the organic growth recovery for Building, yeah, I 'm just wondering if the recovery is due to kind of an easy compare as you started to experience a negative organic growth in Q2 last year. Is it really on the back of – kind of an easy compare?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

That will be a part of it, I wouldn't say that, that's going to be the sole responsibility for. We do see the – some of the larger project that they have one late last year, into the first quarter starting to ramp up, which will help that, that revenue growth, and therefore help the organic growth. So – but some of it will also be as part of the fact that we are comparing. So I don't know if it's on the back of it or if it's just contributing to it, but I wouldn't say that's all of that.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Okay.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

I would say that this was a lot more active in terms of their focused [ph] MMBD (34:24) last year and it starting to pay dividends for us this year.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Okay. Perfect. And just to come back on organic growth for Energy & Resources, did you say that you would expect to be in a positive territory kind of a second half?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Well, I said we'd be – less negative in that category. We see it improving, the trajectory of that improving as it goes through the year. I think something would have to happen in the market place to get it to positive. Now, that's not saying that wouldn't happen, but we'd to have a significant event in the oil and gas business, hence a very strong increase in oil and gas prices for that to happen.

Based on the trajectory today, they will continue to improve, but it will still be negative organic growth. But it will improve quarter-by-quarter as we move through 2017.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Okay. And just in terms of special items, despite a CAD 90 million of deferred tax related to Innovyze, I was wondering are there any non-recurrent recurring items or integration costs that we should take into account? And maybe if you could quantify the IT spending in the quarter that would be great?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

So, on the Innovyze, I think what we've try to do as provide as much information in the materials and the pro forma information around the impact of the sales. We aren't expecting anything more to come out as certainly we're going to have some adjustments, certainly looking at the tax implications and all of that, as we finalize the accounting in Q2. So I think what you see is going to be pretty close to what we end up with. So, not expecting anything materially different from what we've shown.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Okay.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

With respect to the IT costs, there are – there is a lot of additional effort and time and costs incurred in integrating and then to put an exact number on it would be pretty difficult. But it's in the order of CAD 10 million I would say in terms of the impacts of the additional IT costs that we incurred in the quarter.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. And is it fair to say that those additional costs on the IT side are mostly over or there was still be some in Q2 there?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Well, I think there will be some in Q2 and remember, when we set our targets at the beginning of the year, we talked about some additional costs in setting up our new core infrastructure, our new data center and those type of things. So, those aren't related to the MWH integration, but they are still costs that we will incur through 2017. So there maybe some impact there, but I think that's all tied into our estimates that we had previously. So, I don't see that having a material impact that will change our targets that we have set out.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. And pro forma post the Innovyze divestiture, could you then provide where would you expect your net-debt-EBITDA to stand at on the pro forma basis?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Sure. I think, we reported in the quarter, I think, we're about 2.4 times as of the end of Q1. I think, by the end of Q2, we'll probably be well below 2 times. I think we'll be 1.7 times to 1.8 times is again, where my expectations would be.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. Perfect.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

So, very, very comfortable at that level.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. And am I right to say that the – that in terms of M&A strategy, obviously the focus is on MWH integration but maybe some tuck-ins like you said in the UK and Australia?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Correct. Now that's what we're really trying do, is looking to diversifying MWH's operations in the UK and Australia and still continuing the U.S. strategy that which shouldn't – that we still felt that even without MWH, we still had opportunities in the U.S. to continue to fill-in a number of sectors and a number of geographies. So, really, we're looking at three platforms, the U.S. continued platform, the UK and Australia and New Zealand. So we anticipate going forward, we're going to get back to a pretty busy M&A strategy.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. And last one for me. Just in terms of gross margin for Construction, a slight improvement versus Q4, so 37.4%. I was just wondering if there was some seasonality or maybe the level in the quarter was a little bit higher than expectation.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Yeah, less do with seasonality, I think it's just a mix of projects in the quarter. You're going to see a little bit of fluctuation quarter-to-quarter, but nothing materially outstanding there.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Yeah, certainly that group is performing very well at this point.

