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Siena Market Line
3rd week of April 2016

Dycom Industries, Inc.

DY

Analyst: Nicolas Morand
Sector: Industrial Goods

BUY on DY

Price Target: $80.00

Key Statistics as of 04/15/16

Market Price:	$67.13
Industry:	Heavy Construction
Market Cap:	$2.208 B
52-Week Range:	$45.45 - $90.82
Beta:	1.02

Thesis Points:

- Strong financial results for Q2 2016
- Large telecom provider's need to improve their network
- Increase in both backlog and CapEx

Company Description:

Dycom Industries provides specialty contracting services to both the infrastructure and the telecommunications industry. These services includes engineering, construction, maintenance and installation services to telecommunication providers, underground facility locating and electric and gas utilities services with its business primarily done in the U.S and Canada.

Thesis

Dycom has recorded its best second quarter and its fifth best quarter in its history. The company EPS has doubled since Q1 and the firm has liquidity over $309 million and cash on hand that will probably be used to continue the firm's share buyback program of $100 million. Telephone companies are increasing investment in their infrastructure network such as fiber so as to offer 1-gigabit high speed connection in the U.S. The firm is expected a strong demand from its key customers and has already increase investment in CapEx so as to handle this increase in demand. The firm's backlog has increased over $1 billion compare to Q1 to $5.05 billion in Q2, which reflects the strong performance of the firm and the future new work planned.

Industry Outlook

Nowadays, the telecom sector is gathering momentum and is expected to remain at the epicenter for growth and innovation. Telecom companies are spending a lot of capital so as to connect more people into their networks. In average, US consumers look at their connected devices around 8 billion times a day according to the Global Mobile Consumer Survey. The number of connected devices continues to grow, the internet of thing is expected to become a strong market and leading telecommunication companies are looking for new opportunity to grow their revenues by increasing their network connectivity. This internet of things business will consist of connected cars, connected houses and rapidly, many sectors such as manufacturing, hospitality, retail, utilities and others will be contributors of this market development. Smart cities will also help telecommunications companies to find opportunity for growth, as cities are using more and more connected devices to manage lighting, video security and asset monitoring. Government is already aware of it and many telecommunications companies are upgrading their infrastructure network so as to boost internet speed in in rural cities many times faster than what was previously allowed by the law. The internet of things will be achievable only through the improvement of the telecommunication sector. More speed, less latency and greater efficiency are an absolute requirement to support connected things such as smart cars. The current technology does not allow this expansion yet, which is why many telecommunications companies are upgraded their infrastructure network so as to be more efficient.

Porter's Five Forces

<u>Bargaining power of suppliers:</u> **LOW**

There is a low bargaining power of suppliers. There are many suppliers that can provide raw materials needed to the manufacturing process of fiber optic and coaxial cables. In addition, Dycom's operating subsidiaries include suppliers that decrease the overall bargaining power of suppliers.

<u>Bargaining power of customers</u>: **HIGH**

The bargaining power of customers is relatively high for Dycom as the firm's top five largest customer made approximately 69% of the firm's revenue. These clients includes AT&T, CenturyLink, Verizon, Comcast and one anonymous company. Strategic moves from these customers to do business with a competitor could harm Dycom business, however, the firm has strong relationships with its clients that are more and more investing in the fiber network.

<u>Threat of substitutes:</u> **LOW**

Dycom provides a wide panel of services including Engineering, construction, maintenance, installation, electric and gas utility and other services which protect them from any new substitute on the market. Besides, for the telecommunications services, Dycom provides the cables needed for the telecom companies, provides civil and tower construction for wireless carriers but also plans out the route, gets permits and does the installation on sites. It brings a whole expertise that cannot be easily replace.

<u>Existing rivalry:</u> **High**

The intensity of existing rivalry is high as Dycom five biggest customers do have teams that can contract services provided by Dycom. The firm can handle the entire process for telecommunications infrastructure from installation to maintenance. Dycom can only differentiate itself through effectiveness.

