Paul Martinez

Bjorklund Fund

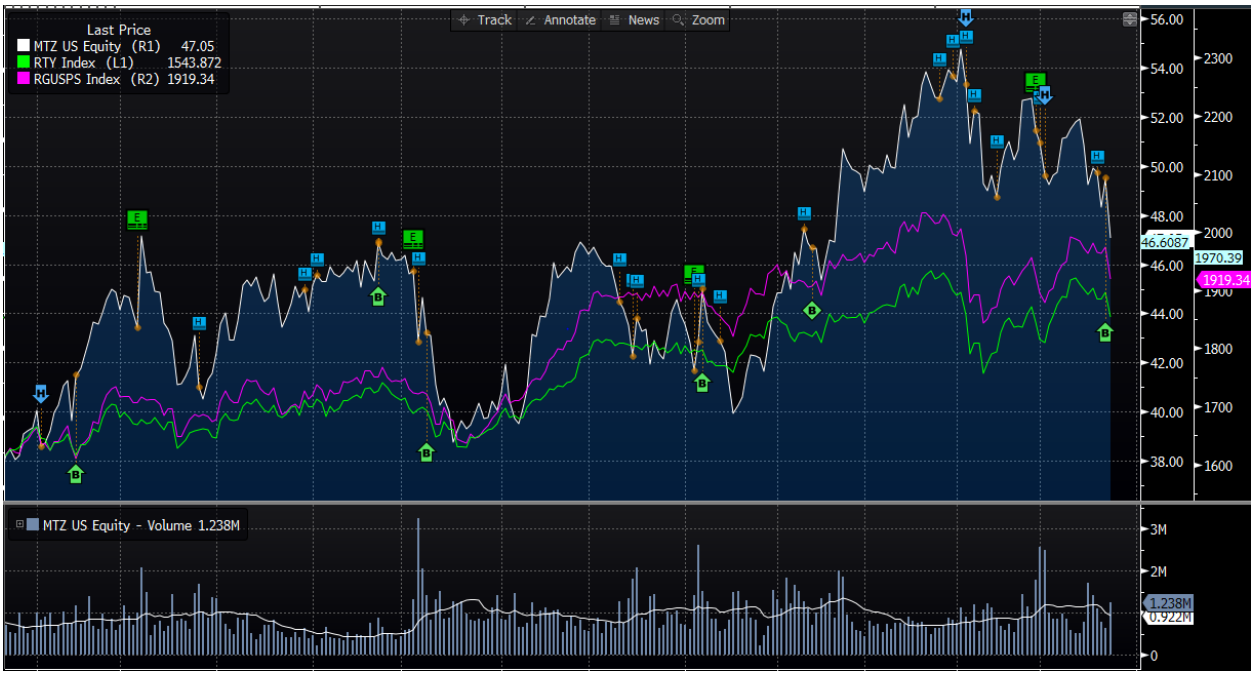
March 22, 2018

MasTec, Inc (MTZ)

SUMMARY: Buy MasTec, Inc (MTZ) at its current price of $45.95. I believe that there is a possible 1Y bullish return of close to 50% and a realistic return of approximately 35% with target prices of ~71 and ~63 respectively.

BRIEF DESCRIPTION: MasTec is a leading infrastructure construction company operating primarily throughout North America. Operations include the engineering, building, installation, maintenance and upgrade of:

- Wireless, Wireline (Fiber), install-to-the-home and customer fulfillment
- Petroleum and natural gas pipelines and facilities
- Electrical transmission and distribution
- Power generation and industrial



1. **Record breaking Backlog Revenues in three out of five segments:**
    a. Communications Segment – $3.6 Billion for 18 month period
    b. Oil & Gas Segment – $2.5 Billion for 18 month period
        i. Reflecting multi-year projects
    c. Power Generation Segment – $577 Million for 18 month period
        i. Reflecting increases in renewable energy, overall demand, and biomass facility construction
    d. With this backlog revenue alone, MasTec will beat their guidance on annual revenue for 2018
2. **Margin Improvement:**
    a. From 2016 to 2017, MasTec has been able to improve EBITDA margins in every single segment of their business
        i. Communications (37% of Revenue) – EBITDA margins at *11.2%* from approximately 7%
        ii. Oil & Gas (53% of Revenue) – EBITDA margins at 11.5% projected to grow to *13%* in 2018 (Q4 Guidance)
        iii. Electrical Transmission (6% of Revenue) – EBITDA margins at *4.8%* from -9%
        iv. Power Generation (5% of Revenue) – EBITDA margins at *7.5%* which was "much improved" per MasTec's last earnings call
        v. Industrial (Not Material) – Sometimes categorized with Power Generation
    b. Projected overall EBITDA margins for 2018 to be approximately *10.2%*
3. **Macro Growth Opportunities:**
    a. Strong Oil & Gas markets
    b. Communications opportunities with Fiber and Wireless convergence
    c. Electrical transmission improvements
    d. Strong benefits from Trump Administration and recent policies

