

Tetra Tech Inc. (TTEK)

\$94.72 (As of 02/07/20)

Price Target (6-12 Months): **\$99.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/02/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: F

Summary

Over the past three months, Tetra Tech's shares have outperformed the industry. The company is currently focusing on high-end consulting and engineering services. It remains bullish about its growth prospects for the U.S. federal, U.S. state and local, U.S. commercial, and international clients. In first-quarter fiscal 2020, the company's earnings surpassed estimates by 9.1% and grew 20% year over year. For fiscal 2020, it anticipates adjusted earnings of \$3.40-\$3.55 per share, up from \$3.35-\$3.55 per share mentioned earlier. For the fiscal year, the company expects revenues of \$2.4-\$2.6 billion, whereas it recorded \$2.4 billion in fiscal 2019. However, the stock looks overvalued compared with the industry. Rising costs, concerns related to the U.S. federal business and headwinds related to international exposure might be concerning.

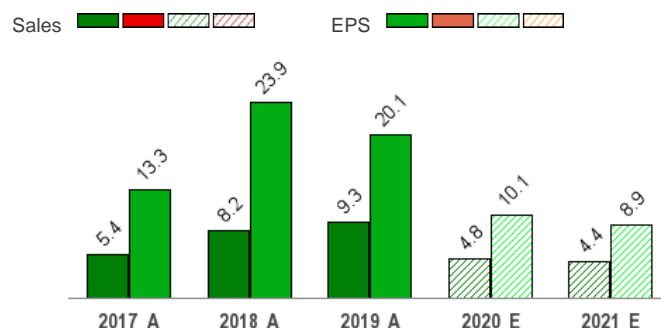
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$95.07 - \$54.54
20 Day Average Volume (sh)	248,897
Market Cap	\$5.2 B
YTD Price Change	9.9%
Beta	0.98
Dividend / Div Yld	\$0.60 / 0.6%
Industry	Pollution Control
Zacks Industry Rank	Top 27% (69 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.1%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	1.7%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	28.6
P/E F1	27.1
PEG F1	1.8
P/S TTM	1.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	643 E	642 E	649 E	672 E	2,632 E
2020	614 A	607 E	642 E	659 E	2,522 E
2019	553 A	585 A	623 A	640 A	2,406 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.88 E	\$0.85 E	\$1.02 E	\$1.05 E	\$3.80 E
2020	\$0.84 A	\$0.76 E	\$0.92 E	\$0.98 E	\$3.49 E
2019	\$0.70 A	\$0.70 A	\$0.89 A	\$0.88 A	\$3.17 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/07/2020. The reports text is as of 02/10/2020.

Overview

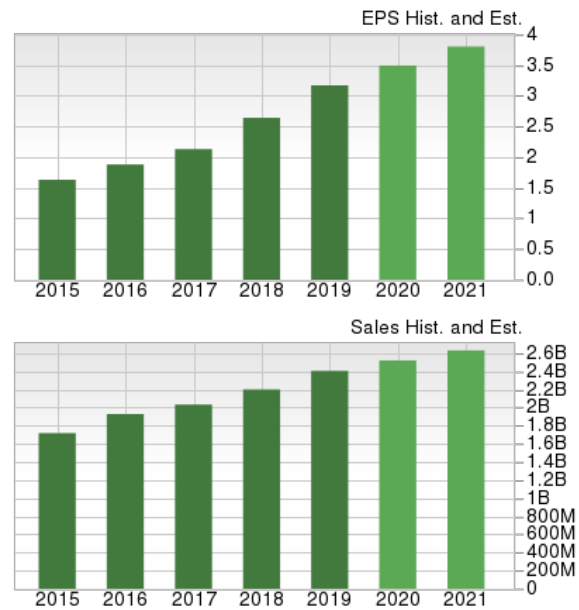
Headquartered in Pasadena, Tetra Tech is a leading provider of consulting, construction management, engineering, program management and technical services. It serves clients by providing cost-effective and innovative solutions on dealing with the fundamental needs for water, environmental and alternative energy services. Tetra Tech's has a diverse base of international and U.S. commercial clients, as well as U.S. federal and U.S. state and local government agencies.

