MasTec, Inc. (MTZ)

Company Description
MasTec, based in South Florida, is a leading North American infrastructure construction company/specialty contractor with operations in the telecommunications (wireless, wireline/fiber and install-to-the-home), oil & gas (midstream infrastructure, petroleum/natural gas pipelines and pump facilities), and power (electrical transmission/distribution, wind power generation) markets. The company has consistently ranked among the top specialty contractors as measured by Engineering News-Record.

Revenue Profile

Company Description
MasTec competes with a number of public and privately-held contractors, depending on end market including Dycom (DY), Quanta Services (PWR), MYR Group (MYRG) and Primoris (PRIM), among others.

Quick Summary
- **Good optionality longer term, discounted valuation today.** MTZ's execution on what it can control remains top-notch and secular drivers behind most of its businesses keep us favorably disposed for the long term. Undoubtedly, Oil and Gas operations contain large uncertainty, which we believe is already well reflected in shares as expectations/estimates have fallen sharply. We like a modest degree of O&G optionality today combined with the company's exposure to 5G/telecom/wireless (all longer term secular drivers) underpinned by a company that generally executes well, the basis for our Outperform rating.
- **Recent earnings.** 1Q20 revenues were 9.6% better than consensus, Adjusted EBITDA was 10%, better leading to a 30% beat to Adjusted EPS. Backlog was a record, providing good visibility in uncertain times. However, guidance was cut on COVID-induced delays and softening O&G markets. Still, Oil and Gas accounted for most of the outperformance with impressive 20.7% segment

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margins. Communications revenues were 6% better than low expectations. T&D and Power Generation both had better-than-expected results.

Investment Thesis

The call: 5G opportunity, manageable pipeline risk. MTZ has executed well in the past few years against good underlying demand and with an improving capital investment backdrop in wireless and wireline communications (5G). That said, market factors aside, recent stock slide reflects investor concerns surrounding durability of Oil & Gas EBITDA contribution, by far largest source of recent years' profits. 2021 is the key question; however, we see good value, even under significant profit cut assumptions at fairly modest attributed multiples. Further, Communications profit ramp could be understated, as 5G investment nears. High short interest also a positive. Net, at <10x 2021 P/E, shares simply too cheap to ignore (market volatility provides opportunity), particularly for a quality contractor with historical good execution.

Secular growth opportunities. Long-term growth opportunity at MTZ is underpinned by increasing data demands, desire for faster/higher-bandwidth wired and wireless internet speed needs (5G deployment), an aging electric grid with increased reliability mandates, and North American energy supply chain (pipeline) bottlenecks. Thematically, MTZ shares should appeal to investors seeking exposure to these core themes, in our view.

Aggressive growth strategy with a history of end-market expansion through M&A. Since 2007, MTZ has diversified its end markets, with essentially all excess capital being deployed toward M&A. MasTec has quickly scaled new end markets, utilizing the company's balance sheet to leverage capable, but under-resourced core franchises. We expect M&A to remain a key growth tenet and a primary source of capital deployment in conjunction with share buybacks.

Risks & Caveats

Economically sensitive end-market exposure, high regulatory risk, competitive industry. Demand for MTZ's services is cyclical and can be impacted by macroeconomic conditions and fluctuations in commodity prices, regulation, customer access to capital and technological innovation. Economic downturns could reduce capital expenditures in the industries MasTec serves, resulting in less work. Further, MTZ operates in highly competitive industries with many good competitors.

Customer concentration magnifies risk or customer loss. Mastec derives a significant amount of revenue from a handful of large customers, with MasTec's top-10 customers accounting for >60% of revenue. A handful of individual companies often account for 25% or more of quarterly revenue, depending on project mix, including AT&T across multiple business lines. Customer concentration increases risk of individual customer capital budgets cuts.

Project risk/execution uncertainties. Like all E&C contractors, MasTec faces execution risk should the company fail to properly manage projects or face project delays, which could result in additional costs or claims to the company. While approximately 45% of contract work is generated under master service agreements with fixed unit terms, remaining operations are project-dependent, relying heavily on management forecasts and execution quality. Investor insight into individual bid terms is limited, which can also create volatility from external factors such as weather. 2015's earnings challenges exemplify this risk. Recently, bidding terms/conditions have improved, however.

Higher-than-average levels of leverage amplify financial risk. Cash flow in the E&C industry is volatile and MasTec carries leverage (1.6x TTM Adjusted EBITDA). Management has stated comfort with leverage levels in the 2.0-2.5x range, however, a level which we believe is somewhat high for risk profile.

Closely held company and poor governance. MasTec's founding family holds a ~30%+ equity stake in the company, two-thirds of which is disclosed to the public through the company's Chairman and CEO who are sons of the company's "founder." As such, the family maintains significant influence in the board room and with company strategy. A three-tiered staggered board is also notable, as are various related-party arrangements. The executive compensation package is opaque and heavily influenced by EBITDA growth without a balancing returns-focused metric.

Supplemental Information

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Source: Baird estimates
Appendix - Important Disclosures and Analyst Certification

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Rating and Price Target History for: MasTec, Inc. (MTZ) as of 05-21-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of MTZ.

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