DeMatteo Research

IDEA NOTE

Michael Zhuang ▪ (212) 833-9920 ▪ mzhuang@dmllc.com

DY

S SHORT

Dycom Industries Inc

Industrial/Transportation

02/20/2018

PRESENTED			CURRENT			
DATE		02/15/2018	PRICE	$75.02	MARKET CAP	$2.34B
PRICE $115.28	MARKET CAP $3.68B	ENT VALUE $3.60B	Image type unknown Chart https://portal.dmllc.com/storage/ideas/Chart/a08A000001E5wOuIAJ.jpg			
P/E RATIO 27.19x	BOOK VALUE $22.29	DIV YIELD 0%				
SHARES O/S 31.89M	AVE DAILY VOL 609,494	SHORT INT 20.42%				

Dycom Industries, Inc. provides specialty contracting services throughout the United States and in Canada. The company's services include engineering, construction, maintenance and installation services to telecommunications providers, underground facility locating services to various utilities, including other construction and maintenance services to electric and gas utilities, and others. It also provides placement and splicing of fiber, copper, and coaxial cables. The company was founded in 1969 and is headquartered in Palm Beach Gardens, FL.

Publicly traded companies mentioned herein: AT&T Inc (T), Centurylink Inc (CTL), Dycom Industries Inc (DY), Quanta Services Inc (PWR), Verizon Communications Inc (VZ)

Highlights

The presenter is short shares of Dycom (DY), on the belief that DY's ability to benefit from the telecom/5G capex cycle is more limited than the market perceives. Major telecom customers have been cutting capex, but DY's current valuation has not reflected these cuts. Despite DY's strong EBITDA growth, cash flows have remained challenged. As such, the presenter thinks DY's current EBITDA multiple valuation is inflated and sees downside in DY shares as multiples return to historic levels.

- DY is levered entirely to telecom, and the stock has been buoyed by excitement around the 5G transition, specifically the FirstNet emergency responder network. DY is the market share leader at 13%, but the market is very fragmented. AT&T is DY's largest customer, representing over 25% of DY's business, and the top 5 customers combine for over 75% of DY's overall revenue.

- The presenter notes that AT&T's capex declined by more than 20% last year, which has negatively impacted DY, causing some misses and guidance cuts. DY pre-announced earnings for fiscal Q2 2018 on February 12, 2018, coming in lower than expected and also cutting future guidance. The presenter states expectations were for flat-to-up revenue growth, but DY is instead guiding towards mid- to high-single digit declines, and 11% EBITDA margins versus expectations of 13%. However, DY shares have not seen a corresponding impact, which the presenter attributes to investors believing in upside from the 5G build-out, which would presumably entail a cyclical spending ramp.

- However, the presenter is skeptical of DY's ability to realize benefit from this 5G cycle, build-out of which has taken longer than expected and could continue to see deferrals. In addition, there are some competitive pressures that would limit DY's upside.
    - DY acquired Quanta Services' telecom infrastructure businesses in December 2012, which included a non-compete clause.

  - That non-compete lapsed a little under a year ago, and the presenter states Quanta has been actively looking to re-enter the space. Quanta has built up over $600m of backlog within two quarters, placing Quanta at 5% of DY. He notes that the barrier to entry in the space is low, especially for an experienced operator with historical expertise, and thinks Quanta could take the business to well over $1B over the next two years. He believes DY will see some combination of pricing pressure and share loss from Quanta's activities.

  - Customer capex has consistently surprised on the downside, both on an absolute basis and with deferrals, and the presenter thinks the situation will be the same for this 5G cycle. As aforementioned, AT&T and other customers had a big step-down in capex last year. Verizon, another top 5 customer, is pursuing a "One Fiber" strategy that will be more piecemeal and spread out over many years, instead of one massive ramp as DY would've liked.

  - Though some customers, like CenturyLink and AT&T, are growing capex in the low- to mid-teens this year, it will be off a lower base due to the cuts last year.

- Over the course of ~2010 – 2016, DY generated minimal cash flow, ramping to $100m in 2016. The presenter models "minimal" additional cash flow over the course of 2017, and expects full-year results to once again come in at around the ~$100m level.

  - Though DSOs appear flat on a reported basis, when AT&T impact is adjusted, DSOs have gone up significantly, per the presenter's calculations.

  - Unbilled revenue has climbed from low-40% of revenue to the mid-50% range.

- During past "telecom bubble years" over the course of 2007 – 2014, DY generated ~$100m - $150m of EBITDA per year, and ~$440m in 2017 as 3G and 4G led to a "massive" ramp. Though EBITDA is expected to improve to ~$500m in 2018, the presenter states cash flow remains challenged since the 5G ramp is not coming as quickly as expected. In addition, he expects EBITDA to retreat from $500m down to $400m or lower by 2020.

