Quanta Services Inc. (PWR)

$48.20 (As of 08/10/20)

Price Target (6-12 Months): **$51.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 01/02/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:A
	Value: B | Growth: A | Momentum: C	

Summary

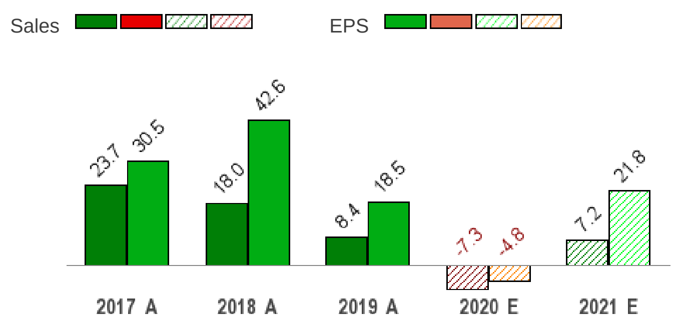
Quanta Services' shares have outperformed the industry year to date. The trend is likely to continue, as it delivered impressive earnings for second-quarter 2020 despite a challenging environment. Adjusted earnings of 74 cents not only surpassed the Zacks Consensus Estimate by 54.2% but also grew an impressive 138.7% on a year-over-year basis. Operating margin rose 170 basis points (bps) from a year ago despite 11.7% low revenues. Adjusted EBITDA improved 29.4% year over year. Backed by resilient strategies and operational excellence, it lifted its adjusted earnings, adjusted EBITDA and non-GAAP free cash flow projection for 2020. However, COVID-19 impacts on gas utility infrastructure services and a rapid decline in the global demand for refined products are concerns.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$49.89 - $23.77**
20 Day Average Volume (sh)	**1,046,631**
Market Cap	**$6.6 B**
YTD Price Change	**18.4%**
Beta	**1.13**
Dividend / Div Yld	**$0.20 / 0.4%**
Industry	**Engineering - R and D Services**
Zacks Industry Rank	**Bottom 27% (184 out of 253)**
Last EPS Surprise	**54.2%**
Last Sales Surprise	**-1.2%**
EPS F1 Est- 4 week change	**2.9%**
Expected Report Date	**10/29/2020**
Earnings ESP	**-0.9%**
P/E TTM	**14.7**
P/E F1	**15.2**
PEG F1	**1.1**
P/S TTM	**0.6**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	2,728 E	2,887 E	3,128 E	3,056 E	12,036 E
2020	2,764 A	2,506 A	3,114 E	3,088 E	11,229 E
2019	2,807 A	2,839 A	3,353 A	3,113 A	12,112 A

EPS Estimates

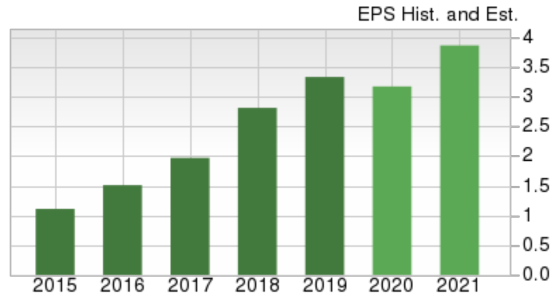
	Q1	Q2	Q3	Q4	Annual*
2021	$0.60 E	$0.77 E	$1.01 E	$1.28 E	$3.86 E
2020	$0.47 A	$0.74 A	$1.12 E	$1.10 E	$3.17 E
2019	$0.96 A	$0.31 A	$1.14 A	$0.93 A	$3.33 A

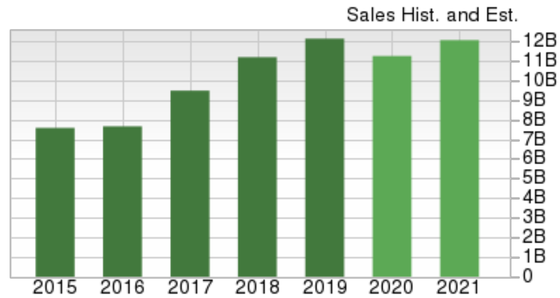
*Quarterly figures may not add up to annual.

The data in the charts and tables, except sales and EPS estimates, is as of 08/10/2020. The reports text and the analyst-provided sales and EPS estimates are as of 08/11/2020.

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 59% to 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; emergency restoration services; installation of “smart grid” technology on electric power networks; supports the development of renewable energy generation, including solar, wind, hydro power and backup natural gas generation facilities, and related switchyards and transmission infrastructure; and communications infrastructure services.

The Pipeline and Industrial Infrastructure Services segment (41%) 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, integrity testing, rehabilitation and replacement, and the fabrication of pipeline support systems and related structures and facilities for natural gas utilities and midstream companies. It also provides high-pressure and critical-path turnaround services to the downstream and midstream energy markets and instrumentation and electrical services, piping, fabrication and storage tank services.

