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Stantec, Inc. (STN)

Analyst Meeting
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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Stantec Announcement of their Three Year Strategic Plan. Leading the call today are Gord Johnston, President and Chief Executive Officer; and Theresa Jang, Executive Vice President and Chief Financial Officer.

Today's call is webcast and Stantec invites those dialing-in to view the slide presentation, which is available in the Investors Sections at stantec.com. All information provided during this conference call is subject to forward-looking statement qualification set out on slide 2 and outlined thoroughly in their press release dated December 3, 2019 and incorporated in full for the purposes of today's call.

With that, I'm please 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 as we introduce Stantec’s three year strategic plan. Our promise is to design with community in mind and we believe it is our focus and connection with communities that has propelled us to be one of the premier architecture, engineering and environmental firms in the world. We're very proud of what we have accomplished over a 65 year history.
When I was appointed CEO in 2018, I was given a clear mandate by our board of directors to chart a course to enhance our competitive position as a top 10 global design firm that maximizes long-term sustainable value for our clients, employees and shareholders. While this is not a radical change, it's an important acknowledgement that who Stantec is and who we aspire to be must be grounded in value creation. With that clarity, we've already begun to lay the groundwork that will enhance our delivery of long term value.

Let me highlight the most significant changes I've made so far to deliver on this vision. Either best of the construction business that joined us as part of the MWH acquisition, as we felt its risk profile and value proposition were not consistent with that of our core consulting business. To strengthen our alliance with shareholders, we've introduced total shareholder return as a key metric in our executive long-term incentive program, as well, we've discontinued our stock option program that was dilutive to shareholders. With a renewed focus on earnings per share growth, we've made tremendous efforts to shape – reshape our organization to be leaner and more efficient resulting in CAD 40 million to CAD 45 million of annualized cost savings.

With Theresa's arrival, we have re-prioritized our commitment to rigorous and disciplined capital allocation with a clear and unabated focus on total shareholder return. As you see in through 2019, there have been no acquisitions that have met our criteria to proceed other than Wood & Grieve Engineers in Australia. Therefore, we've redeployed our capital towards debt repayment and share repurchases. All of these debts represent a renewed invigorated strategic focus on delivering value. And, today, we'd like to present our three-year strategic plan to you.

Our vision is to remain a top 10 global design firm that maximizes long-term sustainable value. Our plan over the next three years is to grow and diversify sustainably for the benefit of our clients, employees and shareholders. Our strategy is illustrated in the figure on the left hand side of the slide. Our clients are at the center of everything we do and we will create long-term value through the four value creators which surround our client centric model. These will be expanded on throughout our presentation, but as an introduction they're as follows; the first is Excellence. We have reshaped our organization to be lean and highly engaged with clients and project work while maintaining our commitment to exceptional project execution. We will continue to refine our operations to further improve execution and efficiency in order to continue to drive earnings growth.

The next is Innovation, where we will continue to invest in the development of leading edge services with our clients and drive operational efficiency. The talented people who work at Stantec remain our greatest assets, and we aim to provide a workplace that engages, rewards and retains the best talent. And finally, growth. We will create shareholder value through a combination of organic growth and a rigorous capital allocation framework. Earnings growth will be accelerated through selective acquisition initiatives that are focused on the clients, markets and geographies with the highest risk adjusted potential. If we are unable to identify acquisitions that meet our criteria, we will allocate capital to share buybacks when the valuation makes sense. With clients at the core of everything we do, I'm confident this plan will position our organization for continued success. We are committed to achieving this vision and I've set new financial targets that are in greater alignment with shareholders. Earnings per share growth and improved return on invested capital. We'll also continue to measure our success through employee engagement and client satisfaction.

To achieve this, I've realigned the executive team that will own and deliver on this enhanced strategy. Today, we announced in our press release that we are evolving our C-suite structure to ensure that we have dedicated focus and accountability for critical areas of the business. This evolution of our C-suite is a foundational element of our strategic plan. Our current Chief Operating Officer, Scott Murray, will be retiring at the end of 2019. Scott joined Stantec in 2008 with the acquisition of Fuller, Mossbarger Scott and May Engineers and has been our COO since 2016.
Since that time, the company has grown substantially including our global presence outside of North America. And I'd just like to pause for a moment to thank Scott Murray for his leadership and the many significant contributions he's made to Stantec over the years. He has truly helped shape Stantec into the company it is today. And we wish him all the best in his upcoming retirement.

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

We'll also be adding a new role to the C-suite to help drive our innovation initiatives forward. Marshall Davert, currently the business leader for Water will take the new role of Chief Innovation Officer. He'll lead the commercial development of services and digital solutions to improve our long-term competitiveness. Marshall will also focus on driving value from our industry partnerships and create competitive advantage from our creativity and innovation programs. Theresa Jang, Tino DiManno, Steve Fleck, Emree Siaroff and I will remain in our current C-suite roles. These appointments are key to executing our strategic plan. This team will lead our growth initiatives, drive our innovations program forward and continue to strengthen the efficiency of our operations. I'm really excited to work with this reinvigorated C-suite teams moving forward.

Potential to deliver an EPS growth is a continued focus on excellence in project delivery and efficient operations. Our overall operational performance can be viewed through the lens of two broad categories; execution and efficiency. Both played a critical role of driving EPS growth. Strong project execution is a hallmark of Stantec. Our focus on execution is fundamentally about project leadership and maintaining our solid gross margin. We will continue our efforts to build out the processes and tools that support our project management teams throughout the organization to maintain gross margins between 53% and 55%.

Our organizational efficiency improved in the third quarter, reflected in the decrease in administrative and marketing cost as a percentage of net revenue. While our reshaping initiative is largely complete, we will continue to examine our business processes to ensure that they are efficient and remain cost-effective. We will also seek to identify additional areas where we can reduce complexity in our processes and organizational structure. And we will leverage our global operations to deliver the best services in the most efficient way.