Tetra Tech reports its businesses under the following two segments:

Government Services Group: This segment encompasses operations with U.S. government clients (federal, state and local) and all activities with development agencies.

Notably, the segment offers consulting and engineering services globally for a wide range of U.S. government clients. Some of the notable services offered are environmental monitoring, water and waste management, sustainable infrastructure design, international development and various civil infrastructure master planning and engineering design for transportation, facilities, as well as regional and local development.

Commercial / International Services Group: This segment includes activities with U.S. commercial clients and all international activities excluding work performed for development agencies. The segment provides various services like environmental remediation, infrastructure and related environmental and geotechnical services as well as engineering and project management services.



Reasons To Buy:

▲ In the past three months, Tetra Tech's shares have gained 8.9% compared with the industry's growth of 3.6%. In first-quarter fiscal 2020, the company's earnings surpassed estimates by 9.1% and grew 20% from the year-ago quarter. The bottom-line results benefited from sales growth and margin improvement. In a bid to maximize growth prospects, the company is currently focusing on high-end consulting and engineering services, which are helping it promote high-value and high-margin business, thus differentiating it from peers in the marketplace. For fiscal 2020, the company anticipates adjusted earnings of \$3.40-\$3.55 compared with \$3.35-\$3.55 mentioned earlier. Also, it expects earnings of 73-78 cents per share in second-quarter fiscal 2020, whereas it reported 70 cents in the year-ago quarter.

Tetra Tech is enjoying strong backlog level. Also, strengthening client businesses, acquired assets and shareholder-friendly policies remain tailwinds for the company.

▲ Tetra Tech's top-line performance in first-quarter fiscal 2020 was impressive, with sales beating estimates by 0.9% and rising 11.1% year over year. Backlog at the end of the quarter grew 13.3% year over year to \$3,166 million. For fiscal 2020, the company expects sales from the U.S. federal clients to increase 5-10% on growth in the U.S. federal budget. It anticipates sales from the U.S. commercial clients to grow 3-8%, benefiting from sustainable buildings and environmental services. Also, the company expects the U.S. state and local sales to increase 10-15% on strengthening disaster recovering and municipal water infrastructure businesses. It projects International sales growth of 7-12%, driven by environmental and infrastructure programs. Tetra Tech anticipates net revenues of \$2.4-\$2.6 billion for fiscal 2020 and \$580-\$630 million for the second quarter. The mid-point of \$605 million of the second quarter projection is higher than \$585.4 million recorded in the year-ago quarter.

▲ Tetra Tech believes that its acquisitive nature will aid in strengthening data analytical capabilities and business expansion in Europe and the U.K. In July 2019, the company acquired shares of WYG plc, a provider of engineering and consulting services. The buyout is strengthening Tetra Tech's global presence, especially in the U.K. and Europe, and business in environment, water and infrastructure markets. Further, in April 2019, the company acquired eGlobalTech. The buyout has been strengthening Tetra Tech's business from commercial and government customers. eGlobalTech launched an AI solution named Auxilium in July 2019. Moreover, Tetra Tech has consistently returned significant cash to shareholders through dividends and share repurchases. During the first quarter fiscal 2020, the company bought back shares worth \$21.2 million and distributed dividends totaling \$8.2 million. Notably, quarterly dividend rate was hiked by 25% in April 2019. Also, in January 2020, the company received approval for a new \$200-million share buyback program. Exiting the fiscal first quarter, it is left with \$304 million of share repurchase authorization.

