

Focus Stock Report

November 13, 2009

Fluor (FLR U\$44.38, Outperform, Target U\$64.00)

Paul Danesi, CIM – Director, Portfolio Advisory Group

Company Description

Since its founding in 1912, Fluor has developed a solid reputation for precise engineering and construction across a range of industries. Today Fluor Corp. is the world's largest publicly-owned and traded construction and engineering company. Fluor, headquartered in Irving, Texas, is a true multinational employing more than 40,000 people around the globe.

The Company has five key operating segments: Oil & Gas, Industrial & Infrastructure, Government, Global Services, and Power.

Oil & Gas: Fluor's business has always been closely aligned with the energy sector and the division remains the largest component within backlog and as a contributor to revenues. The segment provides a broad range of services to the upstream, downstream, and integrated petrochemicals markets. They build offshore facilities, mid stream processing assets such as refineries, and pipelines. Fluor has completed hundreds of projects for customers in the oil & gas industry. Big wins over the last year include BP America's U\$3.4 B Whiting Refinery modernization project and a U\$1.9 B contract to upgrade Total's refinery in Port Arthur, Texas. In 2008, the Company created a new business unit, Fluor Offshore Solutions, to take advantage of opportunities in the offshore market.

Industrial & Infrastructure: This group provides a broad array of services to a diversified customer base that includes chemicals and petrochemicals, life sciences, manufacturing, mining, microelectronics, telecommunications, power projects, and transportation infrastructure. Featured projects include Infrasppeed, a U\$1.43 billion high-speed rail line project in the Netherlands, a state of the art manufacturing facility in Taiwan for Corning, and the Bay Bridge Project, the largest public infrastructure project in California's history. Fluor also won a U\$420 million contract to build a solar panel complex in Singapore for Renewable Energy Corp.

Power: The Power group designs and builds power plants which use a variety of fuel sources including renewable energy. Recent contract wins include: a U\$1.8 billion contract to build the world's largest offshore wind farm, and another to develop the world's largest photovoltaic power plant in Carrisa Plains, California.

Fluor Corp.
(FLR-Nasdaq)

Rating: Outperform

Risk: Medium

Summary Data (U\$)

Price (Nov. 9/2009):	\$44.38	Fiscal Year-End:	December
12-Month Target:	\$64.00	Dividend:	\$0.50
Total Return:	45%	Yield:	1.1%
52-Week High:	\$58.62	52-Week Low:	\$28.60
ROE Trailing 12 Months	29.1%	Market Value (\$mil)	\$7,984

Earnings Per Share (U\$)

Annual	2008A	2009E	2010E	2011E
EPS:	\$3.90	\$3.85	\$3.40	\$4.00
P/E Multiple:	11.4x	11.5x	13.1x	11.1x

Source: Credit Suisse, Bloomberg

Revenue Breakdown (US\$ millions)

Segment	2012 E	2011 E	2010 E	2009 E	2008 A	2007 A
Oil & Gas	14,551	12,126	10,105	12,323	12,946	8,370
Industrial & Infrastructure	6,234	5,421	4,714	4,285	3,470	3,385
Power	1,647	1,432	1,245	1,311	1,914	1,168
Global Services	2,512	2,284	2,125	2,023	2,676	2,460
Governmental Services	3,086	2,683	2,284	1,944	1,320	1,308
Total Revenue	28,030	23,946	20,473	21,886	22,326	16,691
Oil & Gas	52%	43%	36%	44%	46%	30%
Industrial & Infrastructure	22%	19%	17%	15%	12%	12%
Power	6%	5%	4%	5%	7%	4%
Global Services	9%	8%	8%	7%	10%	9%
Governmental Services	11%	10%	8%	7%	5%	5%
	100%	100%	100%	100%	100%	100%

Source: Credit Suisse



Focus Stock Report

Global Services: Global services provide operations and maintenance support, temporary staffing and asset management to more than 300 plants and other facilities around the globe. For 25 years, Fluor has provided program management, power station maintenance, outage support and construction services for Luminant's 20 power-generating stations throughout Texas.