As an example, we see growing our project delivery and administrative support center in Pune, India as a way to enable our global teams while also driving margin improvements and shareholder returns. We expect this combination of efficiency initiatives to drive administrative and marketing costs as a percentage of net revenue down by 50 basis points or more by the end of 2022.

Sustainability is also a critical component of our excellence value creator and we actively manage our environmental, social and governance impacts. We've placed specific focus on ethical conduct, health and safety, sustainable design, reducing our carbon footprint, and Inclusion & Diversity. And we will continue to track our success in these areas.

Our next value creator is Innovation, which is an essential ingredient for our continued market competitiveness and the key enabler for organic growth. Our Creativity & Innovation programs nurture the efforts of our people as they develop ideas that benefit our clients, our competitive position and our financial performance. Today, we
announced the new executive leadership role of Chief Innovation Officer. And in this role, Marshall Davert will lead a team of dedicated innovation leaders across our business to further our leadership in this area.

The commercialization funnel for our Creativity & Innovation program identifies hundreds of potential opportunities each year. From there, we choose around 50 ideas annually for incubation and business acceleration. These are further narrowed to between 5 to 10 ideas which are selected for significant investment and our goal is to commercialize more than three ideas per year. Marshall’s appointment to this new role highlight the priority we are placing on this program to position us competitively for the future.

The digital landscape is also a key area of focus, and we will continue to invest in digital solutions. Our digital strategy framework has three distinct areas of focus. Highlighted in blue on this slide are solutions that add value to our clients and communities. We offer many client-facing technology based services in corporate developments and mobile data collection, remote sensing and data analytics, to name a few.

Highlighted in orange are solutions that create efficiency and value for our delivery teams. By employing the most current digital applications, we can drive greater profitability in areas such as parametric design, data visualization and virtual reality, business intelligence and our internal project management systems.

Our third area of focus is our back office, where we leverage our enterprise technology platform to create opportunities that drive efficiency, grow project gross margins, deliver higher-quality project outcomes, and enable both organic and acquisition growth.

An example of the success of our Innovation Program is our environmental DNA, or eDNA tool. Working with our partners, we’ve developed the ability to detect the presence of various species simply by taking a water sample. This is hugely beneficial in the environmental assessment and permitting process. Our work has shown that our eDNA system is delivering on its promise as a fast and cost-effective tool for detecting the presence of rare species at low densities in the environment. This innovation, which has led directly to approximately 20 project awards, is an example of how important innovation is to our ability to compete and grow organically.

As I indicated earlier, our people are our greatest asset. We’re focused on ensuring that Stantec remains a place where the best and brightest come to build on each other’s talents, do exciting work and make a big impact. We are proud of the culture we have at Stantec and its unique value proposition for our employees. We are actively positioning our workplace for the future and fostering a culture that inspires our employees while supporting them with the resources and tools that drive project execution.

We are also living on our commitment to inclusion and diversity. We want to ensure people from all backgrounds, genders and orientations feel welcome, safe and supported through programs such as our employee resource groups, developing professionals groups, and our numerous employee engagement initiatives.

A continued focus on employees is key for organic growth at Stantec. This focus is manifested through four key elements. The first is engaged employees. They are the fuel behind Stantec’s organic growth.

The second element is our total rewards program. Our incentive system, which is tied to our strategic objectives and total shareholder return, continues to attract and retain the right talent.

Thirdly, we recognize that learning an organizational development is a necessary component in working with employees at all levels, so that they can continue to grow and evolve in their careers.
And finally, by building strong and diverse talent pools through our talent review and succession programs, we create competitive advantage. We are very proud of our current inclusion and diversity engagement score of 85%, and our voluntary turnover rate of less than 12% is amongst the best in our industry. We intend to maintain or improve on these metrics over the next three years.

Our final value creator is growth. Growth is integral to our ability to compete in a rapidly changing competitive landscape and to our vision of continuing to rank as a top 10 Global design firm. Our growth strategy is built to deliver shareholder value. To measure our success and to drive alignment, we have introduced two new financial metrics. By the end of 2022, we aim to deliver an earnings share CAGR of greater than 11% and a return on invested capital of greater than 10%.

Historically, our net revenue growth has been achieved through a mix of organic and acquisitive growth. In developing our strategic plan, we evaluated the market outlook, key drivers of organic growth, our risk appetite our size, and our desire to balance growth with patient and disciplined capital deployment. This led us to establish our revised long-term net revenue CAGR at greater than 10%.

The opportunity for growth is immense and provides us with confidence that we can achieve our target metrics, and we are well-positioned to capitalize on these strategic growth opportunities. While we already experienced success in all of these areas, look, we will enhance our targeted focus to further increase our market share in the years to come. Combined, just these opportunities represent CAD 24 trillion of project spend in the next decade, translating into roughly CAD 2 trillion in engineering and design spend.

We expect our multipronged approach to tap the opportunities I talked about in the previous slide and deliver 2% to 5% organic net revenue growth over the course of our strategic plan. Our strategic pursuits and corporate campaigns program continues to identify, prioritize and channel the appropriate resources to the most important market opportunities that we have as a company. And we have had considerable success over the past number of years with these programs.

Strong relationships with existing and prospective clients are essential to further our organic growth and success. We continue to focus on these through our account management programs. A key focus of our plan is to cross-sell additional services to our key clients where we are positioned as a strategic partner. Client satisfaction is the foundation of our long-term success. Our goal is to continue our track record of greater than 80% client satisfaction which is top tier in our industry. We are committed to maintaining a robust qualitative and quantitative framework work for our acquisition strategy. We have a strong track record of building business platforms through bolt-on acquisitions which in turn powers organic growth.