Reasons To Sell:

- ▼ On an EV/EBITDA (TTM) basis, Tetra Tech's stock looks overvalued compared with the industry, with the respective tallies of 21x and 12.71x. Also, the company's current multiple is higher than the industry's three-month highest level of 12.87x. In addition to stock's overvaluation compared with the industry, lowered earnings estimates for the company make us cautious. In the past 30 days, the consensus estimate for its earnings has been lowered by 3.8% to 76 cents per share for the fiscal second quarter and by 2.1% to 92 cents for the third quarter.
- ▼ Escalating costs have been concerning Tetra Tech over the past few quarters. For instance, the company's subcontractor costs and other cost of revenues (combined) rose 11.9% in the first quarter of fiscal 2020 from the year-ago comparable quarter. Also, other costs of revenues increased 10.9% in the quarter, while selling, general and administrative expenses expanded 8.1%. We believe that unwarranted rise in costs and expenses might be detrimental to Tetra Tech's financials in the upcoming quarters.
- ▼ The company derives a significant portion of revenues from the U.S. federal, and the U.S. state and local customers. Such customers usually award multi-year contracts. We believe that any changes in the terms and clauses, and funding of these contracts will be detrimental. Also, the company's services offered in mining, and oil & gas markets are highly cyclical and vulnerable to economic downturns, which in turn impact its financials. For instance, fluctuations in market prices of metals — including uranium, precious metals, aluminum, copper, iron ore and potash — can cause its mining clients to cancel or curtail their projects, thus adding to the woes. In addition, demand for its oil and gas services fluctuates, and depends on customers' willingness to spend to explore, develop, produce, and transport oil and natural gas. Moreover, international operations have exposed the company to the adverse impacts of macroeconomic cycles in the United States as well as unfavorable foreign currency movements. It is worth mentioning that approximately 34% of Tetra Tech's revenues were generated from international operations in the first quarter of fiscal 2020.

Concerns related to the U.S. federal business, high costs and headwinds related to international exposure might be concerning for Tetra Tech.

Last Earnings Report

Tetra Tech Surpasses Q1 Earnings Estimates, Ups View

Tetra Tech reported better-than-expected results for the first quarter of fiscal 2020 (ended December 29, 2019), with earnings surpassing estimates by 9.1%.

The company's adjusted earnings per share in the reported quarter were 84 cents, surpassing the Zacks Consensus Estimate of 77 cents. Also, its earnings grew 20% from the year-ago quarter's 70 cents on sales growth and margin improvement.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	0.88%
EPS Surprise	9.09%
Quarterly EPS	0.84
Annual EPS (TTM)	3.31

Revenues & Segmental Performance

In the reported quarter, Tetra Tech generated adjusted revenues of \$797.5 million, reflecting year-over-year growth of 11.4%. Alternatively, adjusted net revenues (adjusted revenues minus subcontractor costs) were \$614 million, reflecting growth of 11.1% from the year-ago quarter.

Further, the company's revenues surpassed the Zacks Consensus Estimate of \$608.7 million by 0.9%.

Backlog at the end of the quarter was \$3,165.8 million, reflecting growth of 13.3% from the year-ago figure.

Revenues from the U.S. Federal customers (accounting for 28% of the quarter's revenues) rose 12% year over year on growth in environmental and water programs. Conversely, U.S. Commercial sales (24% of the quarter's revenues) grew 5% year over year, driven by an increase in the U.S. renewable energy and environmental remediation businesses. Also, the U.S. State and Local sales (14% of the quarter's revenues) decreased 7% due to weakness in disaster response business, partially offset by gain in the water infrastructure business. International sales (34% of the quarter's revenues) improved 25% on growth in renewable energy and UK environmental businesses.

The company reports revenues under the segments discussed below:

Net sales of **Government Services Group** were \$329.7 million, up 8.7% year over year. The improvement was driven by healthy growth in broad-based environmental and water programs, partially offset by a decline in disaster response business.

Revenues from **Commercial / International Services Group** totaled \$284.3 million, reflecting year-over-year growth of 13.9%. Results were driven by healthy growth in environmental consulting in the U.K. and the strengthening of renewable energy sales in North America.

Operating Margin

In the reported quarter, Tetra Tech's subcontractor costs totaled \$183.6 million, reflecting growth of 11.9% from the year-ago quarter. Other costs of revenues were \$504.3 million, up 10.9% year over year. Selling, general and administrative expenses were \$46.4 million, up 8.1% year over year.

Adjusted operating income in the reported quarter grew 12.2% year over year to \$62.5 million, while adjusted margin increased 10 basis points year over year to 10.2%.

