

## **Badger Daylighting Ltd. 2020 Third Quarter Results**

**November 5, 2020**

### **Corporate Speakers:**

- Paul J. Vanderberg; President, CEO & Director; Badger Daylighting Ltd.
- Darren Julian Yaworsky; VP of Finance & CFO; Badger Daylighting Ltd.

### **Participants:**

- Yuri Lynk; Analyst; Canaccord Genuity Corp.
- Margaret Anne MacDougall; Analyst; Stifel Nicolaus Canada Inc.
- Matthew Weekes; Analyst; Industrial Alliance Securities Inc.
- Daryl Young; Analyst; TD Securities
- Jonathan Lamers; Analyst; BMO Capital Markets
- Jeffrey Eric Fetterly; Analyst; Peters & Co. Limited
- Unidentified Participant; Analyst; Unknown

## **PRESENTATION**

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Badger Daylighting Limited 2020 Third Quarter Results Conference Call. (Operator Instructions).

I would now like to hand the conference over to your speaker today, Paul Vanderberg, President and CEO. Thank you. Please go ahead, sir.

Paul J. Vanderberg: Thanks, Destiny. Good morning, everyone. We appreciate you joining Badger's 2020 Third Quarter Investor call. With me today is our CFO, Darren Yaworsky; and Jay Bachman, our VP of Financial Operations.

Our 2020 Q3 earnings, the MD&A and financial statements were released after the market closed yesterday and are available on the Investors section of our website and on SEDAR.

We are required to note that some of the statements made today, which may contain forward-looking information. In fact, all statements made today, which are not statements of historical fact should be considered to be forward-looking statements.

We make these forward-looking statements based on certain assumptions we consider to be reasonable. However, forward-looking statements are always subject to certain risks and uncertainties, and undue reliance should not be placed on them as actual results could differ materially from those expressed or implied. For more information about material assumptions, risks and uncertainties that may be relevant to such forward-looking statements.

Please refer to our Q3 press release and MD&A, along with Badger's 2019 annual MD&A and the 2019 AIF. Further, such statements speak only as of today's date and we do not undertake to update any such forward-looking statements.

So on to the quarter. We are very pleased with Q3 results. Our adjusted EBITDA of \$47.1 million was 94% of the prior year. This is a great outcome in light of the economic downturn and business uncertainty that continues to exist. The strong margins were particularly encouraging and our continuation from last quarter. The improvements made to operating costs beginning in late Q1 and into Q2, drove the better margins, even with revenue being down 15% from the prior year.

This all reflects the strength of Badger's proven and flexible business model. We continue to focus on the major business areas of: number one, obviously, the health and safety of employees and customers; number two, staying close to our customers; number three, on cost management; and number four, maintaining the strength of our financial position.

We're pleased with continuing progress in each of these areas.

With health and safety as Badger's overriding focus, I'm personally very proud of our response to the COVID-19 pandemic and our ability to continue to service our customers. We are an essential services provider and our ability to safely service customers is a testament to all the hard work and dedication of the entire Badger team.

We continue to maintain procedures to address any situation that could arise under COVID and have updated them as we go along based on changes in local circumstances.

So on to the financial results. Revenue for Q3 of \$156.9 million, as I said, was 85% of the prior year quarter. Revenues were impacted by the broad economic slowdown as a result of COVID, combined with lower revenues associated with our oil and gas markets. Revenue trends within the quarter, again, at 85% of the prior year were generally consistent across all three months during the quarter.

We continue to be encouraged by improved activity levels with our customers in general, but do want to highlight that revenues and customer activity layers -- levels continue to vary regionally due to the variability in the reopening of the economy across both Canada and the United States.

Third quarter revenues benefited from several emergency response activities as a result of hurricanes along the Gulf Coast, included with Q3 quarter revenues is about \$7 million in revenue associated with emergency response.

In this segment, Badger is truly unique with our operating scale that allows us to provide trucks from across our network to assist essential utilities and restoring service. I'd like to take a minute and make a comment about our emergency response work. This is extremely challenging work that's often done under very difficult circumstances.

Our ER response team assembles the units based on what our individual utility customers need. And our people mobilize and work in very severely storm damaged areas and are among the first arriving with utility crews. Basics like housing, food, fuel, communications, sanitation are often lacking. And our staff endures very difficult living conditions on these assignments.

Our team really goes all out to make a real and personal sacrifice to perform our ER work, and it does not go unnoticed.

Emergency response work at Badger is the true essence of what an essential service provider means for our fellow employees who are still out there today working on hurricanes data and for all the employees who worked on emergency response throughout the quarter. Thank you.

So let's continue revenue per truck in Q3 was \$28,347 compared to \$36,088 in the prior year and also up from \$23,458 in Q2. So good sequential quarter-over-quarter improvement.

For the trucks that operated during the quarter, revenue per truck was approximately \$33,000, up 2,000 from Q2.

We want to provide input for investors on the RPT for trucks working because it provides insight into the operating efficiency and especially the labor efficiency, which our operations team continues to manage very, very well, very important from the margin perspective.