Benoit Poirier
Analyst, Desjardins Capital Markets
Q

Okay. Thank you very much for the time.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Great. Thanks, Benoit.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Thanks, Benoit.

Operator: And we'll go next to Ben Cherniavsky with Raymond James.

Ben Cherniavsky
Analyst, Raymond James Ltd.
Q

Hi, guys.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Hi, Ben.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Hi, Ben.

Ben Cherniavsky
Analyst, Raymond James Ltd.
Q

Dan, I know you and I – I have asked you, just sort of a recurring question, but the conversion of gross to net revenue. Look it's quite – the numbers are quite sensitive to that and they've been moving around, I understand obviously they've gone up with MW&H (sic) [MWH] (39:47). But can you help us pick a good number as a run rate for what we can expect for this year and next on that ratio?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Yeah. I think in my mind, Ben for the – so you have to break it down between the Construction business unit and the Consulting business operating units or operations, and for Consulting, I would put the number at around 21%, 22% – 20% to 22%. So gross revenue would be a 122% than net revenue. I want to make sure, I make that clear.

And on the Construction business, it's somewhere between 175% and 170% of net revenue. So if you look at it on that basis, I think that's pretty close to what we're thinking it would be going forward.

Ben Cherniavsky
Analyst, Raymond James Ltd.
Q

Okay. So it's best to break our Constructions effectively, in back...?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Absolutely, yeah.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Absolutely, very different business...

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

It's very different.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

...especially in that metric, they're really different businesses.

Ben Cherniavsky
Analyst, Raymond James Ltd.
Q

Yeah. No, I understand that, but I mean assuming your mix doesn't change the overall impact should be blend of the two, I won't do the math right now, but like it's the weighted average of the two, but I guess what you're saying

is, it wouldn't be one shouldn't assume the mix would be the same, like we should expect the Consulting revenue to outgrow Construction over time or how should we work with that?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Over time, yes, but on a quarter-by-quarter basis, there could be fluctuations then, but over time, I think what we've said is on an organic growth basis and then certainly because of an M&A strategy in Consulting and not having one in Construction, it will outgrow it. But that's probably longer term on a short-term basis to probably the mix isn't going to change significantly in the next couple of quarters I'd say.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

And have you guys reconsidered at all the divestiture option of Construction, is that 0still integral and inseparable to the Water business?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

We're continuing to work through that, everything we've seen to-date, they operated as a separate business, but they really do bundle it well, especially in the UK. The UK is a very different business than in the U.S., and I would say the design build is defined much differently in the UK. So they work much closer together and it was really a strategy that was very successful in them winning the majority of the AMP programs in the UK. So, certainly there is [ph] a very evidence (42:18).

In the Unites States the design build sector is probably at this point in the Water business maybe 10% to 15% of the overall market, and there is a differentiator going in to some clients and on some projects on a bundled basis.

So what we're analyzing, Ben over the next year is, the value of that and the upside of that versus the additional risk and we're continuing to go through that. And at this point in time, the business operates well. The last thing we want to do is distract it. So from right now absolutely focused on maintaining that business and exploring where we could accelerate those synergies.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Right. But I, correct me if I'm wrong, but I got the impression the initial strategy was we're not – it's not really even an option to separate and now you're saying it could be under the right circumstances?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

No. We – I think separating is not what we want to do, but you have to continue to explore where the synergies are. The only way you can maintain that long-term strategy is understanding where the synergies are, and as we've said, we've explored in the UK and certainly, it's there or we're exploring it further in the U.S. You never say never, but at this point in time, we have no interest in talking about divesting of Construction.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Could you carve out just the U.S.?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Unlikely, today that there are some synergies that working on some clients, especially the process is very strong, the process capabilities of the treatment operations in the UK is very strong and the way the UK operates is also, I think progressively a decade ahead of the United States. So we do see some opportunities there. Again, you never say never, but certainly that's not our intent.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Okay. If I could just ask you to clarify something in the MD&A that where you note that the oil and gas sector now represents only 3% of gross revenue, so that's – that you're carving out oil and gas within the oil and gas – within the Energy & Resources, right?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Correct. It's – about 3% oil and gas represents – the oil and gas portion within Energy & Resources represents 3% and oil and gas within Environmental Services represents about 3%. So, together they represent about 6% of our total revenue.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

But then there is other ways that you guys are, I think even in – within the energy, you said there were some impact from low oil and gas prices that's affecting...

