QUANTA SERVICES INC
Form 10-Q
August 08, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2012

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to .

Commission file no. 001-13831

Quanta Services, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**74-2851603**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2800 Post Oak Boulevard, Suite 2600

Houston, Texas 77056

(Address of principal executive offices, including zip code)

(713) 629-7600

(Registrant s telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

As of July 31, 2012, the number of outstanding shares of Common Stock of the Registrant was 209,214,607. As of the same date, 3,909,110 Exchangeable Shares and one share of Series F Preferred Stock were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements.***

QUANTA SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share information)

(Unaudited)

	June 30, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 172,868	$ 315,349
Accounts receivable, net of allowances of $5,034 and $3,763	1,138,720	1,066,273
Costs and estimated earnings in excess of billings on uncompleted contracts	352,857	206,159
Inventories	57,649	71,416
Prepaid expenses and other current assets	102,407	105,957
Total current assets	1,824,501	1,765,154
Property and equipment, net of accumulated depreciation of $563,860 and $519,808	1,016,737	971,696
Other assets, net	185,084	153,830
Other intangible assets, net of accumulated amortization of $183,145 and $164,401	206,019	207,224
Goodwill	1,664,962	1,601,210
Total assets	$ 4,897,303	$ 4,699,114
LIABILITIES AND EQUITY		
Current Liabilities:		
Notes payable	$ 33	$ 56
Accounts payable and accrued expenses	635,469	618,925
Billings in excess of costs and estimated earnings on uncompleted contracts	148,469	162,095
Total current liabilities	783,971	781,076
Long-term debt	39,000	
Deferred income taxes	242,226	233,644
Insurance and other non-current liabilities	285,952	295,131
Total liabilities	1,351,149	1,309,851
Commitments and Contingencies		
Equity:		
Common stock, $.00001 par value, 600,000,000 shares authorized, 220,775,240 and 217,479,462 shares issued, and 209,211,829 and 206,203,005 shares outstanding	2	2
Exchangeable Shares, no par value, 3,909,110 shares authorized, issued and outstanding		
Series F Preferred Stock, $.00001 par value, 1 share authorized, issued and outstanding		
Additional paid-in capital	3,268,915	3,216,206
Retained earnings	472,772	361,527
Accumulated other comprehensive income (loss)	(2,522)	710

Treasury stock, 11,563,411 and 11,276,457 common shares, at cost	(202,633)	(196,493)
Total stockholders equity	3,536,534	3,381,952
Noncontrolling interests	9,620	7,311
Total equity	3,546,154	3,389,263
Total liabilities and equity	$ 4,897,303	$ 4,699,114

The accompanying notes are an integral part of these condensed consolidated financial statements.

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QUANTA SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share information)

(Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Revenues	$ 1,516,696	$ 1,010,914	$ 2,941,873	$ 1,859,873
Cost of services (including depreciation)	1,281,289	856,824	2,510,951	1,634,892
Gross profit	235,407	154,090	430,922	224,981
Selling, general and administrative expenses	114,711	89,489	221,357	181,030
Amortization of intangible assets	9,549	6,871	18,943	13,137
Operating income	111,147	57,730	190,622	30,814
Interest expense	(959)	(255)	(1,543)	(510)
Interest income	387	249	795	535
Other income (expense), net	(310)	199	(145)	134
Income before income taxes	110,265	57,923	189,729	30,973
Provision for income taxes	40,468	23,610	69,938	12,965
Net income	69,797	34,313	119,791	18,008
Less: Net income attributable to noncontrolling interests	4,259	2,512	8,546	3,801
Net income attributable to common stock	$ 65,538	$ 31,801	$ 111,245	$ 14,207
Earnings per share attributable to common stock:				
Basic earnings per share	$ 0.31	$ 0.15	$ 0.52	$ 0.07
Diluted earnings per share	$ 0.31	$ 0.15	$ 0.52	$ 0.07
Shares used in computing earnings per share:				
Weighted average basic shares outstanding	212,987	214,827	212,244	214,670
Weighted average diluted shares outstanding	213,087	215,023	212,342	215,606

The accompanying notes are an integral part of these condensed consolidated financial statements.

