

Quanta Services Inc. (PWR)

\$39.15 (As of 01/31/20)

Price Target (6-12 Months): **\$41.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/02/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:A

Value: A

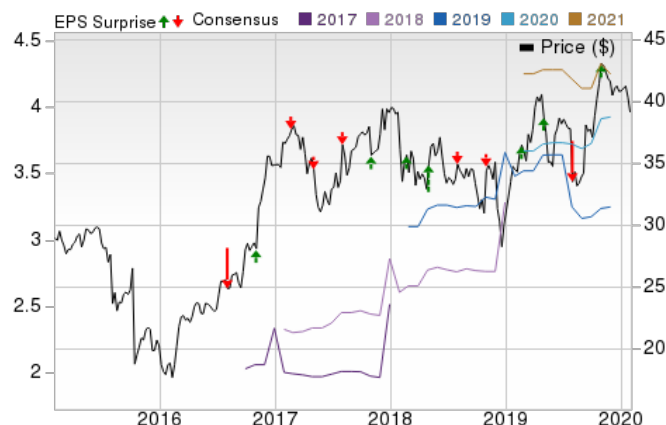
Growth: B

Momentum: B

Summary

Quanta Services' shares have outperformed its industry in the past year. It has been benefitting from strong base business activities in the Electric Power segment. Robust performance of its pipeline and industrial segment, generating record quarterly operating income, also bodes well. Buoyed by strong third quarter performance and increased visibility for infrastructure investment, Quanta Services lifted its 2019 revenues and adjusted earnings expectations. Its communications infrastructure services business is anticipated to benefit from the present industry trends. However, inadequate resource utilization, regulatory challenges and risks like project delays, stiff competition, and oil & gas volatility remains a concern. Estimates for 2020 have remained unchanged over the past 30 days, limiting upside potential for the stock.

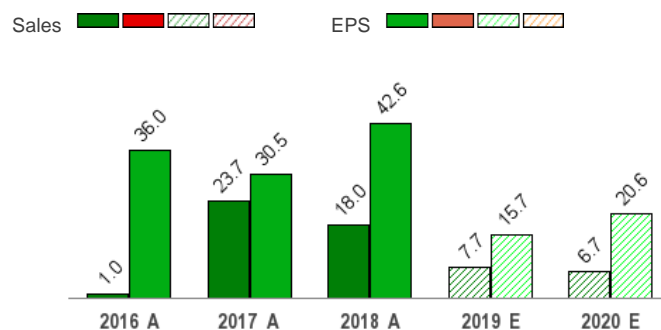
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$44.09 - \$32.11
20 Day Average Volume (sh)	1,034,107
Market Cap	\$5.6 B
YTD Price Change	-3.8%
Beta	1.22
Dividend / Div Yld	\$0.20 / 0.5%
Industry	<u>Engineering - R and D Services</u>
Zacks Industry Rank	Bottom 6% (239 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.6%
Last Sales Surprise	6.2%
EPS F1 Est- 4 week change	-0.2%
Expected Report Date	02/20/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	2,901 E	3,046 E	3,568 E	3,237 E	12,838 E
2019	2,807 A	2,839 A	3,353 A	3,030 E	12,029 E
2018	2,418 A	2,656 A	2,985 A	3,112 A	11,171 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.74 E	\$0.97 E	\$1.18 E	\$1.04 E	\$3.92 E
2019	\$0.96 A	\$0.31 A	\$1.14 A	\$0.84 E	\$3.25 E
2018	\$0.40 A	\$0.59 A	\$0.88 A	\$0.96 A	\$2.81 A

*Quarterly figures may not add up to annual.