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yes.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

...energy infrastructure and of course, the Buildings has knock-on effect. I mean, what you would say as the overall sensitivity of your business to oil and gas prices?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

So the areas that it was impacting was the Middle East operations that their projects and Buildings are very connected, obviously, the clients there are very connected to oil and gas. Some of the Buildings operations in Western Canada connected and some of the Community Development Operations in Western Canada connected to that. You've sort of added all up Ben. I still don't think it's more than 10% of our overall business. Now it's probably impacted today because it's already been impacted, those projects in the Middle East for Buildings are already been put on hold. So, you can't go either further in on hold. They're already on hold and not generating revenues. So, I'd say, to date, the future impact is still less than 10%.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Plus you've chunked up your gross revenues with the Construction business and you've grown the Water side like you've just diluted that business down and it is strong. So, like compared to two or three years ago, it might have been – the overall sensitivity might have in a third of your business. I mean, is that fair to – I'm not going to hold you to the number, but just to get an idea of how that...

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

[indiscernible] (46:11). Absolutely. I think that to me is what's the – that's upside opportunity of all this. We need just one thing to change right now to go back to that and that is oil prices to increase. But you're absolutely right, it was a huge impact, today it's a much less impact overall in our business.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Okay. Thanks, guys.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Thanks, Ben.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Ben, before you leave, Dan here again, I just want to circle back again looking at my numbers again. For gross revenue as compared to net revenue, I think it's at 170% to 175%, if you use 280% because there is so much more, a big portion of that is sub-consultants, which is included in that growth in there. So if we use, 280% gross revenue to net revenue, that would be a better number for Construction. I think I've been guiding around 170%. I think that's too low. That's only the sub-consultant portion of it, not all of the other [indiscernible] (47:10).

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Okay. All right, great. Thanks for that.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Okay. Thanks. I hope that, that clears that's up.

Ben Cherniavsky
Analyst, Raymond James Ltd.

Q

Yeah.

Operator: And we'll go next to Sara O'Brien with RBC.

Sara O'Brien
Analyst, RBC Capital Markets

Q

Hi, guys. Just wondering in the Water segment, what you need to see to a real lift in that organic growth, I mean, I think you gave us 10 – sorry 2% quarter-over-quarter. Maybe year-over-year what are you seeing internally at

MWH and where do you expect to see that where they're going to drive that forward in the U.S. and the UK from here?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

That's a good question. The UK right now is entering the last stages of its AMP program. So, you're probably not going to see significant organic growth in the UK for the next couple of years as the wind down AMP 6 and they start rebidding on AMP 7. So it's not going to be a retraction, but I don't think you're going to see significant organic growth there. We're going to see more organic growth than we've experienced in the U.S. because as we continue to now join together, we're starting to see our win rate go up and we're starting to see some big opportunities.

I think the Australia, New Zealand operations are starting to get their feet onto themselves, but that may not be all in Water and maybe in some Transportation and other sectors. So Water, if you're looking at organic growth pick up, that is really going to be in the U.S. and it is something that doesn't come immediately, it really comes as we join with MWH, how successful are we going to be now in winning those projects. The good news is, lots of opportunities, that pipeline is probably as full as we've seen it, because it's just been a wider pipeline for us to capture opportunities because of having both groups together operating together. So, the 2% actually we're somewhat happy with that. I think it could continue to increase, but it's going to be subject to the U.S., and how well we execute on winning those projects.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

2% relates just to be clear the legacy Stantec business, because we show all the other acquired...