- The presenter views most of the 5G cycle as baked into results and expectations, while the reality is that spending is coming in both slower and lower than hoped for. He believes as the challenged cash flow realities become more apparent, DY shares will trade back down to historical multiples of ~7x EBITDA during peak years, from over 9x today.

For questions regarding DeMatteo Research Events and Services, please contact:

Hans Noering, Co-Director of Research, 212-833-9932, hnoering@dmllc.com

Important Disclosures

This summary has been prepared by DeMatteo Research LLC ("DeMatteo" or the "Firm"). The Firm sponsors events featuring institutional investors ("Presenters"). The opinions, estimates, projections, and views contained in this summary are those of, and exclusively sourced from, the Presenters and may differ from those of the Firm. While the Firm attempts to summarize accurately the comments of the Presenters, the summary is not endorsed by the Presenters.

This summary is provided for information purposes only and does not constitute an invitation or offer to subscribe to or purchase or sell any of the products or services mentioned. It is intended for institutional investors only and should not be forwarded to third parties. Securities, financial instruments or strategies discussed herein may not be suitable for all investors. The opinions and views expressed in this summary do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments, or strategies to particular clients. DeMatteo is not, by making this summary available, providing investment, legal, tax, financial, or accounting advice to the recipient of this summary or any other party. DeMatteo is not acting as an advisor or fiduciary to any client in connection with providing this summary. Past performance is not indicative of future results. This summary has been prepared based on information, including market prices, data and other information, obtained from sources believed to be reliable; but DeMatteo does not warrant its completeness or accuracy. The Firm makes no representation or warranty, express or implied, in respect thereof, and accepts no liability whatsoever for any loss arising from any use of or reliance on this summary or its contents. Information, estimates, assumptions, and/or opinions expressed herein are made as of the date of the Guest Speaker's presentation and are subject to change without notice. DeMatteo assumes no obligation to maintain or update this summary based on subsequent information and events. Further information on any of the securities mentioned in this report may be obtained upon request.

Analysts are compensated through a base salary and an annual bonus. The amount of an analyst's annual bonus is related, among other factors, to the Firm's overall revenues and profitability, and is not tied to any level of investment banking or other similar business in which the Firm engages. Neither the Firm nor any affiliate, in the aggregate, beneficially own 1% or more of any class of common equity securities issued by any company discussed in the report.

- Analysts are compensated through a base salary and an annual bonus. The amount of an analyst's annual bonus is related, among other factors, to the Firm's overall revenues and profitability, and is not tied to any level of investment banking or other similar business in which the Firm engages. Neither the Firm nor any affiliate, in the aggregate, beneficially own 1% or more of any class of common equity securities issued by any company discussed in the report.
- The Firm, the analyst involved in the preparation of this report, and members of the analyst's household do not have a financial interest in securities of any company discussed in the report.
- As of the end of the month immediately preceding the issuance of this Research Report (or the end of the second most recent month if publication date is less than 30 calendar days after the end of the most recent month), no analyst involved in the preparation of this report has received compensation from any company discussed in this report or knows of any other actual, report conflict of interest regarding this report.
- Neither the Firm nor any affiliate has received compensation for investment banking services from any company discussed in the report in the last twelve (12) months.
- Neither the Firm nor its affiliates expect to receive or intend to seek compensation for investment banking services from any company discussed in the report in the next three (3) months.
- No company discussed in the report is, or during the 12-month period preceding the date of distribution of the report, was, a client of the Firm.
- No director, officer or employee of the Firm is a director of any company in which the Firm provides research coverage.
- No analyst involved in the preparation of this report or any member of the analyst's household serves as an officer, director or advisory board member of any company discussed in the report.

- The Firm does not act as a market maker in the securities of any company discussed in the report.
- Neither the firm nor any of its affiliates managed or co-managed a public offering of the securities for the subject company in the past 12 months.
- No analyst received any compensation from the subject company in the previous 12 months.

REG. AC Certification

The opinions, views and / or analyses of the companies and / or industries contained in this document generally consist of a summary of a presentation made by one or more securities professionals at an event sponsored by DeMatteo Research LLC ("DeMatteo") and are not typically the views or opinions of the individual at DeMatteo responsible for the preparation of this document. Where any views or opinions expressed in this document are attributed to the individual responsible for the preparation of this document, then such views or opinions accurately reflect the personal views of the author of this document regarding the subject securities and / or issuers.

No part of the compensation of the individual responsible for the preparation of this report was, is or will be directly or indirectly related to the specific recommendations or views contained in this document.