Our Environmental Services business is a great example of a successful business built on a combination of acquisition and organic growth. This slide shows various firms that had some focus on Environmental Services who have joined us over time. These acquisitions form the basis of our Environmental Services business that has continued to grow organically. Today, our ES business generates over CAD 0.5 billion in annual net revenues and is delivering double digit organic growth. The foundation of that growth was built through acquisition and is now paying dividends organically. Over the next three years, we’ll evaluate our acquisition initiatives to have the potential to continue our growth in North America, grow our Australia and New Zealand business and diversify our UK and European operations.

Let me take a minute to describe each of these in a little bit more detail. Our growth plans in North America centered on instilling our presence in Canada and building out our US geographies and services. While we have a mature presence in Canada, we still have room to diversify in certain markets, like the Greater Toronto Area,
Québec and with the Canadian federal government. While we have opportunities in the all areas and business lines, in particular, we’re looking to expand our Water and Infrastructure presence in Eastern Canada.

In the US where we have single-digit market share, we see considerable opportunity for growth in many geographies and business lines. Specifically, we’re looking for opportunities in Environmental Services, Water and Infrastructure, particularly in the US West. We’re looking to further diversify our Buildings business from our focus on healthcare, education and commercial sectors into civic and workplace. And we look for niche offerings in Energy & Resources, such as strong hydropower capabilities to augment our existing team or within Power in California with a focus on transmission and distribution. In short the US will continue to be a primary focus for acquisition growth for the foreseeable future.

Moving to our growth aspirations in Australia and New Zealand, we gained a foothold in these countries with the acquisition of MWH back in 2016. We’ve made investments in our own backend infrastructure to allow further acquisitions to quickly be integrated into our company. Basically, we’re following the same playbook that led to our successful growth in North America. In Australia, we’ve achieved a top tier presence in Buildings Engineering and strong geographic coverage in the Sydney, Melbourne, Brisbane and Perth. We will look thoughtfully to diversify our service offerings with the focus on Water, Transportation, Community Development and Environmental Services through a combination of organic growth and smaller transactions.

Australia is not a homogeneous market. The Community Development market in the Southeast has been very robust for many years, and as a result development firms are looking for high multiples on large earnings, making them less attractive acquisition targets. However, there are opportunities for firms and other types of businesses and in other locations throughout the company at more reasonable and attractive valuations.

In New Zealand, we’re one of the three largest design firms in the country, with 16 offices spanning the North and South Islands. There’s opportunity for additional service diversification in Community Development, Environmental Services as well as Buildings Engineering.

In the United Kingdom, we have a top tier Water presence. Following the necessary investments in our Infrastructure, we’re well-positioned to make smaller tuck-in acquisitions that will diversify our offerings into other business lines, specifically in Infrastructure, Environmental Services and Buildings. And this year, we refined our European growth strategy. Our analysis produced three clusters of focus for long-term growth, the Netherlands, Scandinavia and our development work with the international financial institutions.

Experience has shown us that achieving sustainable earnings growth requires both business mix and geographic diversification. This will be accomplished through a combination of organic growth and prudent acquisition. With respect to our business mix, we will seek to grow all of our business lines to augment our existing operations. In particular, we expect our Buildings and Water businesses to experience outsized growth and become a larger proportion of revenue, such that over the longer-term our three largest business operating units of Infrastructure, Buildings and Water will each make up approximately 25% of our overall revenue mix. Taken together, we target around 85% of our business to come from non-cyclical revenues. While we anticipate continued organic growth and smaller tuck-in niche acquisitions in our more cyclical Oil & Gas and Mining businesses, we do not see larger acquisitions in that space. This reflects our view of an optimal long-term business mix that will likely take us beyond 2020 to achieve.

We’ve grown from a small Canadian focused engineering firm to a top 10 global design firm due to our relentless pursuit of market leadership and our targeted acquisition program. We’ll be prudent and disciplined in our M&A execution. We see tremendous opportunity to participate in the industry trend of consolidation and we continue to
be an acquirer of choice. We’re committed to doing what we’re good at, focusing on small to medium sized acquisitions. We will not grow the via acquisitions just for the sake of growth, and we will only pursue those targets that meet our strict minimum requirements. That is, they must be accretive to earnings and have a risk adjusted internal rate of return in excess of our weighted average cost of capital. The earnings potential of the merged organization must be greater than the parts, resulting in long-term total shareholder return. We must be able to achieve earnings synergies, resulting in improved margins by placing the acquired company on our global back office and marketing platforms. The firm must fit our risk profile. And finally there needs to be a strong business and cultural fit.

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

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

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

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

Central to my mandate is to ensure that we have a value-focused approach to capital allocation with a clear prioritization in order to achieve the best risk adjusted returns. Our core commitments of sustaining capital, maintaining a strong balance sheet and our core base dividend will be our highest priority. Beyond this; however, is the competition for capital that exists when we compare the benefits of acquiring our own shares versus any contemplated acquisitions. The decision to pursue an acquisition or to return capital by a share buyback will be measured against their respective immediate and long-term impact on total shareholder return. And if the relative valuation of potential acquisitions is too high or if they don’t meet our minimum requirements, buying back our own shares at the right value is the low risk use of capital.

While we’ve included acquisitions in our net revenue growth targets the cadence of our acquisitions will vary based on the quality of acquisitions available. The pricing of those acquisitions, timing and our own performance in the capital markets. We’re not handcuffed to our acquisition growth targets, if the opportunities, timing and pricing do not make sense we’ll wait. Achieving our return on invested capital target by the end of 2022 depends on our discipline in allocating capital prudently and effectively. We’re also committed to maintaining a healthy balance sheet with a net debt to adjusted EBITDA ratio of between 1 and 2 times providing me with the flexibility to manage the seasonality of our cash flows. Even at 2 times our capital structure is not overstressed. When a compelling and strategic opportunity arises, we may consider flexing above our target range, but only if there is a clear line of sight to be inbounds within our range within 12 months.