Labor efficiency did drive improvement in gross margin, which for the quarter was 35.8% up 300 basis points from the prior year. The improvement in gross margin was also driven by cost reduction initiatives and a modest benefit from the Canadian emergency wage subsidy, the (Qs) program.

If we exclude the \$1.9 million impact from Qs in the quarter, gross margin would have been 34.6%, up 180 basis points from last year.

We anticipate that we'll continue to benefit from cues. But under the existing program and the way it's structured, the benefit is expected to tail off as we go through the fourth quarter and into 2021.

In addition to the benefit of cost reductions, we're anticipating that gross margin will continue to benefit from improved operating leverage and fleet utilization as market conditions improve.

We continue to see operations -- opportunities to further improve margins as a result of increased visibility also into the new ERP system, some real, real good tools that our people are leveraging.

We're still in the early stages of harnessing all these tools, but we're very encouraged by the early success and look forward to unlocking further value from both an operational and obviously, a financial perspective.

I did want to make a comment, though, on operating expenses, and in particular, our direct cost, especially labor cost as we look forward through Q2 -- Q4 and into early 2021.

These could be impacted by the timing of costs that we traditionally have incurred to get our operations -- operators staffed up and trained for the summer construction season.

Historically, Q1 is the period where we prepare for summer, bringing on and training operators. For 2021, obviously, there's lots of uncertainty from COVID, and this is going to make the ramp-up process in the hiring and training process, especially challenging.

We're going to be very closely analyzing our individual markets based on local conditions and expected activity levels. And we're going to be making the calls to ramp up based on the best information available as we go into and through Q1. Very, very important for our margins going into Q2 and Q3 next year.

We also have been in the process of selectively bringing back furloughed employees based on higher levels of revenues and higher levels of customer activity levels. This is a modest amount of activity, but a very welcome one.

So what we're saying is that for 2021, we're going to be very keenly focused on how the spring and the summer ramp up looks and how we staff up as we go through Q1. It will be an important one for all of us to watch.

So far in 2020, we have scaled back our branch openings due to COVID, but it's important to note that even with all the uncertainty, we still opened 19 new locations year-to-date. We're very pleased with this progress and continue to position Badger to grow in a number of attractive markets. We're also in the process of recruiting a new VP of sales and marketing to strengthen our leadership team.

This key hire adds additional leadership and sales and will further help drive future growth. It's important to note that these activities continue through COVID and Badger has always managed and continues to manage for the long term. A year like 2020 is not an exception.

Adjusted EBITDA for the third quarter was \$47.1 million, as I mentioned, at the outset, 94% of the \$50.1 million last year.

Our adjusted EBITDA margin was 30% compared to 27.3% last year. If we exclude the Qs impact, Q3 adjusted EBITDA margin would have been 28.7% compared to 27.3% last year, up 140 basis points. Again, we are pleased with the margin performance, which continued from last quarter.

As we discussed in the past several quarters, we continue to anticipate a lower G&A expense rate as 2020 -- as during 2020, the required spend on various IT and ERP-related costs have been completed and ramped down. And this trend has continued as expected and as previously communicated.

Our G&A as a percentage of revenue for the third quarter was 5.7% compared to 5.5% in the prior year quarter, but that percentage is based on 15% lower revenue. Our actual G&A expense dollars were \$1.1 million lower than prior year and ran at \$9 million. So we're on track at the \$40 million average rate.

We previously disclosed that we expect 2021 to track at \$40 million, and we're real pleased with how that's all come in as we've gone through our run rate in 2020.

But as discussed in this call last quarter, and I think I make this comment in every quarter, we continue to review all aspects of the business in order to drive further enhancements on both the operating and the financial performance side.

On Badger's financial position, we continue to focus on ensuring the strength of our balance sheet. As part of our COVID plan that we implemented earlier this year to preserve capital and liquidity in addition to driving increased capital utilization and fleet utilization, we had curtailed production of hydrovacs.. The curtailment not only helps us preserve the strength of the balance sheet, but also provides us with the opportunity to leverage fleet utilization and capital efficiency improvements.

During Q3, we brought 11 new hydrovacs into service while retiring 12. We continue to anticipate lower capital spending until we have additional clarity on the markets and customer activity levels.

And we also continue to focus on driving fleet utilization, which is obviously a priority before we look to add units.

Since April, we've relocated approximately 120 units to areas that have had stronger demand, and this trend always continues at Badger.

Based on the current state of the economy and our current view, we expect that the number of hydrovacs and specialty units we would build next year would generally be consistent with the run rates that we experienced in Q3.

Badger continues to maintain a strong financial position. As at September 30, we had in excess of \$330 million in total liquidity with a combination of cash on hand of approximately \$20 million and over \$300 million in committed credit facilities. At the end of the quarter, our total debt less cash to EBITDA ratio was 1.2x, which is well within our 4x financial covenant.

Subsequent to quarter end, we repaid an additional \$10 million against the credit facilities, which now stand at \$75 million versus the \$85 million at the end of September.

We continue to make progress on management of our accounts receivable portfolio during the quarter. Since Q2, we reduced our expanding accounts receivable in each of the aging buckets over 61 days and subsequent to the quarter end, have reduced our outstanding receivables in the over 120-day bucket by an additional \$2.7 million.