Barriers to Entry: **Low**

There is very low barriers to enter this industry. As many competitive industry, the main characteristic required to build and maintain a long-term relationship with customers is efficiency. If a fresh company appeared to be more efficient than Dycom, we might expect its customers to require its competitors' services.

Product Portfolio

Dycom provides services to telecom providers, underground facility locating and electric utilities and others. The telecommunication segment represents 90% of the total revenue for the year 2015 and is composing of several services. The first service provided by Dycom is the engineering service. The firm's engineer are designing various fiber optic and coaxial cable to expand infrastructure from business to consumer home. Concerning telephone companies, Dycom is designing terminals, both aerial and buried drops, central office equipment, transmission and fiber cable needed to their infrastructure expansion. For the cable television companies, Dycom is providing make-ready studies, field walk-out strand mapping, the frequency design of computer-aided radio and fiber cable needed to their network. These companies have an increasing desire to invest in new technologies which will allow them to deliver high-speed data so as to gain more customers. Upgrading infrastructure network is a requirement for telecommunication providers to achieve their growth expansion. Then, Dycom is providing maintenance and installation services. This consists of the installation of fiber optic cable on sites. The firm is digging the trenches in which it will place the cables from cable operator facilities to consumer home. Then Dycom is managing the maintenance of these facilities. It connects, deploys new networks and maintain existing network for both cable television and telephone companies. Another services offer to various companies and local government is the premise wiring service. This consists of the installation, repair, maintenance and upgrade of the telecommunication infrastructure. The second segment of Dycom operations, which accounts for 6.2% of the firm's total revenue is the utility line locating. Its underground facility locating services, provided to various utility company include the cable television, power, water, sewer, locating telephone and gas line for those utility companies.

Finally, the last segment of the firm's operations, which account for the remaining 3.8% of revenues is electric utilities and other services. Under this segment, the firm is installing and maintaining underground power distribution lines. The firm is combining project and joint trenches so as to install both electrical and telecommunication equipment. On different trenches, Dycom is also using its knowledge and technology to installs underground gas distribution systems for local states.

Strong Financial Performance and Management

Dycom's stock price has been hammered. The stock peaked early in December at $90 per share and was trading just under $50 per share in the middle of January because of both slightly missed earnings and a drop in the market. Indeed, because of the slowdown in China and the energy crisis, January has been a terrible month for the stock market where major Indexes recorded the worth month in years. During Q2 2016, Dycom managed to record revenues at $559.5 million, an increase of 26.8% year over year where 19.4% is organic growth. This is mostly driven by a strong growth from key customers. Indeed, There is an increasing demand for 1-gigabit wireline networks from key customers, as a number of industry participant are upgrading their network and are deploying both fiber to the home and node technologies, so as to offer a high speed connection for individual consumers. Dycom's top five customers are producing 68.9% of the firm's total revenues and are growing organically. Dycom manage to profit from this growth in revenue to increase its EPS. In only two quarter, the firm managed to double its EPS from $0.27 to $0.54. This represents the best second quarter of the company and their fifth best quarter in history. If we take a look at the company's backlog, we can see a positive sign that we are not expecting to see any decline in revenues. Indeed, since the first quarter of 2016, the company's backlog increased by $1.09 billion, proving that its customers continue to plan aggressive initiative for the coming years. The firm's backlog was $5.056 billion for Q2 compared to $3.967 for the previous quarter. Out of this backlog, management is expected to see almost $2 billion to be completed in the next 12 months. This backlog analysis reflects the firm's ability to book new orders and to maintain existing work. This creates an opportunity for the firm to gain some market shares, to expand its geographic reach and to grow accordingly. In addition, the firm managed to decrease operating costs, improving its margins. The firm's EBITDA increased by 39.5% from $47.6 million in Q1 2016 to $66.4 million in Q2 of the same year. Over the same time slot, revenues increased by 26.8%, proving the management ability to reduce operating costs and creating value to the company. Another value creation ratio to look at is the ROIC/WACC ratio. As you can see on the summary output at the end of the paper, we currently have a ratio of 1.51, meaning that the firm is currently creating value. During Q2, CapEx net of disposals, which is one of the driver of the stock price, represented $48.7 million. Thanks to the extension of tax regulation, the firm has been able to generate important cash tax savings for 2016 related to CapEx which will improve their operating cash flow. Dycom has managed to increase its investment in CapEx to $147 million. The firm is counting on the investments of its assets to contribute to higher operating levels that are represented in their increasing backlog of $5 billion. Management plan to continue to invest in its assets up to $175 million for the year 2016. On the debt side, Dycom has no significant debt maturing in the next coming years. Senior credit facility are maturing in 2020 as well as the firm's 0.75% coupon convertible notes where its aggregate principal represents $485 million. This allows the firm to have $309 million of liquidity and cash on hand. Management will probably use this cash on hand to continue their share buyback program. The Board of Directors gave the authorization to increase this share buyback program from $50 to $100 million, which clearly demonstrate that the firm believes its current stock price is undervalued. Furthermore, as illustrate the fundamentals graph below, we can see that Dycom is doing better than its major competitors and the construction and engineering sub industry.