And so we’re providing four very simple financially driven targets for 2022, that will hold ourselves accountable to and measure ourselves against. By the end of 2022, we aim to achieve a long-term net revenue CAGR of greater
than 10%, an adjusted EBITDA margin as a percentage of net revenue of 16% to 17%, an adjusted earnings per share CAGR of greater than 11% and a return on invested capital of greater than 10%.

Having set out our financial targets for 2022, let me spend a little bit of time focusing on what we expect for next year. Consistent with our three-year plan, our 2020 targets are focused on three key measures. Our target for adjusted EBITDA is in the range of 15.5% to 16.5% net revenue. We've essentially tightened the range from where it has been historically. Adjusted net income should continue to be equal to or greater than the 6% of net revenue. And return on the invested capital is targeted to be equal to or greater than 9%.

And let me just give you some of the building blocks of these targets. In terms of net revenue, we expect organic net revenue growth to moderate somewhat from levels achieved this past quarter. As Gord articulated in the strategic plan, we continue to target organic net revenue growth in the low-to-mid-single digits. And this would include any impacts from changes in foreign exchange.

In terms of acquisition, net revenue growth recall that this represents revenues from acquisitions made within the preceding 12 months. You've heard us reaffirm our commitment to our acquisition program, but be assured we will not pursue growth at any cost.

We expect to maintain solid gross margin in the range of 53% to 55% and we expect admin and marketing costs to remain within 37% to 39%. We do anticipate a stronger adjusted EBITDA margin in 2020 relative to 2019 with a full year's benefit from our reshaping initiative. We've also chosen to tighten our range to 15.5% to 16.5% to better represent what we believe we can achieve.

Turning to our balance sheet, our continued prudent management of leverage will keep our net debt to adjusted EBITDA between 1 and 2 times. As I said earlier, I'm very comfortable with our leverage being anywhere within this range. Our capital structure and our cash flow generation can comfortably support leverage at the upper end of this range. And as was the case earlier this year when we acquired Wood & Grieve, I'm equally comfortable with going outside this range would be fund the acquisitions so long as we have a line of sight to getting back within the range in 12 months.

We have an excellent track record of managing our leverage and that should give you confidence in our focus on maintaining the strength of our balance sheet. In terms of DSO, we are going to move to reporting DSO, including deferred revenue because I believe it's appropriate to take deferred revenue into consideration. This should also improve comparability amongst our peers. Although I would still caution that as a non-IFRS measure there's really no way of knowing if it's being calculated on a consistent basis across the board.

In 2019 we set a very aggressive target that we've not been able to achieve to-date despite our best efforts. We're going to continue our efforts to reduce our DSO, but we don't expect it will change meaningfully in 2020.

As I said in Q3 our net working capital is generating return that is consistent within their peer group. And so while we continue to look for ways to chip away at our DSO target, it's much more impactful for us to be focusing on delivering increasing operating income margins.

In terms of our other metrics, we've provided details around our expectations for capital expenditures, depreciation and amortization, tax rates et cetera in today's news release, in the appendix of this presentation and on our website. And with that I'll turn the call back to Gord.
Gordon Allan Johnston  
*President, Chief Executive Officer & Director, Stantec, Inc.*

Thank you, Theresa. In closing our presentation, our vision is clear to be a top-10 global design firm that maximizes long-term, sustainable value. We are working to enhance our competitive position and shareholder value through the value creators we talked about today, excellence, innovation, people and grow.

I'll now turn it back to the operator to start the Q&A session.

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**QUESTION AND ANSWER SECTION**

**Operator:** Thank you, sir. [Operator Instructions] Our first question will come from Jacob Bout with CIBC.

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**Jacob Bout**  
*Analyst, CIBC World Markets, Inc.*

Good morning.

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

Good morning, Jacob.

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

Good morning.

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**Jacob Bout**  
*Analyst, CIBC World Markets, Inc.*

So long-term net revenue targets of 10% implies pretty decent acquisition growth longer term. Talk a bit about your acquisition pipeline and where valuation of these potential targets stand right now? They've been moving higher.

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

Yeah. Good question, Jacob. We – our acquisition pipeline is very full. Certainly good opportunities in North America, particularly in the United States. Outside of North America, we’re talking at any time with a number of firms in Australia in particular, the UK, sort of the Nordics and Scandinavian countries. So in general, we’re seeing valuations. And as I said in my remarks there, valuations also seem to fluctuate a bit by geography and even within a country. So as an example, we do find in Australia, there’s considerable variation in valuation multiples from Sydney and some of those areas have had significant residential expansion. Land development firms in those regions are looking for a very high multiple. But yet in Australia, if you go to Western Australia, mining companies there have a lower valuation. So valuations fluctuate we’re finding based on geography and based on the type of business that you’re involved in.
Jacob Bout  
Analyst, CIBC World Markets, Inc.

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

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

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

Jacob Bout  
Analyst, CIBC World Markets, Inc.

Okay. And then last question here is just on your culture and the success of rebuilding this culture. Talk a bit about what your success has been and what the turnover rate has been since restructuring was announced.

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

Specifically, I'll talk about the voluntary turnover rate because that's the one that where people have decided that they'll go and work for a client or a competitor. And our goal in voluntary turnover rate is to be less – have that being less than 12%. And we've consistently been below that number for several years, and if that number maintains below 12%, that is really amongst the best in the industry as well.

In terms of the culture, I view our culture as being very entrepreneurial. We are not a command and control structure. We have certain things, again, I always talk about underneath the immovable umbrella of ethics and safety, we want our people to be engaged with clients and making the decisions to service their clients appropriately, get the right projects at the right revenue and at the right earnings profile to continue to drive the business forward. So, I think it's that entrepreneurial focus that's key to our culture, and that's what keeps people at Stantec.