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QUANTA SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	$ 69,797	$ 34,313	$ 119,791	$ 18,008
Other comprehensive income (loss), net of tax benefit (provision):				
Foreign currency translation adjustment, net of tax of $0, $0, $0 and $0	(14,560)	(2,183)	(3,242)	8,995
Other, net of tax of $1, $0, $2 and $0	5		10	
Other comprehensive income (loss)	(14,555)	(2,183)	(3,232)	8,995
Comprehensive income	55,242	32,130	116,559	27,003
Less: Comprehensive income attributable to noncontrolling interests	4,259	2,512	8,546	3,801
Total comprehensive income attributable to Quanta shareholders	$ 50,983	$ 29,618	$ 108,013	$ 23,202

The accompanying notes are an integral part of these condensed consolidated financial statements.

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QUANTA SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Cash Flows from Operating Activities:				
Net income	$ 69,797	$ 34,313	$ 119,791	$ 18,008
Adjustments to reconcile net income to net cash provided by operating activities				
Depreciation	31,036	29,168	61,643	57,364
Amortization of intangible assets	9,549	6,871	18,943	13,137
Amortization of debt issuance costs	227	119	450	237
Amortization of deferred revenues	(2,554)	(2,898)	(5,140)	(5,848)
Gain on sale of property and equipment	(584)	(58)	(605)	(66)
Foreign currency (gain) loss	647	(54)	374	201
Provision for doubtful accounts	623	403	2,359	836
Deferred income tax (benefit) provision	1,298	(1,391)	2,919	10,092
Non-cash stock-based compensation	8,094	5,953	14,575	11,494
Tax impact of stock-based equity awards	2,868	484	(42)	(1,530)
Changes in operating assets and liabilities, net of non-cash transactions				
(Increase) decrease in				
Accounts and notes receivable	(19,489)	(45,435)	(45,415)	(55,284)
Costs and estimated earnings in excess of billings on uncompleted contracts	(44,292)	1,501	(144,488)	26,910
Inventories	14,435	(9,150)	15,800	(10,295)
Prepaid expenses and other current assets	(571)	10,575	5,715	(25,472)
Increase (decrease) in				
Accounts payable and accrued expenses and other non-current liabilities	47,733	22,242	(2,328)	5,081
Billings in excess of costs and estimated earnings on uncompleted contracts	(33,144)	5,721	(15,979)	9,258
Other, net	626	(2,206)	(2,491)	(2,153)
Net cash provided by operating activities	86,299	56,158	26,081	51,970
Cash Flows from Investing Activities:				
Proceeds from sale of property and equipment	6,256	1,390	7,455	4,583
Additions of property and equipment	(49,975)	(52,204)	(85,319)	(89,692)
Cash paid for acquisitions, net of cash acquired	(26,823)		(68,727)	
Payments to acquire equity method investment	(48,844)	(35,000)	(53,750)	(35,000)
Net cash used in investing activities	(119,386)	(85,814)	(200,341)	(120,109)
Cash Flows from Financing Activities:				
Borrowings under credit facility	349,620		349,620	
Payments under credit facility	(310,620)		(310,620)	
Proceeds from other long-term debt		2,231		4,025
Payments on other long-term debt	(33)	(2,185)	(33)	(4,176)
Distributions to noncontrolling interests	(3,747)	(471)	(6,237)	(471)
Tax impact of stock-based equity awards	(2,868)	(484)	42	1,530
Exercise of stock options	445	(12)	924	495
Repurchase of common stock		(94,466)		(94,466)
Net cash provided by (used in) financing activities	32,797	(95,387)	33,696	(93,063)
Effect of foreign exchange rate changes on cash and cash equivalents	(4,209)	2,406	(1,917)	2,363

Net decrease in cash and cash equivalents	(4,499)	(122,637)	(142,481)	(158,839)
Cash and cash equivalents, beginning of period	177,367	503,019	315,349	539,221
Cash and cash equivalents, end of period	$ 172,868	$ 380,382	$ 172,868	$ 380,382
Supplemental disclosure of cash flow information:				
Cash (paid) received during the period for				
Interest paid	$ (424)	$ (189)	$ (780)	$ (326)
Income taxes paid	$ (23,330)	$ (3,235)	$ (70,924)	$ (6,010)
Income tax refunds	$ 988	$ 2,614	$ 2,293	$ 2,789

The accompanying notes are an integral part of these condensed consolidated financial statements.

QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BUSINESS AND ORGANIZATION:

Quanta Services, Inc. (Quanta) is a leading provider of specialized contracting services, offering infrastructure solutions to the electric power, natural gas and oil pipeline and telecommunications industries throughout North America and in select international markets. Quanta reports its results under four reportable segments: (1) Electric Power Infrastructure Services, (2) Natural Gas and Pipeline Infrastructure Services, (3) Telecommunications Infrastructure Services and (4) Fiber Optic Licensing.

Electric Power Infrastructure Services Segment

The Electric Power Infrastructure Services segment provides comprehensive network solutions to customers in the electric power industry. Services performed by the Electric Power Infrastructure Services segment generally include the design, installation, upgrade, repair and maintenance of electric power transmission and distribution networks and substation facilities along with other engineering and technical services. This segment also provides emergency restoration services, including the repair of infrastructure damaged by inclement weather, the energized installation, maintenance and upgrade of electric power infrastructure utilizing unique bare hand and hot stick methods and Quanta s proprietary robotic arm technologies, and the installation of smart grid technologies on electric power networks. In addition, this segment designs, installs and maintains renewable energy generation facilities, in particular solar and wind, and related switchyards and transmission networks. To a lesser extent, this segment provides services such as the design, installation, maintenance and repair of commercial and industrial wiring, installation of traffic networks and the installation of cable and control systems for light rail lines.

Natural Gas and Pipeline Infrastructure Services Segment

The Natural Gas and Pipeline Infrastructure Services segment provides comprehensive network solutions to customers involved in the transportation of natural gas, oil and other pipeline products. Services performed by the Natural Gas and Pipeline Infrastructure Services segment generally include the design, installation, repair and maintenance of pipeline transmission and distribution systems, gathering systems and compressor and pump stations, as well as related trenching, directional boring and automatic welding services. In addition, this segment s services include pipeline protection, integrity testing, rehabilitation and replacement, and fabrication of pipeline support systems and related structures and facilities. To a lesser extent, this segment designs, installs and maintains airport fueling systems as well as water and sewer infrastructure.

Telecommunications Infrastructure Services Segment

The Telecommunications Infrastructure Services segment provides comprehensive network solutions to customers in the wireline and wireless telecommunications industry and the cable television industry. Services performed by the Telecommunications Infrastructure Services segment generally include the design, installation, repair and maintenance of fiber optic, copper and coaxial cable networks used for video, data and voice transmission, as well as the design, installation and upgrade of wireless communications networks, including towers, switching systems and backhaul links from wireless systems to voice, data and video networks. This segment also provides emergency restoration services, including the repair of telecommunications infrastructure damaged by inclement weather. To a lesser extent, services provided under this segment include cable locating, splicing and testing of fiber optic networks and residential installation of fiber optic cabling.

Fiber Optic Licensing Segment

The Fiber Optic Licensing segment designs, procures, constructs, maintains and owns fiber optic telecommunications infrastructure in select markets and licenses the right to use these point-to-point fiber optic

QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (*Continued*)

telecommunications facilities to its customers pursuant to licensing agreements, typically with terms from five to twenty-five years, inclusive of certain renewal options. Under those agreements, customers are provided the right to use a portion of the capacity of a fiber optic network, with the network owned and maintained by Quanta. The Fiber Optic Licensing segment provides services to enterprise, education, carrier, financial services and healthcare customers, as well as other entities with high bandwidth telecommunication needs. The telecommunication services provided through this segment are subject to regulation by the Federal Communications Commission and certain state public utility commissions.