We're also in fairly late-stage negotiations with export development Canada to put an insurance arrangement in place for our accounts receivable portfolio.

And in addition, obviously, collection of the AR continues to be a top priority. We've made great progress in our internal credit management processes over the last several quarters.

They are in the finance team have really raised the bar on our internal processes. And this progress has been supported by, obviously, the improved visibility into our operations from the ERP to improve credit granting, billing administration and collections processes. I'm very optimistic on the go forward, we're going to have a much better set of practices and business processes.

And then on the management leadership side, I'm very pleased to let our investors know that (Dave Whalen) recently joined Badger as our Vice President of Manufacturing.

Dave has a great leadership history in the transportation and agricultural equipment manufacturing industries, an excellent experience in manufacturing efficiency, production, cost reductions, supply chain and in business strategy.

All of which will be a tremendous value to Badger and the team as we execute our long-term growth plans. So Dave, welcome.

So some closing comments before we open it up for questions.

The news flow from this week says at all. These continue to be unprecedented times. We anticipate that heightened level of uncertainty will continue until we have a vaccine and the pandemic is brought under control.

The timing of which is still a little up in the air. But at some point, we do expect the economy can return to more of a state of normalcy.

As I mentioned at the outset, we've taken a range of actions to manage through this environment, which we believe are required and prudent, and the team has executed well on them, namely focusing on health and safety, staying close to our customers, continuing to focus on our costs and continuing to focus on maintaining a strong financial position.

In addition to the good execution that our teams had on these areas, we're very happy with the increased visibility into our business from the ERP system.

We will continue to focus on leveraging and enhancing our capabilities and the tools that come from this ERP to drive further operational improvements. We are in the early days on leveraging this tool.

As I said a minute ago, we've also continued to grow, opening 19 new locations in spite of the COVID challenges, and we're looking to strengthen our sales and marketing organization.

Longer-term and despite the uncertainty, and I've said this previously, nothing we've seen since the onset of COVID causes us to change our view of the significant U.S. and Canadian opportunity for nondestructive excavation services and change our view of Badger's long-term growth prospects.

In fact, we believe that heightened awareness across all of society driven by COVID about safety, will ultimately support further demand for nondestructive excavation.

So 2020 has been a great test of Badger's proven business model. Our operating scale and flexibility, our diversification across the end-use and geographic markets, all combined with our operating track record across all stages of the economic cycle. We've certainly seen all stages in 2020. And this all supports our long-term growth aspirations.

While this year has been challenging, we believe that the benefits of the Badger model were certainly proved out and will certainly be proved out as we go into 2021 and beyond.

We remain focused on generating long-term sustainable growth and driving shareholder returns, consistent with all of our previous communications in previous quarters, our long-term strategic, financial and operational milestones are to double the U.S. operations from this year over a period of three to five years. To target adjusted EBITDA growth, 15% on average over the next three to five years, to target adjusted annualized EBITDA margins at 28% to 29%, and to target revenue per truck over \$30,000 per month.

So with those comments, let's turn it back to Destiny for questions.

## QUESTIONS AND ANSWERS

Operator: (Operator Instructions).

You do have a question from the line of Yuri Lynk with Canaccord Genuity.

Yuri Lynk: A bunch of questions here. I'll try to just pick one or two. What are you trying to say for the first quarter?

It sounds like, obviously, it's highly uncertain, but are you kind of warning that if you get the right demand signals that the summer is going to be busy, you're going to have to train a lot of people in the first quarter when revenue still might be depressed? Is that kind of the just of it.

Paul J. Vanderberg: Yes. Well, historically, we've always staffed up in Q1, recruited, brought people on board and trained to get ready for the summer season.

And if you look at that, I don't see that changing. I mean, Badger has done that every year.

But this year, just -- we're in a period of really heightened uncertainty because of COVID. So we're going to be really looking at this on a micro basis, market by market, and it's going to be really important that we get the matching of the staffing with the market opportunity, right? So we saw what happened back in Q1 of 2020, where we're all staffed up with well over 200 people, and we had to shut it down.

So that's the one end of the book end, the negative end. And there's other years where we're staffed up and the summer kicks in, and it's all good. But this is just a different year. And we don't expect to have any particularly concerns, have our ability to do all that because we've done it historically. That's part of our seasonal business model. But that's something we're looking at in our internal budgets and just for our internal purposes. And so I thought it would be important just to mention it. We're watching it closely. We'll manage it one way or the other. We always do. But with the uncertainty going into 2021, it's just a very strange period.

Yuri Lynk: So you might hire less people -- just what are you going to do different this year?

Paul J. Vanderberg: Well, we're not sure what we're going to do yet for 2021. That's why I bring it up. So we're going to be watching things very closely.

We'll probably be doing different things in different markets depending on activity levels. But it's too early to make a broad generalization. It's just a very, very uncertain year.