Jacob Bout  
Analyst, CIBC World Markets, Inc.

And that voluntary turnover rate is up in the same across divisions, was that higher, say, in Water or...

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

Yeah, I don't have numbers by – we don't track it by in particular business line, but I'd say anecdotally, I don't see any areas that are higher than others. There's some geographies where there's some pricing pressure from salaries. And so in those regions, there is some additional increase in turnover from us and other firms because a lot of people just seem to walk across the street for an extra CAD 10,000 or CAD 20,000 in their annual pay package. But in general, no, I wouldn't see that that varies by business line.
Jacob Bout  
Analyst, CIBC World Markets, Inc.  

Thank you very much.

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

Thanks, Jacob.

Operator: Thank you. Our next question comes from Benoit Poirier with Desjardins Capital Markets.

Benoit Poirier  
Analyst, Desjardins Capital Markets  

Yeah. Good morning and thank you for giving a lot of color about the three-year strategy plan. Could you talk, Theresa, a little bit about the free cash flow conversion that we should be looking for over the next three years?

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

Yes, certainly, Benoit. So when we look at what we expect for the next couple of years, we are expecting to be in excess of 1 time our net income for our free cash flow. It should strengthen considerably over the next couple of years and we've seen that occur this year as well. So that's the trend we're on, but I would expect it to strengthen over the next three years.

Benoit Poirier  
Analyst, Desjardins Capital Markets  

Okay. And when you look at some flex with respect to some M&A or willingness to go above the 1 to 2 times range, but with the sight of being back within the range in 12 months, what would be kind of the upper limit that you would feel comfortable with?

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

That's a little bit tougher because it sort of depends, Benoit, on where we are at during the year. So as you saw in this past year, in the first quarter when our operating cash flows tend to be at their lowest, (indiscernible) (00:37:48) higher this year post the IFRS, we were right at 2 times. And so I could see ourselves going 2.1, 2.2 times and again comfortably bringing it back over the course of the year. If it's later in the year like we are now where cash flow generation is really strong, then [indiscernible] (00:38:08) high, so it will moderate depending on where we are in the cycle.

Benoit Poirier  
Analyst, Desjardins Capital Markets  

Okay, perfect. And with respect to DSO, you already mentioned some target about the 2020, but is there more color that we should be looking for, for the next three years in terms of potential improvement with DSOs?

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

Okay, perfect. And with respect to DSO, you already mentioned some target about the 2020, but is there more color that we should be looking for, for the next three years in terms of potential improvement with DSOs?
Yeah, I mean, I think we believe that we can over a longer period of time bring DSO down by 3 to 5 days. I think what we’re finding this year is that as much as we aspire to bring it down that the contract structures and so on that we are tied to in our current [indiscernible] there’s not a lot of flexibility. I think we understand a lot better today than we did at the start of the year where those challenges are and why they exist. And so that’s why really in the upcoming 12 months, we don’t see as much opportunity to really meaningfully change that number. But over the course of the three years, we should be able to bring that number down. But again, we think DSO is an important metric, there is no doubt about it. But on balance, we do think it’s more important for us to be prioritizing the degree of operating income margin that we’re generating that moves the needle far more than knocking it there so off DSO. So again, we’ll do both, but that’s what I see for the next couple of years.

Benoit Poirier
Analyst, Desjardins Capital Markets

Okay. That’s great color. Thank you for the time.

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

Thanks, Benoit.

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

Thank you.


Derek Spronck
Analyst, RBC Capital Markets

Okay, good morning. Thank you for taking my questions and thank you for the additional detail there on your three-year strategic plan. I was just curious with the development of these measures. Did you kind of look at what you could achieve from a cost savings and growth perspective and then develop those metrics, or did you kind of set the targets and then say, okay, these are all of the different levers that we have and our ability in achieving those metrics?

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

So that was really developed from the ground up to look at, as you said, in the first case what could we develop from a growth standpoint what are the opportunities to drive margin improvement, how can we tighten our allocation of capital, and what does that produce and then how – what’s our confidence level in being able to achieve those targets. That’s really the process we went through.

Derek Spronck
Analyst, RBC Capital Markets

Okay. And what would you say in terms of the conservatism around those metrics?

Theresa B. Y. Jang
Chief Financial Officer & Executive Vice President, Stantec, Inc.
I think these are good solid targets for us.

Derek Spronck
Analyst, RBC Capital Markets

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

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

Yeah, we have Derek – Gordon here, we have a robust program of client engagement. We conduct regular client surveys. We ask that each of our project managers and everyone who's engaged with clients to conduct certain number of these on an annual basis. And so we work through everything from, were you satisfied with the project manager? Were you satisfied with the product that was delivered? How is the pricing schedule? All of those forms of engagement. And then at the end, we have a question that just says, are you satisfied or would you hire the company again. And so once we weight all these things, we certainly think that 80% client satisfaction is a very solid number. And currently we're above that. So we want to continue improving on that one.

Derek Spronck
Analyst, RBC Capital Markets

Okay, that's great. And maybe one more for myself before I turn it over, just at the digital innovation side, it seems really interesting and some really cool stuff that you're working on. Would you say this is largely table stakes at this point or are you actually kind of ahead of the curve here in driving new applications that could potentially be material from a revenue and margin perspective longer-term.

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

We do think that a number of things that we're working on are pretty exciting and really can adapt. For example, our parametric design programs allow an engineer or a technical person to rapidly increase the speed at which they can design detail of the floor slab or the alignment of a railway and so on so. That's particularly important and very helpful when we're working on lump sum projects, because we can do it faster. If we're dealing with a fixed fee, then we can increase our margins. What we have to look at is, if we can just do things faster and we're getting paid hourly, how do we share that value created with the client? So those are some of the things, that not just us, but overall the industry is working through, but I do think the number of the things that we're engaged in are – we're ahead of the curve. So I'm pretty excited about it.