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Good point.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

...revenue and the acquisition growth.

Sara O'Brien
Analyst, RBC Capital Markets
Q

I mean...

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

So we don't...

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Yeah.

Sara O'Brien
Analyst, RBC Capital Markets

Q

Maybe, can you comment on how the acquired business MWH is done in the U.S. and the UK in terms of organic growth or quarter-to-quarter because that's what you have?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yeah, we haven't tracked, Sara, the – how they've done in organic growth relative to their prior year's revenue. What we can say, as they are meeting their budgets, they're performing as we expect to not just slightly better than we're expecting.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Certainly, in the Water sector, I think…

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yeah.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

…is where they are exceeding their budgets. So I'd have to say that intuitively, if we would have said what where they doing this time last year in Water to this time last year and added it to our organic growth in Stantec, it would be higher than 2 points today.

Sara O'Brien
Analyst, RBC Capital Markets

Q

Okay. And then just going back to the restructuring costs, the CAD 10 million, that was CAD 10 million of expenditures during the quarter for – or expense on the P&L, that went through for new platforms and softwares?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

That's correct.

Sara O'Brien
Analyst, RBC Capital Markets

Q

Yeah. Okay. And is that related to MWH or is that Stantec in general redoing systems and investing?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

A lot of it is MWH, there is – when you merge companies, you have to align your business software and all your other systems, so a lot of it is related to that, some of it is related to the core network, but a good portion of it is really getting everyone onto our domain, and there is a lot of extra effort there.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Yeah, the majority them. A majority is the domain on the...

Sara O'Brien
Analyst, RBC Capital Markets
Q

Okay. And you said we should expect some more of these types of costs in Q2, does it kind of taper off there or should we expect to stick around through the year?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

I think as I indicated, we're going to have some more utilization related costs, things that are going to impact the utilization, mostly training associated with the MWH folks, and we will get some more IT costs as we go through the year, but we'll try to articulate that as we go through...

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

It will be less, because I think...

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

It would be less.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

...this one was the U.S. and now we're moving into other areas.

Sara O'Brien
Analyst, RBC Capital Markets
Q

Okay. And then I just wondered on the Innovyze sale, if there were any targeted synergies from that, whether they be tax or cross-selling or something that you had factored in when you bought MWH?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Sorry, synergies associated with Innovyze [indiscernible] (51:55)

Sara O'Brien
Analyst, RBC Capital Markets
Q

That's right. Like do they have tax loss carryforwards that would have benefited...

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

No. If they had tax loss carryforwards, we could have used that to all...

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

That would be have been nice but...

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

No, unfortunately.

Sara O'Brien
Analyst, RBC Capital Markets
Q

Okay. Thank you.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Thanks, Sara.

Operator: And we do have a follow-up question from Yuri Lynk with Canaccord Genuity.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.
Q

Yeah, thanks. Was Innovyze, that was included in Q1 EBITDA and it will be included into May 5 of Q2, and I think – I just want to make sure I am thinking about that right?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

You're thinking about that correctly, Yuri.

Yuri Jonathan Peter Lynk
Analyst, Canaccord Genuity Corp.
Q

Okay. Okay, that's good for me. Thanks.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Okay. Thanks, Yuri.

Operator: And we'll go next to Anthony Zicha with Scotiabank.

Anthony Zicha
Analyst, Scotia Capital, Inc.
Q

Yes, Bob. Can you give us a bit of color on the California market and how does it compare to last year at the same time and how important of a market is it for your overall U.S. growth and what are some of the prospects in Western U.S.A.?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

I think California, now we have a much larger presence in the California because of the MWH, so it has become a larger part of our growth and a part of our performance. And it is an important market, it is the size of Canada from a population perspective and when you look at Water especially, it has every problem you can think of in Water. So last year drought, this year flood, so it is a very intriguing part of our business right now. And I think we can get stronger in a number of other sectors in that. I think we have now a number one Water position in California as a result of combining with MWH. And what we'd like to strengthen is our Transportation sector in that area, that certainly is an area where we're not as strong as we'd like to be.