Fundamentals	CY 2014 12/31/2014	CY 2015 12/31/2015	Current 04/16/2016
Gross Margin	11.19	10.57	10.51
Dycom Industries Inc	18.58	21.22	21.75
MasTec Inc	13.74	11.57	11.57
Primoris Services Corp	11.31	11.40	11.40
EMCOR Group Inc	14.12	14.06	14.06
Tetra Tech Inc	15.19	18.37	18.22
Operating Margin	5.22	3.83	3.59
Dycom Industries Inc	4.52	7.63	8.74
MasTec Inc	5.23	-0.65	-0.65
Primoris Services Corp	4.98	3.51	3.51
EMCOR Group Inc	4.51	4.27	4.27
Tetra Tech Inc	8.27	5.10	4.93
Profit Margin	2.71	2.71	2.59
Dycom Industries Inc	2.21	4.17	4.38
MasTec Inc	2.51	-1.88	-1.88
Primoris Services Corp	3.03	1.91	1.91
EMCOR Group Inc	2.63	2.56	2.56
Tetra Tech Inc	5.82	2.27	2.16
Return on Assets	5.07	4.74	4.52
Dycom Industries Inc	3.38	6.56	7.44
MasTec Inc	3.57	-2.43	-2.43
Primoris Services Corp	5.88	3.31	3.31
EMCOR Group Inc	4.92	4.97	4.97
Tetra Tech Inc	6.06	2.34	2.28
Return on Equity	9.26	9.08	8.60
Dycom Industries Inc	8.75	17.00	18.78
MasTec Inc	10.73	-7.59	-7.59
Primoris Services Corp	14.84	7.87	7.87
EMCOR Group Inc	11.70	11.91	11.91
Tetra Tech Inc	10.77	4.18	3.99

Dycom is outperforming both the industry and its competitors in terms of gross margin, operating margins, profit margins, return on assets and return on equity proving the quality of the management in place.

Valuation

The valuation of Dycom is based on a pro forma that values the firm with a discounted cash flow and focuses on the company's return on invested capital. A summary of the outputs used for this valuation can be found at the end of this paper. Revenue growth are computed to follow analysts' estimate and converging to 3% in the long-term, which is the long-term T-note rate. A country weighted average risk premium has been calculated at 6.00%, because Dycom activities are located in both the U.S with 99.4% of its business and Canada with 0.6% of its business. The corporate tax rate has been calculated at 39.91% using the same method. Other variables used for the valuation, can be found in the summary output at the end of the paper. After launching a Monte-Carlo simulation, I calculated an intrinsic value for the stock at $69.59, a one-year target price of

$80.00 (a 18.06% increase compare to its current price) and a 86.6% probability of a stock price increase.