P/E TTM	11.6
P/E F1	10.0
PEG F1	0.7
P/S TTM	0.5

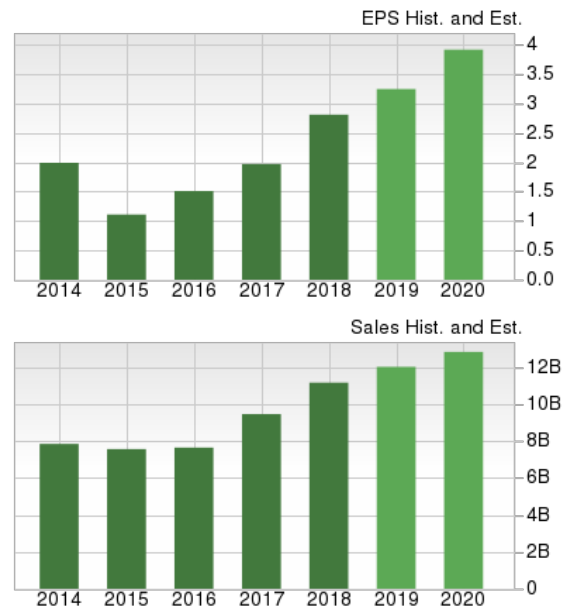
The data in the charts and tables, except sales and EPS estimates, is as of 01/31/2020. The reports text and the analyst-provided sales and EPS estimates are as of 02/03/2020.

Overview

Quanta Services is a leading national provider of specialty contracting services, and one of the largest contractors serving the transmission and distribution sector of the North American electric utility industry. Quanta Services has operations in United States, Canada, Australia and other selected international markets. The company has two reportable segments that are as follows:

The Electric Power Infrastructure Services segment (which contributed 56% to third-quarter 2019 revenues) provides comprehensive network solutions to customers in the electric power industry. Services performed include the design, installation, upgrade, repair and maintenance of electric power transmission and distribution networks, and sub-station facilities and the installation of "smart grid" technology on electric power networks.

The Pipeline and Industrial Infrastructure Services segment (44%) provides comprehensive network solutions to customers involved in the transportation of natural gas, oil and other pipeline products. Services include the design, installation, repair and maintenance of oil and gas transmission and distribution systems and related trenching and directional boring services. Also, this segment provides pipeline protection services and performs pipeline integrity and rehabilitation services.



Reasons To Buy:

▲ **Strong Performance & Robust Growth Strategy:** Quanta Services has been delivering robust performance over the last few quarters. Notably, the company's earnings grew 30.3% year over year in the first nine months of 2019, backed by strong segmental performance. Quanta Services believes that the delivery of energized services differentiates it from its competitors and helps win new businesses. Currently, the company is pursuing a three-pronged growth strategy focusing on timely delivery of projects to exceed customer expectation; leverage on core business to expand in complementary adjacent service lines and continuation of exploring new service lines.

Solid end-market prospects of both of its segments, namely Electric Power and Pipeline and Industrial Infrastructure, are likely to boost profit.

Overall, the company's engineering and project management capabilities allow it to capitalize on market trends that are currently skewed toward an engineering, procurement and construction or EPC model. The company ended the third quarter with a record backlog of approximately \$13.28 billion and 12-month backlog of \$7.56 billion. This compares favorably with \$12.34 billion of total backlog and \$6.98 billion of 12-month backlog at 2018-end. Also, the reported backlog was up from total backlog of \$12.21 billion and 12-month backlog \$7.48 billion reported at the end of third-quarter 2018. This demonstrates the strength of its core operations.

Going forward, the company expects a strong rebound in its end markets as it enters a renewed multiyear up-cycle for businesses. Quanta Services' optimism stems from healthy backlog levels which are expected to grow further. Quanta Services remains confident about end-market prospects of both of its segments, namely Electric Power and Pipeline and Industrial Infrastructure Services.