So I think our growth in California is going to be how well do we execute on combining MWH in Stantec to win what is some is great opportunities in California, and some very large ones.

And two, how can we execute better in M&A strategy up and down the West Coast really in the United States, where we have not been as successful as we have been in the U.S. East. So, that is certainly opportunities for us in California, so centered around that.

Anthony Zicha
Analyst, Scotia Capital, Inc.

Q

Okay. And then, what about the Western region beyond California?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Certainly, we don't have as much exposure in Seattle, and up in the Pacific North West that we'd like to have, even in Colorado. So, that whole Western part of the United States if you look at the Stantec math and look at our density, that's really where we see some opportunities, both organically and from an M&A perspective. Denver now having a very strong base of operations with MWH's headquarters there. We see that's an area for investments and we did a very small firm in Pacific North West this quarter, that was really to start strengthening in diversifying. So, that is a part of the United States that from a geographic standpoint, we feel it's is an opportunity for us.

Anthony Zicha
Analyst, Scotia Capital, Inc.

Q

Okay. Well, thank you very much.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Thanks, Anthony.

Operator: We'll go next to Maxim Sytchev with National Bank Financial.

Maxim Sytchev
Analyst, National Bank Financial

Q

Hello. Good afternoon.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Good afternoon.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Good afternoon, Max.

Maxim Sytchev
Analyst, National Bank Financial
Q

Dan, I just wanted to follow-up on the one-off or one-time costs. So in terms of IT, it was roughly CAD 10 million and were there any incremental restructuring costs that were incurred in the quarter?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Well, I think you refer to it as restructuring costs. We're always balancing our workforce wherever there is a weakness or strength for that matter. And so, there was some severance cost incurred again in the quarter, we go through that every quarter. I wouldn't say it was materially different than or is a completely different than what we had in Q1 of 2016. So they were pretty close in terms of the severance costs that we would have incurred, other than that there was really no other what we've referred to as restricting costs, Max.

Maxim Sytchev
Analyst, National Bank Financial
Q

Okay. And anything specific on the integration costs or the only impact was the utilization?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

It's impacting utilization and as we mentioned some of the IT.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.
A

Yeah. I think I just can't stress that enough though that utilization is, it's your most senior people unfortunately that need to get together and figure out how do you work together and devising what systems you're going to use, the best of both companies. It is that full integration strategy. It's not easy to do, especially in that first year. So, I think you're seeing signs of that, that should improve as we go, but it is still something that we will continue to incur as we go through that full integration strategy.

Maxim Sytchev
Analyst, National Bank Financial
Q

Yeah, for sure. And I mean, just some food for thought. Is it possible to disclose these numbers on a going forward basis, in the press release or MD&A because we'll have to wait basically the entire day to get that granularity if it's possible?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.
A

Yeah. I think what we've tried to do Max is where there are impacts that are materially different from what we were to previously disclosed then we'd like to highlight those. But if they are part of our business, and part of our business, this integration, and we don't try to make excuses for what is impacting the results, then we report it the way it is. But if there are material differences then we will highlight those.

Maxim Sytchev
Analyst, National Bank Financial

Q

Yeah. Well, I guess CAD 10 million in IT costs, it is still significant, right?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Well, on a CAD 4 billion business, that's where you have to kind of weigh, whether what's material or what isn't.

Maxim Sytchev
Analyst, National Bank Financial

Q

Right. Okay...

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

But certainly I'll take your point.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah, I think the MWH just because of its size, some of those costs are starting to creep up to be more material, because that's just a bigger transaction, but as Dan said, we've done the same thing with every transaction we've done. We just never really has disclosed it, because it's never been as big. Now MWH is this bigger, it's a 30% of our company. So that has a bit of an impact, but we really don't want to go down that path of, okay, well, let's start disclosing all of this, because as we said, it's part of our strategy.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

And we're adjusting for it.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

We're adjusting for it.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

More importantly. Yeah.