Balance Sheet and Cash Flow

Exiting the fiscal first quarter, Tetra Tech had cash and cash equivalents of \$110.8 million, down 8.2% from \$120.7 million recorded at the end of the last reported quarter. Long-term debt was up 22.2% sequentially to \$322.5 million.

In the fiscal first quarter, the company generated net cash of \$18 million from operating activities, 17.8% above the prior-year quarter. Capital expenditure was \$3.3 million, down 13.5% year over year.

During the quarter, the company bought back shares worth \$21.2 million and distributed dividends totaling \$8.2 million.

Outlook

For fiscal 2020 (ending September 2020), Tetra Tech anticipates sales from U.S. Federal clients to increase 5-10%, driven by growth in the U.S. Federal budget. It expects sales from U.S. Commercial clients to grow 3-8% on gains from sustainable buildings and environmental services.

Also, it anticipates U.S. State and Local sales to increase 10-15% on strengthening disaster recovery and municipal water infrastructure businesses. It expects International sales growth of 7-12%, driven by environmental and infrastructure programs.

For fiscal 2020, the company anticipates net revenues of \$2.4-\$2.6 billion, while adjusted earnings are predicted to be \$3.40-\$3.55, revised from \$3.35-\$3.55 per share mentioned earlier. For the fiscal year, it expects effective tax rate of 23%.

For the fiscal second quarter (ending March 2020), the company anticipates net revenues of \$580-\$630 million and earnings per share of 73-78 cents.

Recent News

On **Jan 27, 2020**, Tetra Tech's board of directors approved a quarterly dividend payout of 15 cents per share to shareholders of record as of Feb 12. The payment will be made on Feb 28. Also, the company received approval for a new \$200-million share buyback program.

On **Dec 11, 2019**, Tetra Tech announced that it has secured a contract from the U.S. Environmental Protection Agency's Office of Science and Technology (EPA/OST). Per the \$21 million, single-award contract, the company will be responsible for supporting the Agency's objective in assessing and managing threats to ecological and human health.

On **Dec 3, 2019**, Tetra Tech announced that it has secured an architect-engineer contract from the U.S. Army Corps of Engineers, Transatlantic Middle East District (TAM). The five-year contract was valued at \$45 million. Notably, the company will provide services, including planning, program development, design generation and construction. These services will be vital in upgrading existing facilities and constructing state-of-the-art facilities for the federal agency.

Valuation

Tetra Tech shares are up 9.9% and 66.6% in the year-to-date period and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Industrial Products sector are up 0.6% and down 0.8% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 29.5% and 10.6%, respectively.

The S&P 500 index has moved up 3.2% year to date and 21.9% in the past year.

The stock is currently trading at 26.27x forward 12-month earnings per share, which compares to 21.96x for the Zacks sub-industry, 18.17x for the Zacks sector and 19.12x for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.81x and as low as 12.46x, with a 5-year median of 18.65x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$99 price target reflects 27.58x forward 12-month earnings per share.

The table below shows summary valuation data for TTEK.

Valuation Multiples - TTEK					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	26.27	21.96	18.17	19.12
	5-Year High	26.81	22.5	19.89	19.34
	5-Year Low	12.46	14.23	12.6	15.18
	5-Year Median	18.65	18.24	16.62	17.47
EV/EBITDA F12M	Current	18.93	12.5	17.81	12.66
	5-Year High	18.93	12.5	18.2	12.66
	5-Year Low	6.82	5.16	10.68	9.08
	5-Year Median	10.85	7.8	14.03	10.79
EV/Sales F12M	Current	2.21	1.84	3.14	3.26
	5-Year High	2.21	1.84	3.14	3.37
	5-Year Low	0.8	0.86	1.76	2.3
	5-Year Median	1.3	1.35	2.28	2.79

As of 02/07/2020

Industry Analysis Zacks Industry Rank: Top 27% (69 out of 254)