I believe that MasTec (MTZ) has positioned themselves correctly in the industry and has set themselves up for another record-breaking year in 2018. The increase in YoY revenue growth, macro growth as a whole, and increasing margins will result in value creation and continue to drive stock price. Historically, MTZ has exceeded their guidance and we can expect them to outperform throughout 2018 as well.

INVESTMENT THESIS:

1. **Backlog Revenues**

Although Backlog is not a term recognized under GAAP, it is a very common measurement in the industry and majority of companies report it. Backlog represents the amount of revenue that the company is expected to realize over the next 18 months from future work, contracts, and including new contracts.

Backlog Revenue by Segment				
	2014	2015	2016	2017
Communications	2965	3138	2824	3628
Oil & Gas	756	2006	2223	2525
Electrical Transmission	296	252	268	354
Power Generation	298	265	246	577
Industrial and Other	31	13	6	3
Total (In Millions)	4346	5674	5567	7087
Growth		31%	-2%	27%

The Communication segment has record-breaking 3.6 Billion in backlog revenue, this revenue compromises primarily from Master Service Agreements (MSAs) and long-term contracts with Energy Transfer Affiliates, and AT&T, which make up 40% and 25% of revenue respectively. With the expansion of 5G, 2018 and 2019 backlog revenues are expected to increase in both size and scope. This has already been noticeable through the increase in wireless backlogs toward the end of 2017. The Oil & Gas segment is also at a record-breaking 2.5 Billion in backlog revenue. This segment has room to grow with much of these revenues coming from multi-year projects, and the improving commodity price environment overall. Finally, the Power Generation segment which at EoY was at 577 million in backlog revenues. These backlog revenues more than doubled YoY because of an increase in renewable energy, high demand, and the biomass facility construction. Management is very bullish on this segment and believes that this segment will be a significant driver of growth and performance for the coming years (Q4 Earnings Call).