Acquisitions

During the second quarter of 2012, Quanta completed the acquisition of an electrical power infrastructure services company with operations primarily in the Southeastern United States. During the first quarter of 2012, Quanta completed three business acquisitions, which included an electric power infrastructure services company and a natural gas and pipeline infrastructure services company based in the United States and an electric power infrastructure services company based in Canada. The results of these acquisitions have been included in the condensed consolidated financial statements as of their respective acquisition dates.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation

The consolidated financial statements of Quanta include the accounts of Quanta Services, Inc. and its wholly owned subsidiaries, which are also referred to as its operating units. The consolidated financial statements also include the accounts of certain of Quanta s investments in joint ventures, which are either consolidated or proportionately consolidated, as discussed in the following summary of significant accounting policies. Investments in affiliated entities in which Quanta does not have a controlling financial interest, but over which Quanta has significant influence, usually because Quanta holds a voting interest of 20% to 50%, are accounted for using the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation. Unless the context requires otherwise, references to Quanta include Quanta and its consolidated subsidiaries.

Interim Condensed Consolidated Financial Information

These unaudited condensed consolidated financial statements have been prepared pursuant to the rules of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures, normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted pursuant to those rules and regulations. Quanta believes that the disclosures made are adequate to make the information presented not misleading. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the financial position, results of operations, comprehensive income and cash flows with respect to the interim consolidated financial statements have been included. The results of operations and comprehensive income for the interim periods are not necessarily indicative of the results for the entire fiscal year. The results of Quanta have historically been subject to significant seasonal fluctuations.

Quanta recommends that these unaudited condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto of Quanta and its subsidiaries included in Quanta s Annual Report on Form 10-K for the year ended December 31, 2011, which was filed with the SEC on February 29, 2012.

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QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (*Continued*)

Use of Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions by management in determining the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities known to exist as of the date the financial statements are published and the reported amount of revenues and expenses recognized during the periods presented. Quanta reviews all significant estimates affecting its consolidated financial statements on a recurring basis and records the effect of any necessary adjustments prior to their publication. Judgments and estimates are based on Quanta s beliefs and assumptions derived from information available at the time such judgments and estimates are made. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of financial statements. Estimates are primarily used in Quanta s assessment of the allowance for doubtful accounts, valuation of inventory, useful lives of assets, fair value assumptions in analyzing goodwill, other intangibles and long-lived asset impairments, equity investments, loan receivables, purchase price allocations, liabilities for self-insured and other claims, multi-employer pension plan withdrawal liabilities, revenue recognition for construction contracts and fiber optic licensing, share-based compensation, operating results of reportable segments, provision (benefit) for income taxes and the calculation of uncertain tax positions.

Reclassifications

Certain reclassifications have been made in prior year s segment disclosures to conform to classifications used in the current year.

Cash and Cash Equivalents

Quanta had cash and cash equivalents of $172.9 million and $315.3 million as of June 30, 2012 and December 31, 2011. Cash consisting of interest-bearing demand deposits is carried at cost, which approximates fair value. Quanta considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents, which are carried at fair value. At June 30, 2012 and December 31, 2011, cash equivalents were $71.2 million and $165.9 million, which consisted primarily of money market mutual funds and investment grade commercial paper and are discussed further in *Fair Value Measurements* below. As of June 30, 2012 and December 31, 2011, cash and cash equivalents held in domestic bank accounts were approximately $28.7 million and $230.9 million, and cash and cash equivalents held in foreign bank accounts were approximately $144.2 million and $84.4 million.