Reasons To Buy:

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

- **Robust Growth Strategy**: Quanta Services 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. 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 second quarter with total backlog of $13.9 billion and 12-month backlog of $7.7 billion. This compares favorably with $12.8 billion of total backlog and $7.5 billion of 12-month backlog a year ago. This demonstrates the strength of its core operations. It expects utility, communications, and certain pipeline and industrial infrastructure services — which currently account for approximately 80-90% of revenues — to remain robust in 2020. Quanta Services' optimism stems from healthy backlog levels which are expected to grow further.

- **Strong Electric Power Operations**: Electric Power operations continued to execute well from a top line perspective. Segment revenues, which comprise revenues from base business activities including communications operations, grew 4.8% in first-half 2020 from the comparable year-ago period. Also, excluding the Latin America unit, the segment's revenues grew 4.8% year over year. Solid performance 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. It is important to note that approximately 65% of Quanta's revenues is directly tied to regulated electric and gas utility customers, which is core to its business.

  As of Jun 30, 2020, the segment's 12-month backlog was $5.3 billion and total backlog was $9.7 billion, up 7.7% and 11.5% 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 been strong since 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, 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 going forward, 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.

- **Robust Prospect for Pipeline and Industrial Infrastructure Services Unit**: 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.

  Meanwhile, the company's Pipeline and Industrial Infrastructure segment remains strong on the back of 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.

- **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. In July 2020, it acquired a Chicago, IL-based leading professional engineering firm that provides infrastructure engineering and design services to electric utilities, gas utilities and communications services companies, as well as permitting and utility locating services. The acquisition enhanced Quanta's turnkey and communications engineering capabilities in core utility markets.

  Again in the first-quarter 2020, the company acquired a Canada-based industrial services business that performs catalyst handling services — including changeover and shutdown maintenance — for customers in refining and chemical industries. Also, it acquired an electric power infrastructure business located in the United States, which primarily provides underground conduit services. Quanta Services invested $400 million in the strategic acquisition of seven companies in 2019 (compared to four buyouts in 2018). 2019 and 2018 buyouts strategically expanded its domestic electric power and communications service offerings.

- **Strong Liquidity Position**: Quanta Services has been maintaining a strong liquidity position to navigate through the current environment. The company ended the second quarter with $2.1 billion liquidity, including $530.7 million cash and cash equivalents, along with approximately $1.6 billion of available capacity on a five-year, $2.14-billion revolving credit facility. Its current cash level is sufficient to meet the short-term obligation of $162.2 million, down sequentially from $165 million. Long-term debt obligations (including operating lease liabilities, net of current portion) totaled 1.5 billion, down from $1.8 billion reported at first quarter-end. Meanwhile, the company has no significant debt maturity until Oct 31, 2022.

Reasons To Sell:

Quanta Services remains vulnerable to COVID-19 impacts, regulatory challenges and risks like project delays, stiff competition, and oil & gas volatility.

- **Coronavirus Woes to Ail Near-Term Results**: Overall energy markets have been facing challenges due to COVID-19. Customers have started restricting onsite activity for other services. Also, they have been deferring maintenance and certain turnaround projects to the latter part of this year or 2021. The company expects these headwinds to persist in the near future.

- **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 first-half 2020 revenues were down 23.9% year over year, primarily due to the absence of larger pipeline projects. Also, operating margin for the period contracted 180 bps from a year ago.

- **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. 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.

- **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.

- **Cyclical Nature of the Business**: Demand for Quanta's services is cyclical and hence, is largely vulnerable to reduction in government and private industrial spending. Historically, volatility in commodity prices has negatively impacted the oil & gas business as well as the business regions whose economies are substantially dependent on commodity prices.

  Persistent volatility in the oil and gas market, given declining prices and decrease in spending levels, is hurting the company's Pipeline and Industrial Infrastructure Services segment.

Last Earnings Report

Quanta Beats on Q2 Earnings, Lifts EPS & Cash Flow View

Quarter Ending	06/2020
Report Date	Aug 06, 2020
Sales Surprise	-1.20%
EPS Surprise	54.17%
Quarterly EPS	0.74
Annual EPS (TTM)	3.28

Quanta Services Inc. reported impressive earnings for second-quarter 2020. Adjusted earnings not only surpassed the Zacks Consensus Estimate but also grew impressively on a year-over-year basis. Revenues, however, missed analysts' expectation and declined from a year ago.

Detailed Discussion

In the quarter under review, Quanta reported adjusted earnings of 74 cents per share that comfortably topped the consensus estimate of 48 cents by 54.2% and increased an impressive 138.7% from the year-ago profit level of just 31 cents.