Maxim Sytchev
Analyst, National Bank Financial

Q

Okay. That's helpful. And then I just had a quick question in terms of the U.S. momentum, just looking at some of the public comps, it feels that the organic growth numbers that are coming from those entities, appears to a bit

higher than the new guys. Are you feeling that maybe you're losing a bit of market share or is it just really a positioning where some of the legacy energy weaknesses is creeping up in those organic numbers, which doesn't make enough, certainly sort of an apples-to-apples comparison?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yeah, told not compare to other companies' organic…

Maxim Sytchev
Analyst, National Bank Financial

Q

For sure.

Maxim Sytchev
Analyst, National Bank Financial

Q

…numbers when you really don't know how that organic number is calculated and the basis on which it's calculated. We can only disclose ours and we feel the 2.4% in Water and 2.2% in Transportation are pretty good, and there are stronger in United States. So, we feel actually we're pretty happy with our market presence and our growth in those areas. Yeah, it compares to some disclose numbers that seem to be higher, either sort of wonder, but all you can do is worry about your own business. And we're pretty comfortable with what we have in Transportation and Water right now. Especially in the United States, we feel pretty comfortable of us.

Maxim Sytchev
Analyst, National Bank Financial

Q

Okay. That's helpful. And the last question, just in terms of M&A, any commentary in terms of the expectations from sellers? Have we seen any inflation in terms of multiples, any changes there? Thanks.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Well, their expectations are always higher, but the final number you pay, I don't think we've seen significant changes to that. When you see, especially in the smaller acquisitions, there you see multiples of the larger firms, there you see the public company multiples, they gravitate to that and figure that they should get those multiples, but those are expectations you can managing manage and go back to and really looking at their businesses. But no, we really haven't seen significant increases, but when you look some of the multiples that have been paid, yeah that's – they're at the higher end, and that doesn't make the job easier, convincing smaller companies that their expectations are unreasonable.

Maxim Sytchev
Analyst, National Bank Financial

Q

Right. And I mean in terms of transactions right now, I guess it's a combination of small and medium and potentially platform type acquisitions, right, that are still under consideration, obviously once you digest MWH, right?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. I know this covers the whole spectrum right now Max, it is a pretty I would say robust M&A environment out there, and all we can say Stantec is capable of playing at all three levels, now at a large level, mid-size and small.

I think that's what gives us an advantages. We're not reliant up on one aspect of the M&A, we're over right now, we can play in any area we want.

Maxim Sytchev
Analyst, National Bank Financial

Q

Okay. Very helpful. Thank you very much.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Thanks, Max.

Operator: We'll go next to Benoit Poirier with Desjardins Capital Markets.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Yeah. Just a follow-up on the Q1, 2016 when you were referring to the severance cost, am I right to see we're referring to the CAD 3.5 million cost taken in Q1, 2016?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yes. That's correct.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Okay.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

It was about the same as what we incurred in Q1, 2017.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Yeah. Okay. Perfect. And just in terms of the backlog, obviously up slightly quarter-over-quarter. Could you quantify what was the FX impact on a sequential basis?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

I don't have the FX impact Benoit, but what I can say is the backlog is up virtually in every business line or business operating unit that we have. It's either up or flat. So very positive, and I don't think the FX would have had a material impact in the quarter from the year-end.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Okay. Perfect. And when we look at the free cash flow, Dan any expectation or thought for the full year, I mean looking at your working cap down in Q1, but there is a lot of seasonality. So any thoughts about the expectation for the year or kind of the free cash flow conversion we should be looking for?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