So labor is just so critical to us that I wanted to put that out there as a highlight. And this is not going to be a long-term concern. It might be a concern one quarter to the next on how the expenses ramp in and how the summer season ramps up. But it's one of those things we just wanted to highlight in the long term, it's not a concern for Badger, but there could be some ups and downs in op expenses based on the timing and quarter-to-quarter, how the market ramps up next year for the summer season.

Yuri Lynk: Okay. Okay. Can you just review the plan for hydrovac builds.



Back in 2011, the company built 97 units. So those would reach the end of their economic life next year, but I thought you mentioned the Q3 run rate is what we should expect until visibility improves. So that would imply you're willing to age out the fleet a little bit next year. Is that a fair assessment?

Paul J. Vanderberg: Yes. Well, mathematically, that would happen. If you look -- if you go back 10 years, as you appropriately do it to start to look at the fleet demographics. We'll build less than what we built and added back in 2011. And it's a minor aging out. But our priority, first and foremost, is to drive the utilization and with RPTs, where they are in the mid- to high (20s), our primary responsibility is to get the utilization up and work the shareholders' capital, which we'll do first before we add units.

So there may be a period coming out of this economic recession where the fleet ages out a little bit.

But we would certainly not change our view that we don't want to add the fleet out or age the fleet out over time.

And we all know that, that's not a good thing for the maintenance and repair costs over the long term. So we see this as a temporary situation. And similar to what we went through in '15 and '16. But it's utilization first.

Operator: Your next question comes from the line of Maggie MacDougall with Stifel.

Margaret Anne MacDougall: So just going to maybe take a little bit of a different approach here. To me, it seems as though you're actually pretty well positioned to manage profitability over the next several quarters, even though I know it's not easy.

Just given the extra tools that you have now with your CBP and ERP, you have probably, I'm guessing better insight into the business.

And so perhaps the ability to sort of manage that margin on a year-over-year basis despite a near-term headwind, just thanks to that project. And so you can sort of confirm or whatever that statement, but the question I have is just given the change in your cost structure. As we look out past the next few quarters, where things are still pretty uncertain. What revenue level do you expect to see your margin growth accelerate as you work towards that 28% consolidated target?

Paul J. Vanderberg: Yes. Well, I mean, I -- maybe I will confirm our real, real -- we're really happy with the way this ERP system has provided better visibility. It's early days. But Darren, with his business insights group is very, very close to rolling out a real comprehensive set of daily dashboards, which will be just excellent tools for folks throughout the whole organization. So it gets -- we get new tools every month. It's been a pretty exciting. It's been like Christmas every month from the Badger operations perspective this year. So we're really pleased about that.

But I think what we've seen in the last two quarters is that we've built, and we've spent the last couple of years, a lot of hard work to build operating leverage into Badger's business.

And that's why we went through the whole CBP process starting back in 2017 and the ERP implementation in '18 and '19. So we've made those investments.

And now it's time to leverage those investments. And we saw a little glimmer of what operating leverage could look like, coming out of the COVID downturn in Q2. We've seen another good snapshot on it in Q3. And I personally am really pleased with how I think this business model is positioned for more volume.

And it's going to be one of those things we're going to test drive quarter-by-quarter. But as you said, Maggie, we've really acted on our cost. We've got them pretty tightened down. And additional volume has a lot of operating leverage in this model. So as we get a little bit of economic tailwind here, is going to be a fun car to drive.

Margaret Anne MacDougall: Okay. And then I'm wondering if you could just give us some comments broadly across your regions and end markets in terms of industry served to discuss where you may see positive strength or weakness.

And then looking out past Q4, your impression of demand because there's got to be a backlog that's being created by this downturn. As we all know infrastructure, construction, utility maintenance. Those things can be delayed, but they ultimately do need to get done.

Paul J. Vanderberg: Yes. No, that's really good. I mean as you -- all of you on the call know, Badger has a geographically diverse business.

And you always have different regions that are up and down for various reasons. Sometimes it's large projects. There's sometimes a seasonality. So that's the beauty of our business model is that, that geographic diversification, which really helps us.

And over the last quarter or so and as we look through the rest of the year, obviously, oil and gas continues to be one of our softer areas.

But we have seen in some of the natural gas areas, some improved activity, which I wouldn't have thought maybe a quarter or so ago. So that's been helpful.

And we've also continued to see -- it's almost been spotty. It's hard to generalize with regions, and I've said this in previous calls, it's almost customer-specific on customer circumstances with utilities or municipalities. And we've seen some big utilities. They have continued all their maintenance programs. Routine maintenance. We've seen others that have limited maintenance to outages. And so to your point, Maggie, is in those areas where there's been deferral of maintenance that can't continue forever.

What we don't know today is when those things may kick in. And that's why I said at the outset, we're staying very close to our customers with their individual circumstances because that's what we've seen.

I mean this economic downturn in COVID has caused each and every organization to consider their own set of facts and circumstances. And like we've responded with our own actions internally, our customers have responded.

But we are hearing that there's a lot of -- a lot of bidding activity and budget activity for infrastructure out there. That does not seem to have slowed down that much. I think that the key is going to be when the final decisions are taken to start a project. And that's why we're staying so close to our customers.