Current and Long-term Accounts and Notes Receivable and Allowance for Doubtful Accounts

Quanta provides an allowance for doubtful accounts when collection of an account or note receivable is considered doubtful, and receivables are written off against the allowance when deemed uncollectible. Inherent in the assessment of the allowance for doubtful accounts are certain judgments and estimates including, among others, the customer s access to capital, the customer s willingness or ability to pay, general economic and market conditions and the ongoing relationship with the customer. Quanta considers accounts receivable delinquent after 30 days but does not generally include delinquent accounts in its analysis of the allowance for doubtful accounts unless the accounts receivable have been outstanding for at least 90 days. In addition to balances that have been outstanding for 90 days or more, Quanta also includes accounts receivable balances that relate to customers in bankruptcy or with other known difficulties in its analysis of the allowance for doubtful accounts. Under certain circumstances such as foreclosures or negotiated settlements, Quanta may take title to the underlying assets in lieu of cash in settlement of receivables. Material changes in Quanta s customers business or cash flows, which may be impacted by negative economic and market conditions, could affect its ability to collect amounts due from them. As of June 30, 2012 and December 31, 2011, Quanta had total

QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (*Continued*)

allowances for doubtful accounts of approximately $5.0 million and $3.8 million, all of which were included as a reduction of net current accounts receivable. Should customers experience financial difficulties or file for bankruptcy, or should anticipated recoveries relating to receivables in existing bankruptcies or other workout situations fail to materialize, Quanta could experience reduced cash flows and losses in excess of current allowances provided.

The balances billed but not paid by customers pursuant to retainage provisions in certain contracts are generally due upon completion of the contracts and acceptance by the customer. Based on Quanta s experience with similar contracts in recent years, the majority of the retainage balances at each balance sheet date are expected to be collected within the next twelve months. Current retainage balances as of June 30, 2012 and December 31, 2011 were approximately $166.0 million and $117.1 million and are included in accounts receivable. Retainage balances with settlement dates beyond the next twelve months are included in other assets, net, and as of June 30, 2012 and December 31, 2011 were $17.3 million and $28.3 million.

Within accounts receivable, Quanta recognizes unbilled receivables in circumstances such as when: revenues have been earned and recorded but the amount cannot be billed under the terms of the contract until a later date; costs have been incurred but are yet to be billed under cost-reimbursement type contracts; or amounts arise from routine lags in billing (for example, work completed one month but not billed until the next month). These balances do not include revenues accrued for work performed under fixed-price contracts as these amounts are recorded as costs and estimated earnings in excess of billings on uncompleted contracts. At June 30, 2012 and December 31, 2011, the balances of unbilled receivables included in accounts receivable were approximately $162.5 million and $140.8 million.

Goodwill and Other Intangibles

Quanta has recorded goodwill in connection with its acquisitions. Goodwill is subject to an annual assessment for impairment, which Quanta performs at the operating unit level. Each of Quanta s operating units is organized into one of three internal divisions, which are closely aligned with Quanta s reportable segments, based on the predominant type of work performed by the operating unit at the point in time the divisional designation is made. Because separate measures of assets and cash flows are not produced or utilized by management to evaluate segment performance, Quanta s impairment assessments of its goodwill do not include any consideration of assets and cash flows by reportable segment. As a result, Quanta has determined that its individual operating units represent its reporting units for the purpose of assessing goodwill impairments.

As further discussed in Note 3, Quanta adopted an update issued by the Financial Accounting Standards Board (FASB), which gives entities the option to first assess qualitative factors to determine whether it is necessary to perform the two-step fair value-based impairment test described below. If an entity believes that, as a result of its qualitative assessment, it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. An entity can choose to perform the qualitative assessment on none, some or all of its reporting units. An entity can also bypass the qualitative assessment for any reporting unit in any period and proceed directly to step one of the impairment test, and then resume performing the qualitative assessment in any subsequent period. This update also includes new qualitative indicators that replaced those previously used to determine whether an annual or interim goodwill impairment test is required to be performed. For instance, deterioration in macroeconomic conditions, declining financial performance, or a sustained decrease in share price, among other things, may trigger the need for annual or interim impairment testing of goodwill associated with one or all of its reporting units.