Derek Spronck
Analyst, RBC Capital Markets

Got it. And do you think it's material enough to actually drive results and the margins going forward or...

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

I think from a long-term perspective, we might see that. But, Derek we're looking at things like those, the technologies to help drive long-term margin improvements. We also mentioned, our Pune, India delivery center that's also an area where we could get a little bit more margin improvement. So these are all things that we're working on that we don't see a big uptick next year because of these things, but this is a long-term investment that we see strengthening our competitiveness in the years to come.
Okay. That's great. Thanks, Gord and Theresa, I'll turn it over.

Thanks, Derek.

Operator: Thank you. Our next question comes from Maxim Sytchev with National Bank Financial.

Hi. Good morning.

Good morning, Max.

I just had a quick question in relation to page 27, the one that describes the share buybacks versus M&A. And Gordon, I don't know if you were trying to telegraph something specific, the fact that share buybacks is on the left-hand side. I don't know, it doesn't suggest that there is more of a priority in terms of that specific capital allocation right now in relation to access cash, or are you viewing these things obviously as a moving targets depending on what's available to marketplace from acquisitions perspective, where the stock price is and so forth, so just trying to get a bit more color in relation to the priorities. Thanks.

Yeah. Sure. So, Max, I would not read anything to the positioning of the boxes on the slide. I really view buybacks and acquisitions is part of the same equation. And so it does go back to where the opportunity lies. And as I said earlier where we see we can create the greatest value. And so both, share buybacks and acquisitions have to be at a value that we believe can drive long-term returns. And the one that drives the greatest value is going to win the day. But it is part of really all the same equation for me.

Yeah. No. Makes sense. And then I'm wondering if you've ever specifically disclosed this information, but in terms of your weighted average cost of capital what do you guys use as a benchmark?

Yeah, we have not disclosed that. I don't think it's that hard to try and recreate, you can probably get pretty close, but no we have not disclosed our – the internal [ph] WACC (00:46:21) that we've used.
Maxim Sytchev
Analyst, National Bank Financial

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

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

Okay. Thank you.

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

Thanks, Max.

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

Michael Tupholme
Analyst, TD Securities, Inc.

Thank you. Good morning.

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

Good morning.

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

Good morning, Michael.

Michael Tupholme
Analyst, TD Securities, Inc.

First question is about the revenue mix and the suggestion that you expect Buildings and Water to achieve outsized growth and targeting 85% or higher from non-cyclical industries. Is the growth in the areas that you expect to show higher than average growth or outsized growth in such as Buildings, Water and I guess also Environmental, is that a function of market conditions and your positioning or is this in part driven by the areas that you focus on, or you plan on focusing on for acquisitions?

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

Yeah. I think we look at it pretty holistically, Michael, and what we were trying to say there, this is really a reflection of some of the color that we’ve had over the past number of quarters that as we believe, as we look to run – in the run up to 2014, we were very heavily weighted to the cyclic industries. And when oil and gas in the commodities downturn that hit us significantly in 2014-2015. So as part of the rebalancing and looking at the overall portfolio, as Theresa and I look at that 85% number being non-cyclical, as a good way to develop and confirm this sort of this long-term growth, stable growth rather than it being a little bit more peak and trough like.

And so, as we look at Buildings and Water, again really the reason that we show them a little higher is because they're a little bit less than that 25% that we'd like to see them in the – from a long-term perspective. This is going
to take us – I think we’ve mentioned in the prepared comments, this is going to take longer than just 2022. And we won't forego a good infrastructure acquisition to get – to wait for a Water one. We'll do the right things. And what we're trying to really indicate on this slide is just in general we're looking for that, the big three for us is Infrastructure, Buildings and Water being each about a quarter of our business and about 85% or more of our revenue generated from these non-cyclic industries.

Michael Tupholme  
*Analyst, TD Securities, Inc.*

Okay. Fair enough. Second question is regarding the EBITDA margin range that you've provided. So, as – Theresa, as you mentioned, you’ve tightened the range, which has appreciated. I guess my question is, was the range simply overly wide or unnecessarily wide previously? Or has your line of sight in some way improved and allowed you to tighten that range? And if that is the case what is it that gives you that increased confidence to be able to sort of more narrowly focus in on a particular number?

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

Yeah, I think that's a great question. So when we're looking at EBITDA margin, the first thing we’ve said is we know that we have confidence that the EBITDA margin will improve as we move into 2020. And so as we get a full year of benefit from the reshaping initiatives, we should see a stronger EBITDA margin. And then as we look at the range, I do believe that sort of previous range of 15% to 17% would have been very challenging to achieve the upper end of that range. And over the course of 2019, a couple of other things that have occurred that have helped me just sort of solidify that thinking. In our disclosures over the course of the year, we have talked about an increase in our admin and marketing costs as a result of having to shift the way we accounted for certain software costs.

So these are just about $15 million annualized of cost that has really moved from below the EBITDA line to above the EBITDA line. It doesn't really move our bottom line, but it does shift our EBITDA margin. So when you take that into account that's one of the reasons why I don't believe that 17% EBITDA margin is achievable in 2020. And then as you kind of look at it from the other perspective in terms of what we know we can achieve and where we see continued opportunity for improvement, I think it’s really important for us to set a target, the upper bound that we set at 15% as being something it's hard, but it feels like if everything sort of lined up properly if we maintain a lean organization, if we continue to focus on good project execution and we look at ensuring that we are being very disciplined on our discretionary spend that that's something that we can achieve. So there's been a fair bit of thought that's gone into that range. And I do think that on the whole it is a more achievable range than what we have had in the past.