So that -- to me, that's been really encouraging, the fact that budget work in bidding and that has continued. It's been a decision-making that has been slowed down a little bit.

Margaret Anne MacDougall: Okay. One final question for me. Your financial position is very strong. You're in a great spot.

I'm wondering if you can update us on your priorities for putting cash to work and/or returning it to shareholders just in light of any plans to address your factoring strategy and footprint, the need you have to grow your fleet materially in the next few years, not in the near term, but in the future in order to pursue your goal to grow your U.S. revenue? And then just given the current uncertainty that COVID has presented.

Paul J. Vanderberg: Okay. Well, what I'll do is, I'll make a comment on manufacturing, and then I'll let Darren do some work here this morning on the rest of your question. But as I mentioned, Dave Waylen joined us in October, we're all very pleased.

It seems like he's been here a lot longer than just a few weeks, but we're very pleased with that. And part of the reason Dave joined us is so we have the strategic leadership to sort through our long-term capacity and manufacturing strategy to ensure we have the units to not only replace retirements, but also to support growth. So that's a big part of Dave's charter. And we first talked about this last November at Investor Day and and I'm real pleased about what we have going on there.

From the financial capacity perspective, Badger has a lot of flexibility to do what's right and for our manufacturing footprint and for our capacity long term. So Dave and the team are getting organized, and we'll continue to provide updates on our strategy as we go along there. But for this year, we did comment about driving utilization first. We're very well positioned at Red Deer. We're very flexible. And one of the things we've talked about and positioned ourselves for, if we get some improvement in demand from our supply in perspective, we're very well positioned if we have to, to ramp production up.

So we're not concerned about being short of trucks if the markets recover, that would be a happiness problem. So maybe, Darren, I'll turn over the broader capital allocation question to you.

Darren Julian Yaworsky: Sure. Thanks, Paul. Maggie, you'll recall, we've talked a little bit about our capital allocation philosophy and waterfall just for completeness, I'll just run through it one more time. Our first priority is to invest in the business to support our organic growth.

The second priority is to look at accretive acquisition opportunities. And then the third pillar or third level in that waterfall is to return capital to shareholders in the most accretive way possible. So working back through that waterfall and just pulling out the same threat as Paul on the manufacturing side of things, we really look at manufacturing as being a comparative and competitive advantages that we enjoy versus our peers. And with David joining the team, you may have recalled that we didn't put the ERP system into manufacturing.

So we'll probably look at spending some time and some resources to put in an ERP system for manufacturing, especially if we've got a little bit of a slow time in the production side. Why is that important. If we can continue to reduce our cost to build, I think it just provides a much better value proposition to our entire value chain of freight to service operations to the customer.

The other element of it, we don't really see any kind of meaningful acquisitions on the horizon. So we'll probably see ourselves delever a little bit over 2021. That's probably fine because it will position us well to ramp back up very quickly if need be to build trucks. Again, I think the caveat to that is Paul's comment about asset utilization, getting the truck utilization and the fluidity and the fleet that that John and his team does is super important.

And with regards to the third bucket, we typically look at our shareholder return philosophy in Q4 with the Board, and we had a great discussion with them yesterday, and we'll be looking at that again in Q4.

Operator: Your next question comes from the line of Matthew Weekes with Industrial Alliance Securities.

Matthew Weekes: I'm sorry, I know this has already been brought up. I just wanted to kind of clarify last time the expected sort of run rate.

Hydrovac builds going into 2021, you had said that it would be sort of like an annualized Q3 number, is that correct?

Paul J. Vanderberg: Yes. We did 11 units in Q3, Matthew. I think plus or minus, that rate is an annual run rate x4 with -- is about what we expect right now.

Matthew Weekes: Okay. Just for clarifying that. Going back to the supply chain. I know you had mentioned that you're pretty well positioned to quickly accelerate on builds if conditions improve. I was wondering if you could kind of quantify how many chassis you're able to keep in the yard at a time as you wait for that improvement in conditions?

Paul J. Vanderberg: Yes. Well, as you might expect, we -- with the rapid slowdown and with the long lead times for chassis, we were not able to shut that purchasing down as fast as the market decline back in late Q1, early Q2. So we're in pretty good shape. We have over three dozen chassis in the system right now. And that's why I say we can ramp back up fairly quickly if need be.

So there's not a short-term concern there at all. But as far as long-term ability to store chassis, there's really no limitations. The limitations on sourcing chassis are really what our plan is for building. And is -- but there's no real limitations from what's available from the manufacturers. There's just lead time considerations that have to be managed with our supply chain side.

Matthew Weekes: Okay. That's helpful. Sort of moving over to margins a little bit. And I just trying to get a handle on the pose. I know you guys have been driving a lot of cost reductions and internal improvements through the business. It sounded like from the comments earlier that kind of not seeing that normal ramp-up in hiring and training that you see in Q1 that you'll probably see some pretty strong margins there as you have lower training recruitment on the cost side.

I was wondering if you could kind of provide sort of a run rate gross margin that you maybe expect to achieve next year, assuming conditions are kind of pretty similar. There's not a ton of fleet growth, and there's no wage benefit.