▲ **Solid Performance of Electric Power Operations:** Electric Power operations continued to execute well from a top line perspective. Solid performance in the first nine months of 2019 was backed by base business activities, courtesy of robust spending by electric utilities on grid modernization and infrastructure hardening, particularly in the western United States, as well as by gas utilities on distribution system modernization and safety programs. Acquisitions also added to the positives. As of Sep 30, 2019, the segment's 12-month backlog was \$4.98 billion and total backlog was \$8.64 billion, up 17.8% and 9.1% year over year, respectively. Prospects of the Electric Power segment remain robust, given customers' investment in grid modernization programs to accommodate a changing fuel generation mix toward natural gas and renewables, intended to address the aging infrastructure, strengthen systems for resiliency against extreme weather conditions, and support long-term economic growth.

The company has been witnessing solid Telecom revenues, which are included within the Electric Power segment, mainly from U.S. operations. U.S. telecom revenues have recorded sequential growth in each quarter since first-quarter 2017, when the company officially reentered into the U.S. telecommunications market. With the larger diameter pipeline market expanding, and a multi-year cycle ahead of it, the company remains optimistic about its communications infrastructure services operations. Quanta Services continues to make inroads with customers as they deploy capital for fiber-to-the-home and business, long-haul fiber, 4G wireless backhaul and the early stages of 5G. Meanwhile, the North America electric transmission and distribution markets are expected to act as one of the key growth drivers for the company, as the region continues to deploy more capital for transmission and distribution upgrades to improve system reliability, and deliver renewable electricity from new generation sources to the demand centers.

In a nutshell, growth of the electric power segment is expected to be fueled by the need to maintain and replace aging infrastructure, generation mix shifting to more renewable and natural gas, grid modernization and regulation aimed at improving grid reliability.

▲ **Robust Prospect for Pipeline and Industrial Infrastructure Services Operations:** Quanta Services' Pipeline and Industrial Infrastructure segment outlook looks equally promising, primarily due to the improving mainline and natural gas distribution, and integrity markets. The release of customer budgets, improved weather, and commencement of scheduled projects should boost the segment's results in the coming quarters. Going forward, the company continues to expect healthy levels of base load work including supporting midstream infrastructure, downstream support services and natural gas distribution. The company expects strong performance from pipeline projects going forward, driven by a considerable increase in large pipeline revenue contributions amid an active bidding and negotiating environment.

In the first nine months of 2019, the company's Pipeline and Industrial Infrastructure segment recorded double-digit revenue growth (up 12.8% year over year) and improvement in operating margin (up 200 basis points [bps]). The upside was mainly supported by base business activity in natural gas distribution, pipeline integrity and industrial services operations, as well as significantly larger pipeline project activity. Moreover, a gradual shift from coal to gas for power generation from commercial and residential customers is expected to boost natural gas pipeline projects in the long run. In addition, the company's infrastructure services business continues to thrive, supported by robust demand from communications industry. Quanta Services plans to grow its infrastructure solutions capabilities with strategic partnerships with customers and capital partners. As of Sep 30, 2019, the segment's 12-month backlog was \$2.58 billion and total backlog amounted to \$4.64 billion, up from \$2.41 billion and \$3.79 billion reported at 2018-end, respectively.

▲ **Acquisitions/Partnerships to Boost Market Share & Backlog:** Quanta Services sees acquisitions as a fundamental component of its strategy to boost market share and develop incremental backlog. Quanta Services completed six acquisitions during the nine months of 2019 and four during 2018. The 2019 and 2018 buyouts strategically expanded its domestic electric power and communications service offerings. Notably, the 2018 buyout of Northwest Lineman College, a dominant educational and training organization, enabled the company to offer training services across the entire lifespan of a line worker's career. Again, the acquisition of specialized services company, Stronghold, provided high pressure and critical path solutions to the downstream and midstream energy markets. Quanta Services expects to capture a greater portion of the industry operating and capital spends on the back of this strategic buyout. With positive industry dynamics and visible cross-selling opportunities, the company believes Stronghold's operations can achieve double-digit growth.

