



Mossberg's Investor Digest

Idea Profile

Quanta Services (NYSE: PWR)

DESCRIPTION:

Quanta Services is one of the largest contractors providing services for the electric power (60% of revenue), gas pipeline (16% of revenue), and cable and telecom industries (17% of revenue). With over 16,000 employees, Quanta designs, installs, maintains and repairs network infrastructure for the various industries it serves. The company is headquartered in Houston, Texas and has operations in all 50 states and Canada.

KEY INVESTMENT CONSIDERATIONS:

Due to its focus and size, Quanta is well positioned to benefit from attractive macro trends in all three of the company's major end markets.

Aging electric power grid – Half of the electric grid, or 1.1 million miles of it, was constructed between 1948 and 1970. With a 40 to 50 year useful life, a significant portion of the grid is due for replacement. Combined with the Federal Energy Act of 2005, which mandated reliability standards and promotes private investment, strong demand is expected for services to upgrade U.S. electric infrastructure. Based on analysts estimates, the average annual spending on the power grid for the next 12 years will increase by 80% to \$100 billion annually. In 2009, spending is expected to increase by more than 30%.

Strong competitive pressures among cable and telecom companies – As cable and telecom battle it out for control of voice, video and high speed data services to residential and enterprise customers, demand is increasing for network upgrades.

U.S. shale gas play drives need for transmission infrastructure – With the high price of gas and new drilling techniques, the U.S. shale gas play has emerged as a large source of new energy. There have been 19 geographic basins identified and there were more than 35,000 wells drilled last year. The current recoverable reserves are conservatively estimated at 500 to 1,000 trillion cubic feet, all of which will need infrastructure to be transport gas from the well site. Quanta is in good position to provide infrastructure services to natural gas fields, such as recent finds in the Barnett Shale in TX and the Haynesville Shale in LA.

Large backlog gives visibility – Quanta is continuing to add to its backlog number, growing the total number 10% during the first quarter. Quanta's backlog at the end of the 1Q08 was \$5.1 billion, with \$2.4 billion expected to be recognized during the next 12 months.

KEY RISKS:

Quanta has made several acquisitions since its inception and states that acquisitions are part of the growth strategy going forward. Integrating operations, employees, and cultures is difficult and could cause significant disruption.

CATALYSTS:

Wind Power – Increased environmental scrutiny and the increasing costs of fossil fuels are creating a demand for wind-based power generation. However, to make wind power a viable alternative, there has to be infrastructure that can connect wind farms in remote areas to the power grid. Building this type of infrastructure is Quanta's main business, and they are well positioned to win a significant portion of the contracts when they are awarded. One of the largest new projects is T. Boone Pickens' Mesa Energy, which plans to install 2,000 wind turbines over the next 6 years. Last Thursday, the Texas Public Utility Commission gave preliminary approval to a \$4.9 billion plan to build new transmission lines and Quanta could win a significant portion of this business.

VALUATION:

With a current valuation of 39x EPS, the stock does not appear cheap. However, it appears that Quanta is at the early stages of an upturn in the cycle for infrastructure spending. At the peak of past cycles it generated as much as 14% operating income margin, more than twice the 6.5% operating margin it is currently generating and the 9% to 12% margin it is currently comfortable with forecasting. Applying a modest 15% top line growth to this year's forecasted number and using the 12% to 14% peak operating margin, the company could make as much as \$2.40 to \$2.80 per share in the next three years, which makes the current valuation much more attractive.

(NYSE: PWR)	
Investment Data (as of 7/25/08)	
Recent Price	\$31.16
52-Week Range	18.38 - 34.53
Fiscal Year End	Dec
Dividend	NA
Yield	NA
Shares Outstanding	172.4 MM
Average Trading Volume (3 mos)	2.4 MM
Market Capitalization	5.4 B
Cash	372.2 MM
Long Term Debt	414.5 MM
Enterprise Value (EV)	5.6 B
LT Debt/ Equity	0.19
Tangible BV/ Share	\$4.1
TTM Revenue	2.9 B
P/ Revenue	1.8x
TTM EPS	0.79
P/ EPS	39.5x
TTM EBITDA	281.2 MM
EV/ TTM EBITDA	18.7x

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