Paul J. Vanderberg: Yes. Well, we don't provide future guidance on margin, Matthew. But what we're looking at, and like I said a minute ago, we had a really good glimmer at operating leverage as we went through Q2. We started out the quarter with layoffs and restructuring costs.

And as we exited the quarter, we started to get a real look at what the operating leverage looks like with the new Badger. And if you go back and think about it, we didn't really finish our ERP go-lives until January of this year. So we were just in the toddler stage of running that system as COVID hit. So we really didn't have experience with it. But Q3 has given us a much better view of what some of the cost structure run rates are. And again, that's Q3, which is traditionally the strongest quarter seasonally.

So there's going to be a seasonal cycle. Q1 is wintertime. It's a period where we're ramping up hiring -- historically, a period where we're ramping up and hiring operators and training them for the summer.

So you have some front-end loaded costs in Q1 to get labor ready for the summer. And then Q2, the summer season starts. And then Q3, it's full on summer season historically.

Q4 historically is the winners coming, people are pushing to get jobs done, and people are pushing to get budget spent for construction projects. So the revenue traditionally and historically has tailed off as you get into Q4. So I would expect the seasonalization factor will be there next year.

It has been every year just because of summer construction. What other factors from companies slowing decision down from COVID or other infrastructure owners having to accelerate things like maintenance that Maggie asked about a little while ago are going to be factors that our pluses and minuses around the traditional seasonal cycle next year.

But Q3 is traditionally our strongest season where we'd have the most operating leverage and where we'd have the strongest margins. And I think that's going to continue into the future.

Operator: Your next question comes from the line of Daryl Young with TD Securities.

Daryl Young: I guess I'm just having -- my question is around the margin side. I'm having a little bit of trouble reconciling the need for ramp-up in hydrovac operators next year given where utilizations are at currently. And so trying to understand, I guess, why they need for additional training. Have you lost individuals through the COVID environment to competitors or to different end markets? Or maybe just a little bit of color there on what's happening.

Paul J. Vanderberg: Yes. No, that's a good question. Seasonally, we've always hired in Q1. We don't carry operators through the winter if there's not work there.

So to the extent we can recall them, we recall them, but oftentimes, we don't. So we have to hire and train new. So that's a seasonal practice and a process that Badger's had historically.

So when I talk about that being a key focus for 2021, and especially based on the view of the summer and what's coming. It's only -- only highlight it because this year, the uncertainty is probably higher than it's ever been given COVID. And so it's going to be one of those things we're going to be watching. So we're going to have -- we've traditionally had the hiring and ramp-up in training expenses in Q1 that pays off during the summer.

But it's not that we are not hiring people. It's just the timing, the seasonal timing of what we're doing there. So -- but that's no different than we've done in every other year with our seasonal business.

Daryl Young: Got you. Okay.

And then on the truck retirements, is it accurate, so roughly 100 trucks would be planned for retirement coming into next year based on the 10-year build cycle?

Paul J. Vanderberg: Yes. I mean, if you look back to 2011, as Yuri mentioned, it could be close to 100. We haven't put a pin in that at this stage.

And we'll probably provide some more insight on that along with our Q4 results.

Daryl Young: Okay. And then on the emergency response work, so it looks like it was close to 5% of revenue this quarter.

Are you anticipating that, that will carry into Q4 as well, just given the storm activity was -- remained quite pronounced so far?

Paul J. Vanderberg: Yes. Well, the one storm we've responded to so far was Zeda, and it was a fairly wide geography, but not as much wind intensity. So we don't expect that much from that storm. Although it's interesting, we did have quite a bit of demand in an urgent way to get power to all the polling stations ahead of the elections in the U.S. So that was -- is probably a shorter, much more intense emergency response than we've ever seen. It was pretty urgent.

Daryl Young: Got you. And then would the margins on that work be similar to your normal margins? Or would they be higher?

Paul J. Vanderberg: Well, any time you put a surge of volume through our business model, the operating leverage drives higher margins. And we've seen that with emergency response historically.

If you go back and look at Q4 of 2018, that's probably one of the more extreme examples. But I always like to refer people to that because we had both a hurricane in Florida and also the camp fires in Northern California. And if you want to see what Badger operating leverage looks like, that's a pretty good example on the upside.

Operator: Your next question comes from the line of Jonathan Lamers with BMO Capital Markets.

Jonathan Lamers: Paul, on the guidance for full year 2020 in the press release, 80% to 90% of prior year level.

That implies a very wide range of possible results for the remaining months of Q4. Is this just the case of wanting to provide round percentage numbers? Or is there anything happening with customer demand near-term that would cause you to leave the low and the high end of the ranges in there?

Paul J. Vanderberg: Yes. I think it's just the bookends of the numbers, Jonathan.

I could make a comment to extend the run rates we've had versus last year, and it'd probably be pretty reasonable.

Jonathan Lamers: And this business is known for having very short forward visibility. What are you discussing with your customers today? And what indicators are you watching that might give you insight into staffing levels as far ahead as Q1 and Q2?