Reasons To Sell:

- ▼ **Absence of Larger Pipeline Projects:** Volatility in Pipeline and Industrial operations, and consumer spending have been affecting the company's projects, as well as orders. The segment's third-quarter 2019 revenues were somewhat offset by a decline in revenues from larger pipeline projects. Also, in the first nine months of 2019, its Electric Power Infrastructure Services operating margin declined 160 bps due to the absence of large projects compared with the year-ago period.

Although Quanta Services' shares have outperformed its industry in the past year, estimates for 2020 have been trending downward over the past 30 days, depicting analysts' concern over the company's earnings growth potential.

Quanta Services remains vulnerable to inadequate resource utilization, regulatory challenges and risks like project delays, stiff competition, and oil & gas volatility.

- ▼ **Regulatory Hurdles/Intense Competition:** Quanta Services operates in a highly uncertain environment. Both the company and its customers face stringent regulatory and permit hurdles for projects, especially regarding product quality, safety measures and environmental protection. For instance, on Jul 28, American Electric Power announced that due to regulatory challenges, it was terminating its effort to build Wind Catcher Generation Tie Line, for which Quanta had been awarded the EPC contract. Moreover, the company operates in a highly competitive industry, which already contains numerous small owner-operated private companies, few public companies and several large regional companies. Low barriers-to-entry in the industry and adequate financial resources as well as access to technical expertise may further intensify the competition.

Additionally, as a large chunk of Quanta Services' business involves outdoor activities, it is vulnerable to unfavorable weather conditions. Traditionally, it experiences lower gas distribution business activity in the first quarter due to seasonal weather, which impacts revenues and pressurizes margins. Although the company expects margins to improve in third-quarter 2019, decline in revenues and normal seasonality will likely cause a sequential decline in margins in the fourth quarter.

- ▼ **Project Delays:** At present, one of the biggest challenges for Quanta Services is obtaining the sighting and permission of energy infrastructure projects, including major electric transmission programs, and this is seriously weighing on its profitability. Also, Quanta Services deals with many large projects that are inherently prone to weaknesses such as irregular start-ups, delays and sudden stoppage during work. Intensive regional competition and delay in the bidding activity of transmission projects are headwinds that might hurt the performance of this segment going forward.

For instance, the Atlantic Coast Pipeline Project or ACP has been halted for the past several months due to permitting issues.

Last Earnings Report

Quanta Services' Q3 Earnings Beat Estimates, View Up

Quanta Services Inc. reported solid results in third-quarter 2019. Both the top and bottom lines surpassed the Zacks Consensus Estimate, and increased year over year. Importantly, the company lifted its 2019 revenues, earnings and adjusted EBITDA guidance.

Quanta Services reported adjusted earnings of \$1.14 per share, beating the consensus estimate of \$1.04 by 9.6%. Also, the reported figure increased an impressive 29.5% from 88 cents per share recorded in the year-ago period.

The company reported total revenues of \$3.35 billion, surpassing the consensus mark of \$3.16 billion by 6%. Also, the said metric increased 12% year over year, aided by robust revenue growth across the business.

The year-over-year improvement was mainly driven by its focus on base business, long-term programmatic spend of utilities, and development of infrastructure that supports technology deployments such as 5G and electric vehicles. The company believes the above-mentioned factors, acquisitions — which were completed in the third quarter — and construction on the Watay and East West Tie Line transmission projects to support growth in 2020 and beyond.

Segment Details

The company reports results under two reportable segments: Electric Power Infrastructure Services (accounting for 56%), and Pipeline and Industrial Infrastructure Services (44%).

Revenues from Electric Power Infrastructure Services totaled \$1,876.1 million, increasing 16% year over year. However, operating margins contracted 170 bps to 9.4%.

Within the Pipeline and Industrial Infrastructure Services segment, revenues grew 8% from the prior-year quarter to \$1,476.8 million. Notably, operating margins of 9% also improved 200 bps year over year.