Conclusion

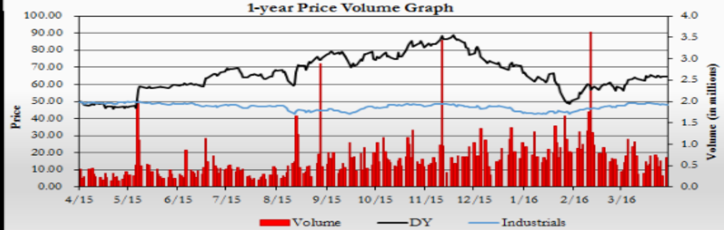
Finally, thanks to both its strong backlog and its recent financial performance, I do believe that the firm has the potential to grow organically, creating value for the company. They are expected strong demand from several large customer, which are all growing organically as well. The firm is investing in CapEx so as to handle this increase in demand, it managed to decrease operating costs and margins are improving overtime. Macroeconomic conditions appear favorable to Dycom as long as the firm keeps its strong relationship with key customers. Management, through its share repurchase program believes its stock is currently undervalued as well. I do believe that the upside potential for this company is greater than the downside, which is why I recommend a buy at its current level of $67.7.

Siena Market Line
3rd week of April 2016

Dycom Industries Inc. (DY) — **CENTER FOR GLOBAL FINANCIAL STUDIES** — **NEUTRAL**

Analysis by Nicolas Morand	Current Price: $67.76	Intrinsic Value $69.59	Target 1 year Return: 18.06%
4/16/2016	Divident Yield: 0.0%	Target Price $80.00	Probability of Price Increase: 86.6%

1-year Price Volume Graph



Description

Dycom Industries, Inc. provides specialty contracting services in the United States and Canada.

General Information

Sector	Industrials
Industry	Construction and Engineering
Last Guidance	November 3, 2015
Next earnings date	May 13, 2016
Estimated Country Risk Premium	6.00%
Effective Tax rate	40%
Effective Operating Tax rate	32%

Market Data

Market Capitalization	$2,228.97
Daily volume (mil)	0.40
Shares outstanding (mil)	32.90
Diluted shares outstanding (mil)	34.32
% shares held by institutions	78%
% shares held by investments Managers	71%
% shares held by hedge funds	17%
% shares held by insiders	4.30%
Short interest	15.06%
Days to cover short interest	5.92
52 week high	$90.82
52-week low	$45.45
Levered Beta	1.25
Volatility	42.47%

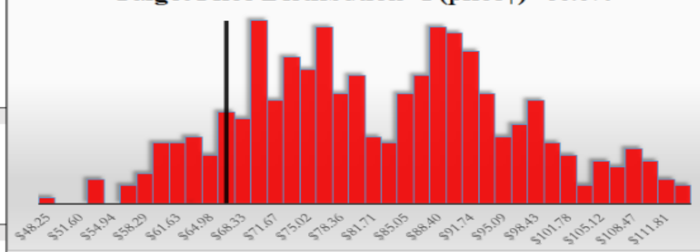
Past Earning Surprises

Quarter ending	Revenue	EBITDA
1/24/2015	3.73%	10.14%
4/25/2015	3.66%	7.84%
7/25/2015	1.49%	3.26%
10/24/2015	4.60%	5.14%
1/23/2016	1.91%	-10.16%
Mean	3.08%	3.24%
Standard error	0.6%	3.5%

Peers

MasTec, Inc.
Primoris Services Corporation
Granite Construction Incorporated
EMCOR Group Inc.
Tetra Tech, Inc.
KBR, Inc.
MYR Group, Inc.
Jacobs Engineering Group Inc.

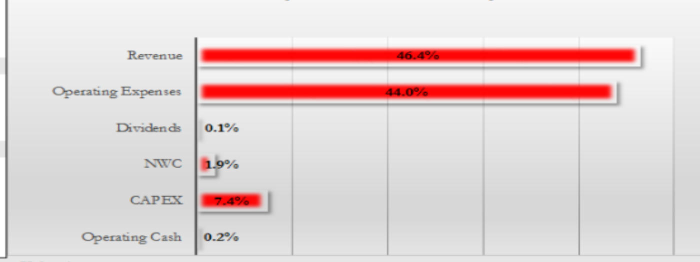
Target Price Distribution--P(price↑)=86.6%