Michael Tupholme  
*Analyst, TD Securities, Inc.*

Okay, that's helpful. And just to, I guess, one sort of follow-up on all of that. It sounds like your ability to hit the upper-end of that range is not dependent or overly dependent on one particular area in terms of cost savings or efficiencies, is that fair to say that it's sort of broad-based, I mean there’s not really one thing that would sort of make or break your ability to get there?

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

Yeah, very much, still I mean if you look at just the nature of this organization with the number of moving parts we have and just like the 10,000 projects going on at any given time when you think about gross margin and project
execution. So everything has to go really well in order for us to be able to believe that we can achieve the upper-end of that range. And so that’s what we’re going to strive to do. And we’ll see how it goes over the course of the year. But it really is a number of moving parts that need to align in order to achieve that upper-end.

Michael Tupholme  
Analyst, TD Securities, Inc.

Okay. Thanks. And then just a question about the dividend payout ratio 25% to 30% targeted over the next three years. Is that – can you just remind what the old target was, and is this an increase relative to the prior target. Because I seem to recall at least at the Investor Day there was mention of something a little bit below that, so just trying to put this new target or just target into contract?

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

Yeah. Sure. It’s important to put that into context, so thanks for asking the question. You’re right at Investor Day the dividend payout ratio that I’ve expressed has been deliberate what I think is an appropriate and balanced payout ratio is in that 20% to 25% range. And I still believe that that’s true for the long-term. If you look at our dividend paying history over the last number of years since it was introduced in 2012, you saw a cadence of about 10% increase year-after-year. And in the period of 2016 to both 2018 our dividend got a little outsized relative to our net income and have pushed our payout ratio into sort of 35% to 40% range. That’s why in 2019 while we still grew the dividend we pulled back a little bit on the year-over-year increase to about 5% to 6%. So sort of you got to follow along this math with me. So if you look at where we expect to be over the next three years, we’re going to be in that 25% to 30% range if we continue to sustain and increase the dividend modestly. But really the idea is sort of growing into a lower dividend payout, that I don’t think is realistic to think that we can get to 20% to 25% over the three-year period of our plan. But beyond that, that would be our objective to bring it back in the 20% to 25% not by cutting it, but still growing it, but because we’re growing it through greater earnings generation. Hopefully that makes sense?

Michael Tupholme  
Analyst, TD Securities, Inc.

Yeah. That makes sense. Thank you.

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

Thanks, Michael.


Ben Cherniavsky  
Analyst, Raymond James Ltd.

Good morning, guys.

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

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

Good morning.

Ben Cherniavsky  
Analyst, Raymond James Ltd.

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

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

Sure. So, maybe I'll take that question on Ben. The real focus of our strategy and I think what's different is a very deliberate focus on shareholder value creation and total shareholder return. So, it's not to say that this was not focused or ignored in the past, but I do believe that if you think about the weighting of focus between top line and bottom line growth that historically we have been a very top line growth focused organization and in a lot of ways that served us really well. You can't help bottom line growth without revenue growth. But I think what we feel differently and what we're introducing and really kind of having permit through the organization is. they need to focus on the whole picture and shareholder value. So, that may sound subtle, but it's pretty fundamental and key to what's different and what drives our strategy.

The other piece that we have said and although again the target range hasn't really moved for 2020 in terms of our gross margins, in our admin and marketing costs, but over the next three years we are focused on driving margin improvement, whether it's through a reduction in the 50 basis points in marketing costs that we've highlighted or in other areas. So that part of is different. As far as historical acquisitions and capital allocation decisions, it's not – it hasn't really been I felt instructive for me to really try and make a judgment on whether tough decisions have been good, bad or otherwise. I think my focus is entirely on looking forward. And, what discipline and rigor I believe is requires where I sit or Gord sits on those decisions. And so that rigor and discipline we talk about is on an absolute basis in terms of my – in my kind of historical track record prior to coming to Stantec on M&A and the rigor that I look for. So I would think about it more as a go forward and a commitment to the rigor and the focus that we'll put on this as opposed to really sort of how we feel about how we've gotten to where we are today.

Ben Cherniavsky  
Analyst, Raymond James Ltd.

Okay. Fair enough. Thanks very much.

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

Thanks, Ben.

Operator: Thank you. Our next question comes from Chris Murray with AltaCorp Capital.
Chris Murray  
Analyst, AltaCorp Capital, Inc.

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

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

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

Chris Murray  
Analyst, AltaCorp Capital, Inc.

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

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

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

And then as we – as we look to how we would adjust an IRR that we would be looking to achieve from that acquisition target. That’s – that’s obviously where it’s going to flux. And so, can’t give you specific examples of getting into the details of what degree to which we flux that risk adjustment, but it’s just – it’s a really important part of that process. So, identifying the risk, stress testing them and then understanding to the extent we choose to accept a particular risk profile, what are the mitigates and goods charged with ensuring that those risks are addressed and how we can factor all that in to a multiple revised pay or an IRR that we’re looking for that clears our hurdle if that’s just all a part of the process.
Chris Murray  
Analyst, AltaCorp Capital, Inc.

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

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

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

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

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

Chris Murray  
Analyst, AltaCorp Capital, Inc.

Okay. And just – just a thought on substantial insurer bids as well?
Okay. And how should we think about what a small and medium-sized firm would be in terms of head count? Can you just put some parameters on that?
Gordon Allan Johnston  
*President, Chief Executive Officer & Director, Stantec, Inc.*

Yeah. So, what we were trying to say there is, is just – to again reaffirm for us that the firms that we're looking for are the smaller and to mid-sized firm, it's kind of the Stantec sweet spot not another MWH sized acquisition. So, for us, a small firm I would view to be less than a couple hundred people. And in medium-sized firm, it would be like Peter Brett Associates that joined us last year or [indiscernible] (01:10:01) that joined us this year, it's kind of in that 500, 600, 700 person range. The firms that we're targeting in general would be less than a 1,000 people roughly.