Quanta s goodwill impairment assessment is performed at year-end, or more frequently if events or circumstances arise which indicate that goodwill may be impaired. For instance, a decrease in Quanta s market

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QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (*Continued*)

capitalization below book value, a significant change in business climate or loss of a significant customer, as well as the qualitative indicators referenced above, may trigger the need for interim impairment testing of goodwill for one or all of its reporting units. The first step of the two-step fair value-based test involves comparing the fair value of each of Quanta s reporting units with its carrying value, including goodwill. If the carrying value of the reporting unit exceeds its fair value, the second step is performed. The second step compares the carrying amount of the reporting unit s goodwill to the implied fair value of its goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss would be recorded as a reduction to goodwill with a corresponding charge to operating expense.

Quanta determines the fair value of its reporting units using a weighted combination of the discounted cash flow, market multiple and market capitalization valuation approaches, with heavier weighting on the discounted cash flow method, as in management s opinion, this method currently results in the most accurate calculation of a reporting unit s fair value. Determining the fair value of a reporting unit requires judgment and the use of significant estimates and assumptions. Such estimates and assumptions include revenue growth rates, operating margins, discount rates, weighted average costs of capital and future market conditions, among others. Quanta believes the estimates and assumptions used in its impairment assessments are reasonable and based on available market information, but variations in any of the assumptions could result in materially different calculations of fair value and determinations of whether or not an impairment is indicated.

Under the discounted cash flow method, Quanta determines fair value based on the estimated future cash flows of each reporting unit, discounted to present value using risk-adjusted industry discount rates, which reflect the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn. Cash flow projections are derived from budgeted amounts and operating forecasts (typically a two-year model) plus an estimate of later period cash flows, all of which are evaluated by management. Subsequent period cash flows are developed for each reporting unit using growth rates that management believes are reasonably likely to occur, along with a terminal value derived from the reporting unit s earnings before interest, taxes, depreciation and amortization (EBITDA). The EBITDA multiples for each reporting unit are based on trailing twelve-month comparable industry data.

Under the market multiple and market capitalization approaches, Quanta determines the estimated fair value of each of its reporting units by applying transaction multiples to each reporting unit s projected EBITDA and then averaging that estimate with similar historical calculations using either a one, two or three year average. For the market capitalization approach, Quanta adds a reasonable control premium, which is estimated as the premium that would be received in a sale of the reporting unit in an orderly transaction between market participants.

For recently acquired reporting units, a step one impairment test may indicate an implied fair value that is substantially similar to the reporting unit s carrying value. Such similarities in value are generally an indication that management s estimates of future cash flows associated with the recently acquired reporting unit remain relatively consistent with the assumptions that were used to derive its initial fair value. During the fourth quarter of 2011, a goodwill impairment analysis was performed for each of Quanta s reporting units, which indicated that the implied fair value of each of Quanta s reporting units was substantially in excess of its carrying value other than those recently acquired reporting units. Following the analysis, management concluded that no impairment was indicated at any reporting unit. As discussed generally above, when evaluating the 2011 step one impairment test results, management considered many factors in determining whether or not an impairment of goodwill for any reporting unit was reasonably likely to occur in future periods, including future market conditions and the economic environment in which Quanta s reporting units were operating. Additionally, management considered the sensitivity of its fair value estimates to changes in certain valuation assumptions and after giving consideration to at least a 10% decrease in the fair value of each of Quanta s reporting units, the

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QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (*Continued*)

results of the assessment at December 31, 2011 did not change. However, circumstances such as market declines, unfavorable economic conditions, the loss of a major customer or other factors could impact the valuation of goodwill in future periods.

Quanta s intangible assets include customer relationships, backlog, trade names, non-compete agreements, patented rights and developed technology, all subject to amortization, along with other intangible assets not subject to amortization. The value of customer relationships is estimated as of the date a business is acquired using the value-in-use concept utilizing the income approach, specifically the excess earnings method. The excess earnings analysis consists of discounting to present value the projected cash flows attributable to the customer relationships, with consideration given to customer contract renewals, the importance or lack thereof of existing customer relationships to Quanta s business plan, income taxes and required rates of return. Quanta values backlog for acquired businesses as of the acquisition date based upon the contractual nature of the backlog within each service line, using the income approach to discount back to present value the cash flows attributable to the backlog. The value of trade names is estimated using the relief-from-royalty method of the income approach. This approach is based on the assumption that in lieu of ownership, a company would be willing to pay a royalty in order to exploit the related benefits of this intangible asset.