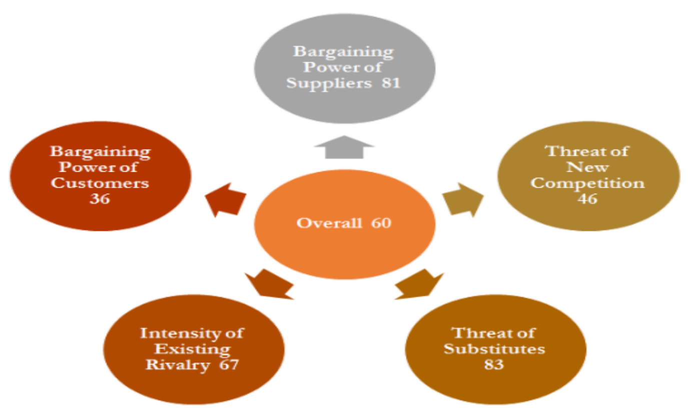
Management	Position	Total compensations growth	Total return to shareholders
Nielsen, Steven	Chairman, Chief Executive Of	18.64% per annum over 5y	15.31% per annum over 5y
DeFerrari, H.	Chief Financial Officer, Sen	18.15% per annum over 5y	15.31% per annum over 5y
Estes, Timothy	Chief Operating Officer and	16.5% per annum over 5y	15.31% per annum over 5y
Vilsoet, Richard	Vice President, General Coun	12.36% per annum over 5y	15.31% per annum over 5y
Dickens, Kimberly	Chief Human Resources Office	N/M	0% per annum over 0y
Roach, Rebecca	Chief Accounting Officer and	N/M	N/M

Profitability	DY (LTM)	DY (5 years historical average)	Industry (LTM)
ROIC	14.0%	10.90%	8.02%
NOPAT Margin	9%	5.91%	2.7%
Revenue/Invested Capital	1.55	1.85	2.97
ROE	18.1%	14.74%	8.56%
Adjusted net margin	8%	4.86%	2.6%
Revenue/Adjusted Book Value	2.27	3.03	3.28
Invested Funds	**DY (LTM)**	**DY (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	1.2%	2.1%	22%
Estimated Operating Cash/Total Capital	1.2%	1.6%	N/A
Non-cash working Capital/Total Capital	32.5%	30.3%	16%
Invested Capital/Total Capital	99.8%	99.5%	74%
Capital Structure	**DY (LTM)**	**DY (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.43	0.58	0.13
Cost of Existing Debt	4.96%	6.29%	6.41%
Estimated Cost of new Borrowing	3.37%	3.77%	6.41%
CGFS Risk Rating	BBB	BB	A
Unlevered Beta (LTM)	1.02	1.26	1.22
WACC	9.30%	10.81%	10.83%

Sensitivity Attribution Analysis



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	23.1%	9.0%	1.51
1/23/2017	17.1%	6.6%	1.16
1/23/2018	9.9%	7.0%	1.19
1/23/2019	13.0%	7.4%	1.25
1/23/2020	11.7%	7.7%	1.30
1/23/2021	10.5%	7.9%	1.33
1/23/2022	9.2%	8.2%	1.35
1/23/2023	8.0%	8.4%	1.37
1/23/2024	6.7%	8.6%	1.39
1/23/2025	5.5%	8.8%	1.40
1/23/2026	4.2%	9.0%	1.41
Continuing Period	3.0%	9.2%	1.43

Period	Invested Capital	Net Claims	Price per share
Base Year	$705.24	$954.82	$67.73
1/23/2017	$762.02	$980.92	$77.04
1/23/2018	$1,138.94	$1,018.76	$86.77
1/23/2019	$1,322.23	$1,023.48	$97.48
1/23/2020	$1,473.41	$1,018.53	$109.16
1/23/2021	$1,687.96	$965.13	$121.86
1/23/2022	$1,913.60	$821.57	$136.84
1/23/2023	$2,163.44	$671.88	$151.42
1/23/2024	$2,419.05	$465.12	$166.86
1/23/2025	$2,704.79	$197.13	$183.09
1/23/2026	$2,979.99	-$134.48	$199.98
Continuing Period			