Top Peers

Leidos Holdings, Inc. (LDOS)	Outperform
Advanced Emissions Solutions, Inc. (ADES)	Neutral
Booz Allen Hamilton Holding Corporation (BAH)	Neutral
CECO Environmental Corp. (CECE)	Neutral
Casella Waste Systems, Inc. (CWST)	Neutral
Exponent, Inc. (EXPO)	Neutral
ICF International, Inc. (ICFI)	Neutral
AECOM (ACM)	Underperform

Industry Comparison Industry: Pollution Control				Industry Peers		
	TTEK Neutral	X Industry	S&P 500	ACM Underperform	EXPO Neutral	ICFI Neutral
VGM Score	D	-	-	F	C	B
Market Cap	5.18 B	49.70 M	24.00 B	7.47 B	4.06 B	1.64 B
# of Analysts	3	3	13	4	3	3
Dividend Yield	0.63%	0.00%	1.78%	0.00%	0.82%	0.64%
Value Score	D	-	-	F	F	B
Cash/Price	0.02	0.09	0.04	0.14	0.06	0.00
EV/EBITDA	22.73	11.40	14.07	32.17	38.91	16.79
PEG Ratio	1.81	1.75	2.04	1.56	NA	1.90
Price/Book (P/B)	5.04	2.26	3.28	1.94	11.37	2.39
Price/Cash Flow (P/CF)	22.37	20.33	13.58	10.60	54.92	16.47
P/E (F1)	27.14	22.28	18.86	19.32	48.89	19.00
Price/Sales (P/S)	1.62	1.26	2.65	0.41	9.74	1.12
Earnings Yield	3.68%	4.29%	5.30%	5.18%	2.04%	5.27%
Debt/Equity	0.48	0.24	0.71	0.87	0.05	0.54
Cash Flow (\$/share)	4.23	0.06	6.89	4.44	1.43	5.29
Growth Score	C	-	-	F	A	B
Hist. EPS Growth (3-5 yrs)	18.41%	30.35%	10.80%	-1.32%	16.23%	13.00%
Proj. EPS Growth (F1/F0)	10.20%	43.04%	7.23%	-11.36%	4.79%	9.55%
Curr. Cash Flow Growth	11.46%	-4.80%	9.51%	-0.31%	15.81%	14.24%
Hist. Cash Flow Growth (3-5 yrs)	7.28%	12.53%	8.55%	15.22%	11.06%	10.36%
Current Ratio	1.47	1.47	1.20	1.16	3.48	1.51
Debt/Capital	32.51%	21.57%	42.90%	46.53%	4.94%	35.05%
Net Margin	5.14%	-0.88%	11.76%	-1.48%	19.76%	4.68%
Return on Equity	18.34%	2.92%	16.98%	10.22%	24.01%	11.87%
Sales/Assets	1.49	1.02	0.54	1.24	0.81	1.08
Proj. Sales Growth (F1/F0)	4.98%	7.98%	4.15%	-33.48%	4.27%	7.45%
Momentum Score	F	-	-	F	A	B
Daily Price Chg	2.16%	0.00%	-0.64%	-1.26%	6.00%	-0.51%
1 Week Price Chg	-3.51%	-0.23%	-2.60%	-2.88%	0.51%	-1.45%
4 Week Price Chg	8.55%	0.00%	0.72%	2.70%	12.86%	-6.34%
12 Week Price Chg	9.69%	-0.95%	4.69%	8.25%	24.89%	0.15%
52 Week Price Chg	71.41%	10.07%	16.01%	62.98%	51.96%	25.94%
20 Day Average Volume	248,897	19,851	1,961,054	1,749,369	160,780	119,855
(F1) EPS Est 1 week change	0.77%	0.00%	0.00%	-26.43%	0.00%	0.00%
(F1) EPS Est 4 week change	1.75%	0.00%	-0.00%	-26.43%	0.00%	-1.36%
(F1) EPS Est 12 week change	1.49%	0.00%	-0.16%	-26.66%	0.00%	-1.36%
(Q1) EPS Est Mthly Chg	-3.81%	0.00%	0.00%	-28.21%	0.00%	-2.14%

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	D
Growth Score	C
Momentum Score	F
VGM Score	D

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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