Paul J. Vanderberg: Yes. Well, as I mentioned earlier, what we've seen with COVID is not broad brush trends even we've not seen broad brush trends within industry segments, it's been very a company and infrastructure owner specific.

And I use the utility example where some utilities have powered through their maintenance and others have slowed things down.

Obviously, that will have to come back at some point. But that's based on individual circumstances of those infrastructure owners. So we're staying very close to them. We continue to do a fair amount of bidding.

John Kelly stays very close to the MSA run rate, where we're putting MSAs in place with customers. We have thousands of those. So our operations team watches those very closely.

And -- but this year, the visibility is not great compared to other years, and we're all watching what might happen with more stimulus and stimulus always takes longer to have an impact than people might expect. But there's nothing but positive that I see from the earlier stimulus round and from any subsequent stimulus rounds. Whether it's tax benefits or assistance to states and municipalities, whatever happens to manifest itself. So we see nothing but positive from where our current run rates are over the next year or two there.

Jonathan Lamers: Right. And this was the second quarter of net truck adds in Canada with net subtraction to U.S. count. Could you remind us what the team has done there.

I know you spoke about relocation, but are you able to expand a bit on what markets the trucks are moving into, where they're moving from and whether there are any remaining opportunities to relocate trucks to improve productivity or if things have kind of stabilized now?

Paul J. Vanderberg: Yes. Well, no, we're not done with moving trucks around. I mean with the RPTs running at where they are, we've got a lot of good opportunity there to drive utilization.

As I mentioned in the prepared remarks, we've moved over 120 units to areas with higher demand since April when COVID hit. So we'll continue to do that. But we got a ways to go, and that's why we made the comments we did about the build run rate in today's disclosure. So we've got a ways to go there. You won't see us adding significantly to the fleet until we get utilization up. But within Canada, specific to your question, we -- in



Ontario, about half our business is franchisees. Our franchisees have had very good growth this year. And we've been real, real pleased with that.

Jonathan Lamers: And one quick question for Paul, if I can -- or sorry, Darren, if I can.

This was maybe the first quarter of watching the truck drive up out of the Valley as Paul said. Looking at the U.S. business, the gross margin percentage was flat in Q3 versus Q2.

I had the sense that Q2 was a very strong margin quarter for a number of reasons that lined up. So my question is, would you consider Q3 to be a relatively normal gross margin for this level of revenue?

Darren Julian Yaworsky: I like how you position your question, very eloquently. We don't give guidance on gross margin. I think probably the best thing to do is to sort of repeat or point back to Paul's comment on our growth margin discussions.

Operator: Your next question comes from the line of Jeff Fetterly with Peters & Company.

Jeffrey Eric Fetterly: A couple of follow-on questions. On the CapEx side, the non hydrovac spend in Q3, there was a real estate piece. And then what you describe as other or specialty. Can you give us some context of what that was related to?

Paul J. Vanderberg: Yes. Specialty trucks include hydrovacs that have rail gear on them to go on the railroads and also sewer flushers and sewer combo units for cleaning out culverts and sewers.

We have a few TV inspection camera trucks in the fleet. So those are the items that would go into that bucket.

Jeffrey Eric Fetterly: And so the big ramp-up in spend in Q3, what was that driven by or related to? And is there a carryforward element there?

Paul J. Vanderberg: No, it's just -- in that particular specialty unit bucket, Jeff, is that your question?

Jeffrey Eric Fetterly: The non hydrovac spend about \$8.5 million in the quarter.

Paul J. Vanderberg: Yes. Basically just timing of specialty units. That will bounce around. It's just timing of units. We've seen good opportunities in a number of regional markets for that type of service. So it was just the way the timing came together of adding those units.

Jeffrey Eric Fetterly: Okay. And (inaudible).

Paul J. Vanderberg: That one bounces around.

Jeffrey Eric Fetterly: Okay. On the margin side, can you give us some context around the strength of Canadian margins? So even if you back out (Qs), you were in the high (30s) on an operating margin basis in Canada, what were the sort of the contributors there relative to what you've seen in prior years or prior quarters?

Paul J. Vanderberg: Yes. No, that's great. Well, one thing is our Canadian team in Western Canada has done just an exceptional job of margin and cost management through the energy downturn.

I could not be more delighted with the team's performance there. So that's one of the factors.

And then the other factor is we have a higher mix of franchise and operating partner business in Canada, which generally, from an EBITDA -- adjusted EBITDA perspective tracks to higher margins just based on the way the revenue is split under those agreements.

Jeffrey Eric Fetterly: Okay. And last thing, Darren, on the DSO side, the commentary about looking for improvement in DSO going into next year. What's your -- what are your stretch targets or where do you hope to get in terms of DSOs?

Darren Julian Yaworsky: Yes. That's -- the challenge in giving guidance on DSOs the denominator of the revenue amount. So trying to normalize the revenue. And obviously, we're working through sort of an aged bucket of legacy receivables that we're cleaning up. Probably the best way for me to answer that question is in the context of the EDC insurance that we're working through. So the insurance policy that we're looking to put in place is going to be dated October 1. So that \$100 million worth of receivables that we'll have in place.