2. Margin Improvement

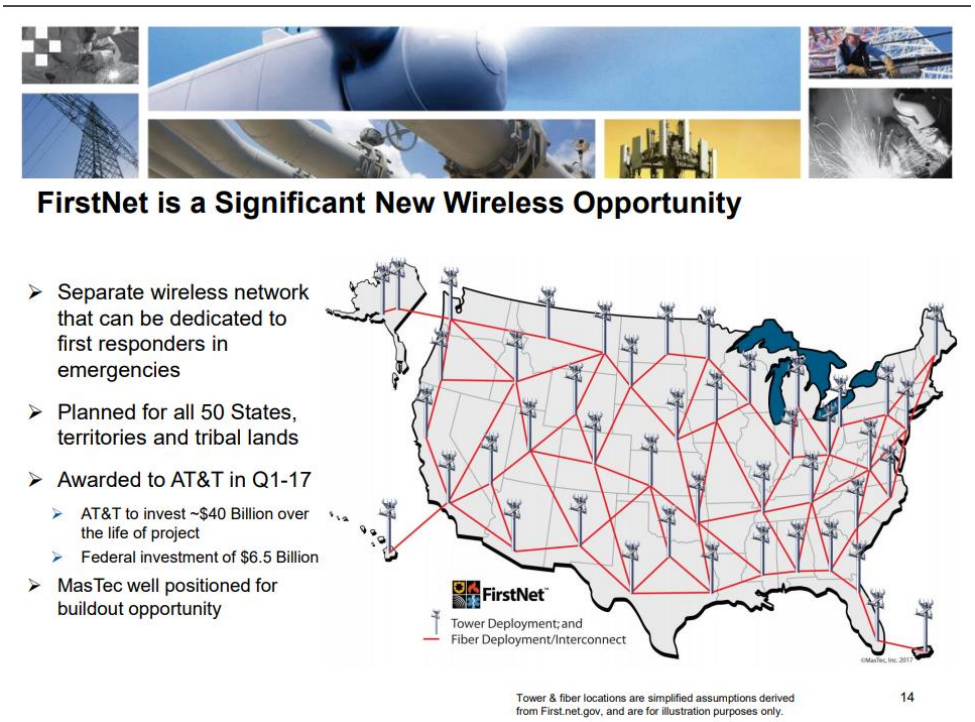
Historically, MasTec has fallen behind some of their major competitors in terms of margins. However, as of recent MTZ has consistently prove themselves as being the industry leader. Over the LTM, MasTec has been able to beat their competitors in terms of EBITDA margins as well as Net Income margins. As mentioned above, MasTec has seen expansion of EBITDA margins in every segment, which is leading to overall value creation. Looking into their margins further, MasTec has the largest margins in their largest segments (Communications and Oil & Gas). As you can see below, MasTec on a cash basis is beating their major competitors, such as Dycom Industries (DY) and Quanta Services (PWR). With this being said, MasTec's margins are only going to increase as they are going to be seeing benefits from the new corporate tax laws. Previously, MTZ was paying an effective tax rate of close to 39% and in their last earnings call, said they expect an effective tax rate of 29% through 2018. Management gave guidance of approximately a 10% (GAAP) EBITDA margin throughout 2018, however, I believe that this margin will be closer to the ~11% (GAAP) range. This would lead to an EBITDA of approximately 743.16 M compared to guidance, which was stated at 678.5 M. I believe that this is more than a reasonable estimate being that in the last 6 quarters, MTZ has beaten guidance with flying colors.

COMMON SIZE VIEW				
	6-year Historical Median		Last 12 Months	
	MTZ	Competitors	MTZ	Competitors
COR/Rev	86.7%	88.7%	87.0%	89.7%
(SGA+Other)/Rev	4.8%	5.8%	2.9%	5.8%
DPR/Rev	3.5%		2.5%	0.0%
EBITA Margin	5.0%	5.4%	7.6%	4.4%
Interest exp/Rev	2.2%	0.7%	2.6%	0.9%
AMORT/Rev	0.5%		0.3%	0.0%
SBC/REV	0.2%		0.2%	0.0%
Other Non-Operating Exp/Rev	-1.3%	-1.3%	-2.0%	-1.3%
Taxes/Rev	0.7%	0.7%	1.4%	0.5%
Net Margin	2.7%	5.2%	5.1%	4.3%

3. Growth Opportunities

Management stated in their last earnings call that "Our revenue growth for 2018 is expected to come from our Communications, Transmission and Power Generation segments". With this being said, MasTec has is in the perfect position to take advantages of macro factors and other growth opportunities.

- Communications Segment
  - FirstNet Opportunity – Separate wireless network that can be dedicated to first responders in emergencies. Planned to be integrated into all 50 states.
    - AT&T project expected to invest over $40 billion throughout the life of project
    - AT&T makes up approximately 25% of MasTec's total revenues
  - Estimated 47% CAGR of Mobile Data Traffic through 2021 this would result in a higher demand for wireless services, which MasTec is a leader in.
- Electrical Transmission Segment
  - Rebounding segment
  - Improving bidding environment with new & larger project awards, benefitting 2018 and beyond.
  - Continued interest in renewable power generation and use of electric vehicles provide additional opportunities for grid infrastructure expansion.
- Power Generation Segment
  - Proven top tier contractor in wind farm construction services, including civil, electrical substation and transmission line integration
  - Wind Operations and Maintenance (O&M) is a fast growing market due to aging wind assets.



OWNERSHIP SUMMARY

Primarily Investment Advisor's own MTZ and have been increasing their positions over the last year. A notable aspect to MTZ is the large interest by Hedge Fund Managers. The short interest would seem relatively high at approximately 12.25%, however, this is because of the shares outstanding compared to the float. Short interest is more accurately below 10%, with DTC of approximately 6.5 days. This goes to show that many Hedge Fund Managers believe that this company is going to grow significantly within the year. With this being said, CEO and Chairman, Jose R. Mas owns approximately 12.6% of shares outstanding. Some may see this as a red flag, however, I believe that Jose is going to continue to want to drive stock price seeing that he owns a significant amount of the company.