Operating Highlights

Operating income during the reported quarter came in at \$209.4 million, up 8.7% from the prior-year figure of \$192.6 million. However, operating margin declined 30 bps from a year ago. Adjusted EBITDA of \$312.2 million increased 14% from \$273.8 million a year ago.

As of Sep 30, 2019, the company reported total backlog of \$13.3 billion and 12-month backlog of \$7.6 billion. This compares favorably with \$12.3 billion of total backlog and \$7 billion of 12-month backlog at 2018-end. Also, the reported backlog was up from total backlog of \$12.2 billion and 12-month backlog \$7.5 billion in second-quarter 2018.

Liquidity

As of Sep 30, 2019, Quanta Services had cash and cash equivalents of \$80 million compared with \$78.7 million at 2018-end. The company's long-term debt (net of current maturities) amounted to \$1,810.5 million, up from \$1,040.5 million as of Dec 31, 2018.

Net cash used in operating activities was \$100.2 million versus \$221.6 million cash provided by operating activities in the comparable prior-year period. Free cash flow was a negative \$283.1 million in the quarter versus a positive free cash flow of \$18 million a year ago.

2019 Guidance Raised

Buoyed by increased visibility and sustained higher infrastructure investment across end-markets served, the company lifted 2019 revenue expectation to nearly \$12 billion from \$11.5-\$11.9 billion projected earlier.

It now expects adjusted earnings between \$3.16 and \$3.28 per share versus \$2.99-\$3.33 expected earlier. Notably, it has increased the lower range of its adjusted EBITDA guidance to \$904 million versus \$852 million projected earlier.

Quarter Ending **09/2019**

Report Date	Oct 31, 2019
Sales Surprise	6.16%
EPS Surprise	9.62%
Quarterly EPS	1.14
Annual EPS (TTM)	3.37

Recent News

Quanta Services Lures Investors With 25% Dividend Hike - Dec 12, 2019

Quanta Services, Inc. recently announced a hike in dividend payout. This hike is reflective of its confidence in the stability of the base business, long-term prospects and solid financial position. The move will also enable it to enhance stockholder value.

The company boosted (approximately by 25%) quarterly dividend to 5 cents per share (20 cents annually) from 4 cents (16 cents annually). This new dividend, approved by the board of directors, will be paid on Jan 16, 2020 to its stockholders of record as of Jan 2. The dividend yield, based on the latest payout and Dec 12 closing market price, is approximately 0.5%.

Valuation

Quanta Services' shares are up 12.6% in trailing 12-month period. Over the past year, the Zacks sub-industry and Construction sector was up 9.5% and 25.3%, respectively.

The S&P 500 index is up 17.4% in the past year.

The stock is currently trading at 9.91X forward 12-month price to earnings, which compares to 13.92X for the Zacks sub-industry, 15.65X for the Zacks sector and 18.5X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.43X and as low as 9.23X, with a 5-year median of 13.49X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$41 price target reflects 10.38X forward 12-month earnings.

The table below shows summary valuation data for PWR

Valuation Multiples - PWR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	9.91	13.92	15.65	18.5
	5-Year High	25.43	16.92	18.83	19.34
	5-Year Low	9.23	9.87	10.63	15.18
	5-Year Median	13.49	13.09	15.93	17.46
P/B TTM	Current	1.43	1.87	3.8	4.4
	5-Year High	1.67	2.45	7.22	4.54
	5-Year Low	0.86	1.14	2.19	2.85
	5-Year Median	1.4	1.59	3.41	3.62
EV/EBITDA TTM	Current	8.18	11.56	18.97	11.95
	5-Year High	11.92	15.24	22.54	12.85
	5-Year Low	6.03	5.37	14.41	8.49
	5-Year Median	8.55	5.35	19.37	10.66

As of 01/31/2020

Industry Analysis Zacks Industry Rank: Bottom 6% (239 out of 255)