Yuri Lynk  
*Analyst, Canaccord Genuity Corp.*

And so in the scenario where you would contemplate going above your targeted leverage range, that wouldn't be necessarily due to a 1,000 person plus acquisition. Those are not going to happen. It would be more – you've had a bunch of medium-sized deals come up, is that how we should think about that?

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

I think that's right. It will be either a bunch of medium-sized deals or as Theresa mentioned Q1 is typically lower from a cash inflow perspective. And we know that we pay our short-term incentive bonuses then too. So, our leverage in Q1 will typically select upwards. So, if we did a – you know, even one of these medium-size in Q1 similar to what happen to us this year in Q1, the leverage would go a bit higher. But, as Theresa said, with a clear line of sight, you're bringing that down as we've done this year.

Yuri Lynk  
*Analyst, Canaccord Genuity Corp.*

Okay. Last one for me, the ROIC target is new, where does that stand if you want to use year-to-date or trailing through September or whatever you want to do, but, just to put the target into some context?

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

Yeah. So, where we are – where we expect to be for this year. I would like to think that we're going to approach the 9%. I'm not sure that we will hit it. But, I think it will be in the vicinity. So, as we look to being 10% or greater in three years, that is expected to demonstrate improvement from where we are today.

Yuri Lynk  
*Analyst, Canaccord Genuity Corp.*

Okay. Thank you.

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

Thanks, Yuri.

**Operator:** Thank you. Our next question comes from Mark Neville with Scotia Bank.
Mark Neville  
Analyst, Scotia Capital, Inc.  

Hey. Good morning. Maybe just to follow-up on the buyback and M&A discussion, again, 2019 was a bit of a light year for M&A and maybe just given where you sit today, where the pipeline is, sort of where your stock price is – would the expectation for 2020 to be sort of an outsized M&A year or more on the buyback?

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

It's always hard to predict what M&A is going to look like. Certainly, we've messaged and the funnel is very full. So, we'll just have to see how these progressed, what the timing of these various firms could progress to get a better feel for what that M&A pipeline will look – will look like. I anticipate the phase to improve or to increase over where it was in 2019.

Mark Neville  
Analyst, Scotia Capital, Inc.  

Okay. And when I look at the – the 2022 targets. Again, this is, I guess – this is what the numbers and I think it's a lot of way, lot of things that can happen in three years, and I guess with the M&A, buybacks, the margin of these targets would come in at, but, I guess, when we sort of boil it down and sort of think about what's most important here, it's sort of fair that we assumed for 2022, it's sort of the adjusted earnings growth in the [indiscernible] (01:13:19), other primary targets and everything – all the other numbers sort of just feed into that. Is that a fair way to think about it?

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

Yeah. It is the right way that we think about it that, as you said, there's a number of moving parts to get the bottom line and the returns. But those are ultimately the key metrics and we think most representative of how shareholder value shows up. So that – that's why those would be the key targets.

Mark Neville  
Analyst, Scotia Capital, Inc.  

All right, thank you. I'll leave it there.

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

Thank you.

Operator: Thank you. Our next question comes from Nauman Satti with Laurentian Bank.

Nauman Satti  
Analyst, Laurentian Bank Securities, Inc.  

Hi, good morning everyone.

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

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

Good morning.

Nauman Satti  
*Analyst, Laurentian Bank Securities, Inc.*

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

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

No, I think the quality there is very solid for us, one of the things that we have talked about is, there is a number of very, very Tier 1 firms and we’ve been speaking to in the UK. And these are solid firms that see the economic uncertainty related to Brexit as a temporary blip in the radar and they’re probably right. And because of that, they are looking to maintain the valuation at a higher level which signifies a strong economy in the short-term and long-term. And so, are those firms, for example, we wanted to wait, we didn't want to pay a higher valuation now which I thought – which would lead us to think there'd be a strong economy in the short-term, while we still had the Brexit uncertainty. If those valuations would soften, we could buy in some uncertainty, but they haven't, and I think that's a reflection of the high-quality of those firms in the pipeline.

Nauman Satti  
*Analyst, Laurentian Bank Securities, Inc.*

Fair enough. And just one more from my end, on slide 11, relating to the innovation cycle, I'm just wondering if there are any new exciting products that are potentially coming out of it in the near future, I mean, similar to eDNA or are there any specific areas that you're focusing on in that part?

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

We chatted about a few of them on the following slide. We've got some really interesting developments in remote sensing that are allowing us to look for vegetation changes. We've done some work on that and we've used that on a number of projects already. Our Stantec analytics is a tool that it’s a big data analysis tool that look for -looks for trends in various large datasets, that's giving us some great opportunities there as well. So, first we see virtual reality as a great enabler of the design process. It allows our clients to immerse themselves in the design that we're putting together earlier in this process. So, if there are adjustments or things that they want to change, they get to just to see an experience that makes the whole process more efficient and certainly it helps to increase our margins. So, a lot of really interesting things going on that have enabled us to secure new projects and I think are moving forward as we expect.

Nauman Satti  
*Analyst, Laurentian Bank Securities, Inc.*

All right. That's it for me. Thank you.

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

Great. Thank you.
Operator: Thank you. At this time, I am showing no further questions in the queue. I would now like to turn the conference back over to Mr. Johnston for closing remarks.

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

Great. Well, we'd just like to thank everyone for taking the time out of your day to join us today to cheer a little bit more about our executive changes but also our three-year strategic plan. And we look forward to catching up with the majority of you here in the short-term. So, thanks very much.

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