Total revenues of $2.51 billion missed the consensus mark of $2.54 billion by 1.2% and decreased 11.7% year over year due to lower contribution from its Pipeline and Industrial Infrastructure Services segment.

Operating margin for the quarter rose 170 bps from a year ago to 4.5%. Adjusted EBITDA of $214.2 million improved 29.4% from $165.6 million a year ago.

The company reported 12-month backlog of $7.66 billion and total backlog of $13.93 billion at June-end. At June 2019-end, 12-month backlog came in at $7.48 billion and total backlog was $12.77 billion. However, the reported metrics were down from 2019-end respective figures of $7.95 billion and $15 billion.

Segment Details

The company reports results under two reportable segments: Electric Power Infrastructure Services segment (accounting for 71.5% of revenues), and Pipeline and Industrial Infrastructure Services (28.5%).

Revenues from Electric Power Infrastructure Services totaled $1,792.9 million, increasing 3.4% year over year. Operating margins expanded 490 basis points (bps) to 10.3%. The segment's 12-month backlog was $5.34 billion, up from $4.96 billion a year ago. Total backlog of $9.68 billion also grew from $8.69 billion reported in the prior-year quarter.

Within the Pipeline and Industrial Infrastructure Services segment, revenues declined 35.4% from the prior-year quarter to $713.3 million. Operating margin of 3% also contracted 330 bps year over year. Segment's 12-month backlog totaled $2.32 billion, down from $2.52 billion a year ago. Total backlog, however, grew to $4.24 billion from $4.1 billion in the prior year.

Liquidity

As of Jun 30, 2020, Quanta Services had cash and cash equivalents of $530.7 million compared with $164.8 million at 2019-end. The company's long-term debt (net of current maturities) amounted to $1,315.6 million, up from $1,292.2 million as of Dec 31, 2019.

Net cash provided by operating activities was $497.5 million for the quarter versus $108.7 million cash used in operating activities in the prior-year period. Free cash flow was $457.2 million for the quarter versus negative free cash flow of $172.9 million a year ago. On Jun 30, 2020, Quanta Services had total liquidity of $2.1 billion, significantly up from $1.7 billion at March-end.

Recently, the company's board of directors authorized it to repurchase $500 million shares through Jun 30, 2023 of its outstanding common stock under a new repurchase program. As of Aug 5, it had bought back approximately 13 million shares under the prior authorization for an aggregate amount of $413.2 million.

Updates 2020 Guidance

The company now expects revenues in the range of $11-$11.4 billion versus prior expectation of $11.4-$11.8 billion ($12.11 billion reported a year ago). It expects adjusted earnings between $3.18 and $3.48 per share compared with $3.04-$3.36 expected earlier. The mid-point of the current projection is in line with the year-ago figure of $3.33 per share. Adjusted EBITDA is projected within $903-$964 million versus $860-$925 billion of prior projection. This indicates a decrease from $941.8 million reported in 2019. Notably, Quanta increased full-year non-GAAP free cash flow projection to $600-$800 million from $400-$600 million anticipated earlier.

Importantly, the above-mentioned projections are inclusive of the expected results from its LATAM operations. LATAM operations are expected to generate revenues of $20-$30 million. Operating loss of $40-$45 million and a loss of 28-31 cents per share are also expected from the same.

Recent Achievements

In June, the company's joint venture company, LUMA Energy, LLC (equally owned by Quanta and Canadian Utilities Limited arm ATCO Ltd.), was selected by the Puerto Rico Public-Private Partnership Authority for a 15-year Operation and Maintenance Agreement with the Puerto Rico Electric Power Authority or PREPA. LUMA, together with Innovative Emergency Management, Inc., operates, maintains and modernizes PREPA's more than 18,000-mile electric transmission and distribution system in Puerto Rico.

Valuation

Quanta Services' shares are up 18.4% in the year-to-date period and 45% in trailing 12-month period. Stocks in the Zacks sub-industry is down 17.8% but the Zacks Construction sector is up 7.2% in the year-to-date period. Over the past year, the Zacks sub-industry is down 2.1% but sector is up 23.7%.

The S&P 500 index is up 3.9% in the year-to-date period and 16.4% in the past year.