I think we'll see similar free cash flow conversion as we will have seen in prior years, certainly in Q1, consistent with every year that at least have been in the role. We had used more cash than we've generated. It surely as a result of the accumulation of short-term incentives and tax payments that are generally due in the first quarter. We do generate, start to turnaround and generate positive cash flows in Q2 and Q3 and maybe a little flat in Q4. With the drawdown or the debt, that should reduce some of our cash flows as well around interest expense. So, I do see some positive cash flow momentum going through the year.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Okay. Perfect. And the last one for me. Any thoughts on the BC election that just happened whether you see some positive, neutral or slightly negative implication going forward in all of your business segments?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Not over yet. So, I guess, we'll have to wait and see what actually – how the dust settles. Certainly with a minority government, Liberal that was supporting pipeline development and resource development, now opposed by an NDP and Green Party that may carry the weight; that could cause some noise. It would be interesting to see how – but at this point in time, it's unknown how it's going to go forward, but that unknown is also not good. So, basically, it's just going to cause a pause, a lot of companies are just going to wait to see what happens.

Benoit Poirier
Analyst, Desjardins Capital Markets

Q

Yeah. Okay. Perfect. Thanks again for the time.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Thanks, Benoit.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Thanks, Benoit.

Operator: And we'll go next to Michael Tupholme with TD Securities.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Thanks. Dan or Bob, can you provide a bit more color around how we should think about the organic growth progression within the Building segments. It sounds like you've won some awards and I guess, it's just a matter of time before you start to see some of those kick in, but I'm trying to get a sense for how we should think about that organic growth number going forward?

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. Dan and I are pointing at each other to answer the question, because you weren't specific on who, so I guess I'll answer it. This is a hard one to look at, and we try to dig in to see, we know how much work they're doing, we see the utilization increasing, they've won the work, those work – does it ramps up? It doesn't happen overnight. Those projects also are slow to start because you're doing schematic design at the beginning for comparing against a not a strong Q2 as we had in Q1 when you look at last year. So all those factors are, it will be better, whether that will turn to a positive in Q2, it's hard to tell. We like to hope it is. Hope is never a good strategy, but at this point, it's not enough clarity to say, but it will be better and certainly throughout the year, we see that turning positive.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

I think the other thing to point to is the we've had material retraction in our Middle East business, and we're seeing some potential opportunities for projects coming back. Nothing fully confirmed yet, but things are starting to look better and that's encouraging.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

A

Yeah. And I think unfortunately when we look at the Middle East, it is not like North America, your clients there don't give you a clear picture, they don't follow a schedule for their projects. It is mainly relationships you're talking about and trying to get a feel for it. So as Dan said, the meetings are going to be positive, things are moving in the direction, they are asking for more information, those are all positive signs, and how quick that happens is really we are having a hard time. We do see all that does happening though this year. We don't see a continued delay into 2018, we see these things happening this year, it's just a matter of win.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Okay. Perfect. And then, just lastly, Dan, is there going to be any change in the amortization of intangibles related to acquisitions as a result of the Innovyze sales?

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yes. Absolutely. And I think we'll spell that out in the second quarter reporting. There will be certainly a portion of the purchase price will have gone to intangible assets as well as goodwill, and we'll have that all clarified in the second quarter. Yes, but you're going to expect some of that to go down.

I think what's important to note though is the reduction in the amortization of intangibles, the reduction in the interest expense that we'll incur will – and according to what we're seeing today will approximately offset the EBITDA contribution that Innovyze provided. So, essentially on a full year basis, it will be more of as a loss.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Right. Okay. I think you may be mentioned that, when you first announced as well. So, that's so close...

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Yeah. Just to clarify that. Yeah.

Michael Tupholme
Analyst, TD Securities, Inc.

Q

Great. Thanks.

Daniel J. Lefaivre
Chief Financial Officer & Executive Vice President, Stantec, Inc.

A

Okay.

Operator: And we have no further questions in the queue at this time.

Robert J. Gomes
President, Chief Executive Officer & Director, Stantec, Inc.

Great. Okay. Thank you very much for your questions. That concludes our call for today. Thanks for joining us and we'll talk to you next quarter.