Compare Current Stats Against 03/18/17

Ownership Type	03/12/17	Curr ↓	Change
11) Investment Advisor	60.72	62.26	+1.54
12) Individual	20.53	17.69	-2.84
13) Hedge Fund Manager	14.67	14.72	+0.05
14) Pension Fund	1.62	2.08	+0.46
15) Bank	0.75	1.53	+0.78
16) Insurance Company	0.40	0.54	+0.14
17) Sovereign Wealth Fund	0.90	0.43	-0.47
18) Brokerage	0.20	0.37	+0.17
19) Endowment		0.19	
20) Government	0.14	0.13	-0.01
21) Holding Company	0.05	0.04	-0.01

OTHER INFORMATION:

- Historically Q1 is worst performing quarter, with Q2 and Q3 being their best.
- Cisco predicts global network traffic to increase nearly threefold over the next five years, with a CAGR of approx. 25%, and broadband connection speeds will nearly double by 2021.
- "MasTec benefits greatly from tax cuts and jobs acts" – Q4 Earnings Call
- "Our expectation is that 2018 will be a record year for MasTec from a cash flow from operations perspective." - CEO

VALUATION:

I believe that MasTec is currently mispriced at its current value of ~46 dollars. This could be reflected in the DCF model below.

DCF	2017	2018E	2019	2020	2021	2022		
	0	1	2	3	4	5		
NOPAT	373.17016	416.558136	510.8044143	530.6690304	612.4544927	661.4508521		
D&A(+)	$ 188.00	$ 220.01	$ 199.85	$ 219.83	$ 287.54	$ 310.54		
Change In W/C (-)	$(397.70)	$ (64.00)	$ (95.94)	$ (225.22)	$ (255.27)	$ (188.85)		
CAPEX(-)	$(123.40)	$ (146.68)	$ (199.85)	$ (219.83)	$ (239.61)	$ (258.78)		
FCF	$ 40.07	$ 425.90	$ 414.87	$ 305.45	$ 405.11	$ 524.36	Ke	10.100%
Discounted FCF		$ 392.95	$ 353.16	$ 239.90	$ 293.56	$ 350.58	Equity Risk Premium	6%
Terminal Value						$ 8,376.98	Kd	4.10%
Discounted TV						$ 5,600.75		
Value of Company						$ 7,230.91	WACC	8.4%
Cash(+)						$ 40.30		
Debt(-)						$ 1,368.60		
IV of Equity						$ 5,902.61		
S/O						82.8		
IV/Share						$ 71.29		
WACC	8.4%							
Terminal Growth Rate	2%							

I believe that these assumptions and mispricing is due to a couple of factors that I have adjusted into my model.

- Underestimates of revenue and EBITDA - Analysts are predicting mid to high single digits, however, MTZ has outperformed past their guidance historically and I believe revenue growth and resulting EBITDA growth of low double digits (11%)
- Company/Analysts Overestimating WACC
    - Bloomberg states WACC to be 10.5% for MTZ by using an equity risk premium of around 9%.
    - With this being said MTZ conducts business in the United States and Canada and should have a more realistic equity risk premium of approximately 6%.

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FCF	$ 40.07	$ 425.90	$ 414.87	$ 305.45	$ 405.11	$ 524.36
Discounted FCF		$ 384.96	$ 338.94	$ 225.56	$ 270.40	$ 316.35
Terminal Value						$ 6,194.15
Discounted TV						$ 3,737.01
Value of Company						$ 5,273.22
Cash(+)						$ 40.30
Debt(-)						$ 1,368.60
IV of Equity						$ 3,944.92
S/O						82.8
IV/Share						$ 47.64
WACC	10.6%					
Terminal Growth Rate	2%					

Ke	13.100%
Equity Risk Premium	9%
Kd	4.10%
WACC	10.6%

As you can see, with a WACC around the same as reported, I was able to get stock price within a dollar of current value, however, I believe that in reality a more realistic WACC for the firm would be within 8.5%-9.5% range.

My Estimates		
WACC	Stock Price	
8.50%	$	71.29
9.00%	$	63.30
9.5%	$	57.78
10.00%	$	52.96