Quanta amortizes intangible assets based upon the estimated consumption of the economic benefits of each intangible asset, or on a straight-line basis if the pattern of economic benefits consumption cannot otherwise be reliably estimated. Intangible assets subject to amortization are reviewed for impairment and are tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For instance, a significant change in business climate or a loss of a significant customer, among other things, may trigger the need for interim impairment testing of intangible assets. An impairment loss would be recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value.

Investments in Affiliates and Other Entities

In the normal course of business, Quanta enters into various types of investment arrangements, each having unique terms and conditions. These investments may include equity interests held by Quanta in business entities, including general or limited partnerships, contractual joint ventures, or other forms of equity participation. These investments may also include Quanta s participation in different finance structures such as the extension of loans to project specific entities, the acquisition of convertible notes issued by project specific entities, or other strategic financing arrangements. Quanta determines whether such investments involve a variable interest entity (VIE) based on the characteristics of the subject entity. If the entity is determined to be a VIE, then management determines if Quanta is the primary beneficiary of the entity and whether or not consolidation of the VIE is required. The primary beneficiary consolidating the VIE must normally meet both of the following characteristics: (i) the power to direct the activities of a VIE that most significantly affect the VIE s economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE, in either case that could potentially be significant to the VIE. When Quanta is deemed to be the primary beneficiary, the VIE is consolidated and the other party s equity interest in the VIE is accounted for as a noncontrolling interest. In cases where Quanta determines that it has an undivided interest in the assets, liabilities, revenues and profits of an unincorporated VIE (e.g., a general partnership interest), such amounts are consolidated on a basis proportional to Quanta s ownership interest in the unincorporated entity.

Investments in minority interests in entities of which Quanta is not the primary beneficiary, but over which Quanta has the ability to exercise significant influence, are accounted for using the equity method of accounting. Quanta s share of net income or losses from unconsolidated equity investments is included in other income (expense) in the condensed consolidated statements of operations. Equity investments are reviewed for impairment by assessing whether any decline in the fair value of the investment below the carrying value is other

QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (*Continued*)

than temporary. In making this determination, factors such as the ability to recover the carrying amount of the investment and the inability of the investee to sustain an earnings capacity are evaluated in determining whether a loss in value should be recognized. Any impairment losses would be recognized in other expense. Equity method investments are carried at original cost and are included in other assets, net in the condensed consolidated balance sheet and are adjusted for Quanta s proportionate share of the investees income, losses and distributions.

On June 22, 2011, Quanta acquired an equity ownership interest of approximately 39% in Howard Midstream Energy Partners, LLC (HEP) for an initial capital contribution of $35.0 million. HEP is engaged in the business of owning, operating and constructing midstream plant and pipeline assets in the natural gas and oil industry. HEP commenced operations in June 2011 with the acquisitions of Texas Pipeline LLC, a pipeline operator in the Eagle Ford shale region of South Texas, and Bottom Line Services, LLC, a construction services company. Quanta contributed an additional $4.9 million to HEP in March 2012 toward the acquisition of 45,435 Class D units of HEP and contributed the remaining $47.4 million in April 2012 to complete the transaction. HEP used the proceeds of Quanta s investment, together with capital contributed by other third party investors, to purchase additional pipeline assets in the Eagle Ford shale region. As a result of this transaction and the other third party investments in HEP, Quanta s total equity ownership interest in HEP decreased from approximately 39% at March 31, 2012 to approximately 31%. Quanta accounts for this investment using the equity method of accounting.

