Quanta Services Inc. (PWR)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

<table>
<thead>
<tr>
<th>Price ($) (5/18/20):</th>
<th>33.39</th>
</tr>
</thead>
<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>44 - 24</td>
</tr>
<tr>
<td>Market Cap (mil):</td>
<td>4,902</td>
</tr>
<tr>
<td>Shares Out (mil):</td>
<td>146.8</td>
</tr>
<tr>
<td>Float (mil):</td>
<td>135.5</td>
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<tr>
<td>Avg. Daily Vol (mil):</td>
<td>1.93</td>
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<tr>
<td>Dividend ($) :</td>
<td>0.20</td>
</tr>
<tr>
<td>Yield (%):</td>
<td>0.6</td>
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<tr>
<td>Rating:</td>
<td>Outperform</td>
</tr>
<tr>
<td>Suitability:</td>
<td>Q1</td>
</tr>
<tr>
<td>Price Target ($) :</td>
<td>38</td>
</tr>
<tr>
<td>L-Term Rev. Gr Rate Est:</td>
<td>7%</td>
</tr>
<tr>
<td>L-Term EPS Gr Rate Est:</td>
<td>12%</td>
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<tr>
<td>Debt/Cap:</td>
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<tr>
<td>ROE:</td>
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<tr>
<td>Outperform</td>
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<td>Higher Risk</td>
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<tr>
<td>FY P/E</td>
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<tr>
<td>2019A</td>
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<tr>
<td>2020E</td>
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<td>2021E</td>
<td>0.93A</td>
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Price Target ($):
- Q1: 38 (5/18/20)
- Q2: 0.31A
- Q3: 0.14A
- Q4: 0.93A

L-Term Rev. Gr Rate Est:
- 7%
- 12%

L-Term EPS Gr Rate Est:
- 30.5%

EPS (Net): EPS is Quanta’s Adjusted or "Cash" EPS

Company Description
Quanta Services provides specialized construction, maintenance and repair services for North American utility and industrial clients within the electric power and oil/gas pipeline industries. The company is the largest specialized US contractor in most of its end markets.

Revenue Profile

Source: Company reports (2019) and Baird estimates

Quick Summary
- Fundamentals remain better than most and recent execution has been good. Overall, 2020 should be a continuation of PWR’s transition to more base business and smaller project work, offering less risk. A few larger jobs will punctuate this outlook, primarily on the Electric side where large projects can span 2-3 years, offering better visibility. Offsetting, the Pipeline & Industrial business will face pressure, perhaps more-than-expected. Still, most work continues with COVID-related disruptions temporary, not structural.

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Recent results. PWR’s 1Q20 results largely met expectations but guidance suffered a severe toll primarily under the weight of mandated work stoppages, rather than fundamental issues. That’s not to say weak commodity prices were not a factor; they were, just not the most significant reason. This is important. Management still sees the potential for record backlog this year with larger electric projects on the horizon. Accordingly, while the oil bust keeps our 2021 estimates down, “new” issues are largely transitory, and PWR's larger electric business appears better insulated.

Investment Thesis
The call: A relatively better E&C opportunity. We continue to see PWR’s end markets as relatively more attractive than most in the E&C sector. We see improving margins, FCF, and a declining risk profile which is more recurring in nature, coupled with a strong backlog outlook and solid relative revenue growth (from a post-COVID perspective) against historically attractive valuation levels. Earnings visibility has improved with some large T&D wins and buyside sentiment remains modest. We’re cautious on the outlook for large-scale pipeline and some broader industrial markets but PWR's earnings are less dependent on it relative to peers.

Secular trends remain favorable in power delivery. Investment in U.S. electric transmission infrastructure has increased from < $10 billion per year a decade ago to just over $20 billion today, according to Edison Electric Institute. Coal/nuclear plant retirements, new gas-fired and renewable power generation assets and an aging power grid facing reliability concerns all support continued power delivery investment. In addition, a shortage of skilled craft labor should support continued utility worker outsourcing to contractors. Broadly, we view electric transmission as a preferred utility investment space, despite a potentially slower relative growth rate today (from previous years' robust pace).

North American pipeline construction opportunity remains robust with an improved permitting environment. We believe Quanta controls approximately 30% of North American capacity to build mainline oil, gas and NGL pipelines. Combined with broad geographic presence and a large skilled labor and equipment base, PWR remains well positioned for the ongoing build-out of North American energy infrastructure. Indeed, the INGAA Foundation (June 2018) forecasts $791 billion in North American oil and gas infrastructure investment through 2035 including the construction of over 41,000 miles of pipelines. Easing federal regulatory constraints are also additive today though local opposition still leaves the permitting environment volatile.

Risks & Caveats
Highly competitive industry. The specialized contracting services Quanta provides are highly competitive and Quanta competes with several national and local firms. Contracts are awarded (in part) on price, which may limit margin upside in the event of price competition. In addition, Quanta faces in-house competition from its utility customers themselves when they choose to manage and maintain their capital expansion needs in-house.

Economically sensitive market exposure. Demand for Quanta's services can be sensitive to economic conditions, including the health of the residential construction market, general credit conditions, and oil and natural gas price fluctuations.

Uncertainty associated with regulatory changes and weather. Regulatory permitting authority remains a subject of ongoing litigation, particularly at the local level where opposition has concentrated legal challenges. Additional regulatory changes from pending or future legislation could also impact/benefit Quanta.

 Acquisition integration risk. Quanta has historically pursued an aggressive acquisition strategy (>100 acquisitions since 1997), and we expect this trend to continue, including 2009's acquisition of Price Gregory (Pipelines), 2010's acquisition of Valard Construction (Electric), 2013's acquisitions of Nacap/PES (Pipelines) and the more recent large acquisitions of Stronghold (2017) and Hallen (2019). An acquisition strategy is not without risk, as the integration process can at times be costly and disruptive to the normal course of business operations.

Supplemental Information

<table>
<thead>
<tr>
<th>Quanta Services Valuation Chart</th>
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<tbody>
<tr>
<td><strong>1Q20 Multiples</strong></td>
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<tr>
<td>Historical Range (10-Year)</td>
</tr>
<tr>
<td>Historical Average (10-Year)</td>
</tr>
<tr>
<td>$38 Price Target Assumes:</td>
</tr>
</tbody>
</table>

*Source: Baird estimates*
Appendix - Important Disclosures and Analyst Certification

Approved on 18 May 2020 17:55EDT/ Published on 18 May 2020 18:00EDT.

Covered Companies Mentioned
All stock prices below are the 5/15/2020 closing price.

MYR Group Inc. (MYRG - $26.86 - Neutral)
MasTec, Inc. (MTZ - $36.64 - Outperform)
(See recent research reports for more information)
Quanta Services Inc.
May 18, 2020

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Quanta Services Inc.
May 18, 2020

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