Top Peers

AECOM (ACM)	Neutral
Dycom Industries, Inc. (DY)	Neutral
Gates Industrial Corporation PLC (GTES)	Neutral
Jacobs Engineering Group Inc. (J)	Neutral
KBR, Inc. (KBR)	Neutral
MasTec, Inc. (MTZ)	Neutral
Willdan Group, Inc. (WLDN)	Neutral
Fluor Corporation (FLR)	Underperform

Industry Comparison Industry: Engineering - R And D Services				Industry Peers		
	PWR Neutral	X Industry	S&P 500	ACM Neutral	FLR Underperform	KBR Neutral
VGM Score	A	-	-	A	B	B
Market Cap	5.57 B	2.65 B	23.55 B	7.63 B	2.51 B	3.85 B
# of Analysts	8	3	13	3	4	6
Dividend Yield	0.51%	0.00%	1.81%	0.00%	2.24%	1.18%
Value Score	A	-	-	A	C	B
Cash/Price	0.01	0.05	0.04	0.14	0.68	0.17
EV/EBITDA	10.10	9.17	13.97	32.46	2.80	8.67
PEG Ratio	0.70	1.32	1.97	1.18	NA	1.21
Price/Book (P/B)	1.43	2.12	3.21	1.95	1.49	2.12
Price/Cash Flow (P/CF)	8.96	11.00	13.36	10.86	4.46	13.73
P/E (F1)	10.15	14.52	18.42	14.56	11.98	13.84
Price/Sales (P/S)	0.46	0.61	2.60	0.38	0.15	0.70
Earnings Yield	10.01%	6.88%	5.43%	6.86%	8.33%	7.24%
Debt/Equity	0.51	0.65	0.72	0.84	0.97	0.77
Cash Flow (\$/share)	4.37	1.38	6.92	4.44	4.01	1.98
Growth Score	B	-	-	A	B	C
Hist. EPS Growth (3-5 yrs)	19.39%	13.30%	10.68%	-1.32%	-18.39%	16.36%
Proj. EPS Growth (F1/F0)	20.64%	7.46%	7.59%	20.48%	115.54%	16.16%
Curr. Cash Flow Growth	28.58%	7.53%	10.81%	-0.31%	14.03%	7.10%
Hist. Cash Flow Growth (3-5 yrs)	5.32%	8.08%	8.78%	15.22%	-9.29%	-6.30%
Current Ratio	1.82	1.38	1.22	1.17	1.38	1.28
Debt/Capital	33.94%	39.52%	42.99%	45.73%	49.29%	43.47%
Net Margin	2.81%	3.10%	11.69%	-1.29%	-7.66%	3.39%
Return on Equity	12.17%	10.60%	17.33%	10.32%	8.94%	12.77%
Sales/Assets	1.53	1.13	0.55	1.37	1.96	1.05
Proj. Sales Growth (F1/F0)	6.73%	3.28%	4.12%	5.02%	2.66%	13.18%
Momentum Score	B	-	-	C	B	C
Daily Price Chg	-1.98%	-0.30%	-1.98%	-2.17%	-3.87%	-0.80%
1 Week Price Chg	-2.16%	-0.25%	-1.09%	-1.33%	-4.79%	-5.58%
4 Week Price Chg	-4.72%	-4.28%	-2.11%	12.22%	-6.63%	-11.49%
12 Week Price Chg	-9.25%	-0.69%	2.15%	14.21%	-5.09%	-6.82%
52 Week Price Chg	10.78%	9.28%	14.15%	57.56%	-51.08%	58.14%
20 Day Average Volume	1,034,107	21,217	1,808,632	1,534,852	1,620,276	1,202,664
(F1) EPS Est 1 week change	-0.21%	0.00%	0.00%	0.00%	-6.27%	0.00%
(F1) EPS Est 4 week change	-0.21%	0.00%	0.00%	0.00%	-6.27%	0.00%
(F1) EPS Est 12 week change	1.15%	-1.01%	-0.09%	-0.20%	-6.27%	-1.01%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	B
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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