

SNC backlog calculation 'aggressive'

Veritas Investment Research says engineering giant's method of projecting revenue differs from that of peers

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Investors need to be wary of **SNC-Lavalin Group Inc.**'s reported backlog because the engineering giant calculates that number more aggressively than its peers, a report by **Veritas Investment Research** suggests.

SNC's calculation method is "amongst the most aggressive in the industry," and helped to inflate its fiscal 2007 backlog by \$2.6-billion or 43 per cent, the report indicates. SNC's backlog includes items like five years of estimated revenue from its stakes in Highway 407 north of Toronto and Calgary-based Altalink LP, a power transmission company.

"The bigger the backlog, the better the company looks as an investment," **Veritas** analyst **Dimitry Khmelnitsky** said. "You have to be very careful if you are doing your valuation based on backlog," he said in a interview.

SNC's chief financial officer Gilles Laramée declined comment on whether SNC's backlog calculation is aggressive. But the Montreal-based firm does divulge its four revenue sources for its backlog in financial statements and annual report, and has been doing so since 1999, Mr. Laramée said. "We are providing full disclosure, and it is reliable and useful information."

Backlog, a common measure in the engineering and construction industry as an indicator of future revenue, is often defined as the total dollar value of work on contracts awarded and in progress.

"Without adjusting SNC's backlog, you would get a higher valuation than you would get from their peers," **Mr. Khmelnitsky** said. "The problem is that there is no standardized methodology of how backlog should be calculated.

"Backlog by itself does not have an impact on the quality of the reported revenues during any given period," he noted. "It only has impact on valuation of the company."

Engineering and construction firms typically include items like services and packages, which may include construction, in reported backlog.

But SNC's backlog also includes estimated revenue from concession infrastructure investments, such as from Highway 407 and Altalink, and operations and maintenance services. Concession investments relate to ownership in anything providing a recurring revenue stream like toll roads, airports, parking garages and utilities.

Companies may also have contracts to operate and maintain everything from power plants to highways, water treatment projects and transit systems.

Other companies that include five years of estimated revenue from operations and maintenance in reported backlog include U.S.-based URS Corp., Shaw Group Inc. and KBR Inc., while Jacobs Engineering Group Inc. and Fluor Corp. include only one year of such revenues.

SNC's Canadian rival Aecon Group Inc.'s backlog number does not include concession or operations and maintenance revenue, the analyst noted.

And Spanish construction giant Grupo Ferrovial SA, which has a 53.2-per-cent stake in the operator of Highway 407 until 2098, also excludes this revenue source in backlog.

While SNC only has a 16.8-per-cent stake in this toll highway, the projected revenue based on past traffic is "an indicative figure and reliable," Mr. Laramée argued.

SNC, which owns a 76.9-per-cent stake in Altalink, includes its share of estimated revenue in its backlog number when companies like Fortis Inc., and Emera Inc. don't, **Mr. Khmelnitsky** added.

Other analysts declined to comment on whether SNC's calculation of backlog is aggressive.

"While we find backlog to be a useful metric in measuring the progression of a company's prospects over time ... we avoid comparing peers on such a metric," Raymond James analyst Frederic Bastien said.

Aecon's vice-president of corporate affairs Mitch Patten said his firm prefers a conservative approach to backlog.

"We need to have a signed contract, and a notice to proceed [for umbrella contracts]," Mr. Patten said.

"Investors always know that what is in our backlog is signed, sealed and delivered, and there isn't an element of management expectations or management forecasting."

"There is no uncertainty," he said. "If something is in backlog and the client decides not to proceed, then we can sue them."

SNC backlog and enterprise value/backlog ratios

As of Dec. 31, '07, \$billion	SNC	Aecon
Reported backlog	10.6	1.2
Operations and maintenance	2.5	0
Infrastructure concession investments	2.1	0
Adjusted backlog	6.0	1.2
Percentage impact	43%	0%
EV/backlog*	0.72	0.63
Adjusted EV/backlog	1.27	0.63

*Includes non-recourse debt related to concession investments.

SOURCE: **VERITAS**