Revenue Recognition

Infrastructure Services Through its Electric Power Infrastructure Services, Natural Gas and Pipeline Infrastructure Services and Telecommunications Infrastructure Services segments, Quanta designs, installs and maintains networks for customers in the electric power, natural gas, oil and telecommunications industries. These services may be provided pursuant to master service agreements, repair and maintenance contracts and fixed price and non-fixed price installation contracts. Pricing under these contracts may be competitive unit price, cost-plus/hourly (or time and materials basis) or fixed price (or lump sum basis), and the final terms and prices of these contracts are frequently negotiated with the customer. Under unit-based contracts, the utilization of an output-based measurement is appropriate for revenue recognition. Under these contracts, Quanta recognizes revenue as units are completed based on pricing established between Quanta and the customer for each unit of delivery, which best reflects the pattern in which the obligation to the customer is fulfilled. Under cost-plus/hourly and time and materials type contracts, Quanta recognizes revenue on an input basis, as labor hours are incurred and services are performed.

Revenues from fixed price contracts are recognized using the percentage-of-completion method, measured by the percentage of costs incurred to date to total estimated costs for each contract. These contracts provide for a fixed amount of revenues for the entire project. Such contracts provide that the customer accept completion of progress to date and compensate Quanta for services rendered, which may be measured in terms of units installed, hours expended or some other measure of progress. Contract costs include all direct materials, labor and subcontract costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs. Much of the materials associated with Quanta s work are owner-furnished and are therefore not included in contract revenues and costs. The cost estimation process is based on the professional knowledge and experience of Quanta s engineers, project managers and financial professionals. Changes in job performance, job conditions and final contract settlements are factors that influence management s assessment of total contract value and the total estimated costs to complete those contracts and therefore Quanta s profit recognition. Changes in these factors may result in revisions to costs and income, and their effects are recognized in the period in which the revisions are determined. Provisions for losses on uncompleted contracts are made in the period in which such losses are determined to be probable and the amount can be reasonably estimated.

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QUANTA SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (*Continued*)

Quanta may incur costs subject to change orders, whether approved or unapproved by the customer, and/or claims related to certain contracts. Quanta determines the probability that such costs will be recovered based upon evidence such as past practices with the customer, specific discussions or preliminary negotiations with the customer or verbal approvals. Quanta treats items as a cost of contract performance in the period incurred if it is not probable that the costs will be recovered or will recognize revenue if it is probable that the contract price will be adjusted and can be reliably estimated. As of June 30, 2012 and December 31, 2011, Quanta had approximately $207.1 million and $77.3 million of change orders and/or claims that had been included as contract price adjustments on certain contracts which were in the process of being negotiated in the normal course of business.

The current asset Costs and estimated earnings in excess of billings on uncompleted contracts represents revenues recognized in excess of amounts billed for fixed price contracts. The current liability Billings in excess of costs and estimated earnings on uncompleted contracts represents billings in excess of revenues recognized for fixed price contracts.

Fiber Optic Licensing The Fiber Optic Licensing segment constructs and licenses the right to use fiber optic telecommunications facilities to its customers pursuant to licensing agreements, typically with terms from five to twenty-five years, inclusive of certain renewal options. Under those agreements, customers are provided the right to use a portion of the capacity of a fiber optic facility, with the facility owned and maintained by Quanta. Revenues, including any initial fees or advance billings, are recognized ratably over the expected length of the agreements, including probable renewal periods. As of June 30, 2012 and December 31, 2011, initial fees and advance billings on these licensing agreements not yet recorded in revenue were $46.2 million and $47.4 million and are recognized as deferred revenue, with $37.7 million and $38.3 million considered to be long-term and included in other non-current liabilities. Minimum future licensing revenues expected to be recognized by Quanta pursuant to these agreements at June 30, 2012 are as follows (in thousands):

	Minimum Future Licensing Revenues
Year Ending December 31	
Remainder of 2012	$ 44,610
2013	74,798
2014	54,272
2015	32,859
2016	24,578
Thereafter	133,972
Fixed non-cancelable minimum licensing revenues	$ 365,089

Income Taxes

Quanta follows the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recorded for future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the underlying assets or liabilities are recovered or settled.

Quanta regularly evaluates valuation allowances established for deferred tax assets for which future realization is uncertain. The estimation of required valuation allowances includes estimates of future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income