We believe that we'll have very high payment certainty, not only from collecting from the customers but backstop from the EDC insurance. If you back that out of the DSOs and do the math, you're probably somewhere in the neighborhood of a 40 to 50 day DSO. That would probably be our stretch target, but that likely isn't going to happen until late 2021, early 2022. So it's going to take a little bit of a glide path for us to get to that point on an adjusted DSO perspective.

But that would be, I think, sub-60 day DSO is achievable, but it's going to take us a little bit of time to get there.

Jeffrey Eric Fetterly: And the EDC insurance, is that a specific bucket of receivables that will fall under that going forward? Or is it a broader context of some of the non Canadian stuff?

Darren Julian Yaworsky: No, we're looking to write a policy that would cover all of our receivables on both sides of the border, up to about \$660 million annually. So it would cover our entire portfolio.

It wouldn't be backdated to cover anything that was past due prior to October 1.

Operator: Your next question is from the line of (Alex Romanic) with Cambridge Asset Management.

Unidentified Participant: Congratulations on the corner, by the way. I'm just kind of looking at your overall forecast. And I'm just.

So you mentioned you want to double like U.S. revenue from 2019 to next three to five years.

Kind of look you have \$500 million in revenue. I'm just wondering how you expect to do that? Is it mainly driven from truck utilization? Or is it mainly driven from builds? And I'm just asking because when I'm kind of looking at like your next year forecast, you're kind of plan to like slow it down a little bit. So just kind of wondering a little bit color there, how you're really playing on doubling overall U.S. revenues?

Paul J. Vanderberg: Yes. You bet, Alex. We've historically doubled our U.S. revenues twice. When we first put this target in place, it was November of '17, and we had a target of doubling the U.S. revenues from a base of ('16).

We achieved that in about 33 months. And then we put the target down again for -- in November of 2019 to double it again from the base of 2019.

Obviously, COVID has put a bit of a pause button on 2020. And I think we haven't formally declared what our new target is, but and what our starting point is, but I think it would be reasonable to put a target in to say, starting with the 2020 revenue, our target is to double the U.S. business in the next three to five years. Obviously, 2020 is a bit of a write-off in that one this as of the recession. But that's what you should expect us to be seeing, and that's been our approach, and that's our internal target that we're looking to do.

Unidentified Participant: Right. Okay. And then as the next one, when in terms of you say like your maximum capacity? I know in 2014, I think it was (220.) Would you say going forward with -- with this facility would be the most trucks you could like pump out in a year? Or that you would like to get to in the coming years?

Paul J. Vanderberg: Yes. No, that's a great question. It's why we brought a new VP of Manufacturing onboard to look at our whole manufacturing strategy and capacity.

But back in '14, we did that 200 and odd units. And we've since put an addition on the Red Deer plant, but we've never really had a chance to test it, to see how much more we

can get out of it. So Dave and the staff at Red Deer will be looking at what tweaks can be made to -- and how far we can drive capacity at Red Deer.

So we know we can get more. Is it 250 is at 300, we're going to have to sort that out with Dave now on board, number one.

And then number two, what we'll be looking at and talking to investors about when we have our thoughts to talk is what is our long-term manufacturing strategy.

We know that and are convinced that there's really good demand long-term for more nondisruptive excavation in the U.S. and Canada. And when we look at the market penetration of hydrovac in the U.S., it's in its very infant stage, very early stage.

So we see the need for lots of additional units. And back to your original question on doubling sales, our approach is to build units and put them to work in an organic growth model. So that organic growth model obviously needs to be supported by truck builds.

So we're looking at that very closely. But I don't ever want to be in a position to be talking to folks on this call and saying we've got lots of market opportunity, but no trucks. So I can assure you we're going to be looking very closely at that. COVID may have bought us some time to do a little bit more planning with the market slowdown.

But looking forward, we're going to be very closely focusing on what our capacity needs to be. And we'll provide updates as we get our heads together and talk to our Board. But we certainly have included capital in our five-year financial plan, our long-range financial plan for additional manufacturing resources.

Unidentified Participant: Right. Okay. And then just one last quick one for me, if that's okay. You mentioned 44 builds in 2021. Was that net or is that gross? (inaudible)

Paul J. Vanderberg: Yes. No, yes, the extension of the Q3 build rate of 11. If you extend it out, it's roughly 44. That would be gross. So we would -- yes, we would be looking to shrink the fleet again.

We'll provide more update on our view of 2021 retirements, along with our Q4 reporting. So everyone can have a better view at that. But I think it's pretty safe to assume continued COVID and recession level activities that we will shrink the fleet slightly in 2021.

Operator: And at this time, sir, we have no further questions in queue. I would like to turn it back over to you for any closing remarks.

Paul J. Vanderberg: Okay. Thanks, Destiny, and thanks to everyone who joined the call. We very much appreciate everyone's interest in Badger. And on behalf of all of us, I'd also like to thank our customers, employees and suppliers, obviously, our shareholders, and it's all of your support that continues to drive Badger's success. So be safe, everybody.

Operator: Ladies and gentlemen, this does conclude today's conference call. You may now disconnect at this time.