The stock is currently trading at 13.42X forward 12-month earnings, which compares to 17.77X for the Zacks sub-industry, 18.7X for the Zacks sector and 22.75X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.43X and as low as 6.64X, with a 5-year median of 13.29X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $51 price target reflects 14.2X 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 F12M	Current	13.42	17.77	18.7	22.75
	5-Year High	25.43	17.77	19	22.75
	5-Year Low	6.64	10.36	10.74	15.25
	5-Year Median	13.29	14.18	15.86	17.58
P/B TTM	Current	1.69	1.86	3.97	4.67
	5-Year High	1.69	2.83	6.74	4.67
	5-Year Low	0.84	0.82	1.71	2.83
	5-Year Median	1.4	1.9	3.29	3.74
EV/EBITDA TTM	Current	8.65	7.4	19.3	12.62
	5-Year High	12.02	10.42	21.24	12.84
	5-Year Low	5.54	5.26	12.41	8.24
	5-Year Median	8.5	7.75	17.89	10.9

As of 08/10/2020

Industry Analysis **Zacks Industry Rank:** Bottom 27% (184 out of 253)

Top Peers

Company (Ticker)	Rec	Rank
AECOM **(ACM)**	Neutral	4
Dycom Industries, Inc. **(DY)**	Neutral	2
Fluor Corporation **(FLR)**	Neutral	3
Gates Industrial Corporation PLC **(GTES)**	Neutral	2
Jacobs Engineering Group Inc. **(J)**	Neutral	3
KBR, Inc. **(KBR)**	Neutral	3
MasTec, Inc. **(MTZ)**	Neutral	3
Willdan Group, Inc. **(WLDN)**	Neutral	3

Industry Comparison Industry: Engineering - R And D Services

Industry Peers

	PWR	X Industry	S&P 500	ACM	FLR	KBR
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	3	3
VGM Score	A	-	-	B	C	A
Market Cap	6.63 B	2.38 B	23.56 B	6.23 B	1.68 B	3.32 B
# of Analysts	7	2	14	3	4	5
Dividend Yield	0.41%	0.00%	1.71%	0.00%	0.00%	1.71%
Value Score	B	-	-	B	A	A
Cash/Price	0.08	0.13	0.07	0.22	NA	0.19
EV/EBITDA	8.26	9.63	13.39	22.92	NA	8.29
PEG Ratio	1.08	1.51	2.92	1.52	NA	1.49
Price/Book (P/B)	1.69	2.02	3.18	1.60	1.00	2.02
Price/Cash Flow (P/CF)	9.36	8.74	12.69	8.74	2.98	9.56
P/E (F1)	15.71	18.59	22.16	18.82	9.66	14.36
Price/Sales (P/S)	0.57	0.57	2.55	0.42	0.10	0.57
Earnings Yield	6.58%	3.87%	4.33%	5.30%	10.37%	6.98%
Debt/Equity	0.38	0.60	0.77	0.53	NA	0.74
Cash Flow ($/share)	5.15	1.90	6.94	4.44	4.01	2.44
Growth Score	A	-	-	B	D	A
Hist. EPS Growth (3-5 yrs)	29.97%	13.22%	10.41%	-4.43%	NA	18.13%
Proj. EPS Growth (F1/F0)	-4.76%	-26.43%	-6.51%	-24.97%	112.01%	-3.79%
Curr. Cash Flow Growth	14.87%	3.89%	5.26%	-0.31%	14.03%	23.99%
Hist. Cash Flow Growth (3-5 yrs)	4.47%	8.80%	8.55%	15.22%	-9.29%	7.96%
Current Ratio	1.74	1.45	1.34	1.27	NA	1.27
Debt/Capital	27.79%	40.35%	44.59%	34.51%	NA	42.53%
Net Margin	3.13%	0.23%	10.13%	-2.91%	NA	-0.50%
Return on Equity	11.02%	8.27%	14.59%	9.85%	NA	13.83%
Sales/Assets	1.40	1.07	0.51	1.06	NA	1.11
Proj. Sales Growth (F1/F0)	-5.19%	-3.88%	-1.54%	-35.64%	-1.87%	1.35%
Momentum Score	C	-	-	C	F	D
Daily Price Chg	3.97%	0.32%	0.91%	0.80%	5.10%	-0.51%
1 Week Price Chg	15.99%	6.00%	2.30%	6.47%	11.68%	5.53%
4 Week Price Chg	29.19%	8.11%	8.54%	9.69%	1.44%	8.76%
12 Week Price Chg	44.35%	16.28%	13.68%	11.96%	14.78%	14.69%
52 Week Price Chg	44.92%	0.93%	3.71%	16.85%	-34.68%	-5.96%
20 Day Average Volume	1,046,631	34,296	2,015,804	787,026	2,100,672	1,260,666
(F1) EPS Est 1 week change	2.03%	0.00%	0.00%	-0.16%	0.00%	0.00%
(F1) EPS Est 4 week change	2.91%	2.91%	1.67%	-0.16%	0.00%	0.00%
(F1) EPS Est 12 week change	1.00%	1.70%	2.27%	3.51%	0.00%	2.39%
(Q1) EPS Est Mthly Chg	0.46%	0.00%	0.67%	-1.64%	0.00%	-7.78%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	B
Growth Score	A
Momentum Score	C
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.

Disclosures

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