Governmental Services: Fluor has provided services to the U.S. and other international government agencies for more than 65 years. Fluor provides E&C services as well as contingency response, site and facilities management and maintenance, and logistics. A featured project includes a contract to provide non-combat support for U.S. troops in Afghanistan and a U\$1 billion contract to reconstruct Iraq's potable water infrastructure.

Types of Contracts: While the terms or conditions of the contracts vary greatly, Fluor generally performs its work under two groups of contracts: cost reimbursable, and guaranteed maximum or fixed-price contracts. Under the cost reimbursable contract, the client reimburses Fluor for the cost incurred plus a predetermined fee or fee based upon a percentage of the cost incurred. Under the guaranteed maximum contract, Fluor is responsible for cost overruns, but benefits if costs are less than the negotiated maximum. Fixed price contracts can be either negotiated fixed price contracts or lump-sum contracts. About 75% of the Company's backlog is cost reimbursable.

Engineering and construction contract revenue is recognized on the percentage-of-completion method based on contract cost incurred to date compared to total estimated contract cost. Contracts are segmented between types of services, such as engineering and construction, and accordingly, gross margin related to each activity is recognized as those separate services are rendered.

Key elements supporting this investment include:

Fluor Corp. provides an investment in a company that has financial strength, a solid history of profitability, and a revenue mix that is diversified not only by business offering, but also by geography as the company is a multinational with almost half of its revenues coming from outside the United States.

Play on Global Infrastructure: Fluor is a direct play on global infrastructure development, both expansion and maintenance, which is a recurring investment theme for the foreseeable future. Fluor's Oil & Gas segment has been the primary driver for the business and remains the single largest component of backlog and contributor to revenue and earnings. While there have been some short-term setbacks in the energy group, longer-term investment in oil and gas projects is likely to remain substantial. Large new project awards will likely come from LNG, refining, and international offshore markets. Over the last few years, Fluor has seen solid growth in its Industrial & Infrastructure segment. The company should be a beneficiary of federal government stimulus spending on infrastructure projects in 2010.

Order Backlog: Order backlog, a key metric for the construction and engineering sector, is experiencing a bit of a rough patch, especially where the energy sector is concerned. However, weakness in Oil & Gas is being offset by strength in other businesses. Backlog growth was strong in Industrial & Infrastructure rising 21% quarter over quarter. I&I backlog accounts for approximately 30% of consolidated backlog, second only to Oil & Gas at about 50%. Government backlog grew rapidly, albeit from a small base. Over the last 12 months, Fluor was awarded 20 new large contracts valued at U\$11.3 billion. Backlog at the end of Q3 of U\$28 billion was down 23% year-over-year and 9% sequentially fuelled by weaker bookings. Despite the decline, backlog still represents well more than a year of business at the current revenue run rate. The Company is well positioned to gain new business as the global economy recovers and management aims to keep the value of contracted projects near U\$30 billion. Higher margin cost reimbursable projects account for about 75% of backlog.

Fluor Corp. : 5-Year Price Chart (U\$)



Focus Stock Report

Competitive Strengths: Fluor has a number of competitive strengths including:

- Excellence in program execution
- Financial strength
- Safety record
- Global platform
- Market diversity
- Long-term client relationships

Persistent Profitability: Fluor has consistently made money over the last 17 years and 2009 will be no exception. The consensus of estimates of U\$3.86 implies 6% EPS growth in 2009 despite the severe downturn in the global economy and lower commodity prices. Although current analyst estimates anticipate a decline in earnings for 2010, we would note earnings expectations are rising; ultimately we would be surprised if earnings were lower in 2010. Backlog should convert into contract awards that will be incremental to current forecasts.

Balance Sheet: Fluor has the highest credit rating of any publicly-traded company in their industry. Fluor's pristine balance sheet with net cash gives the Company greater financial flexibility than many of its competitors. The Company's ample cash resources will support future growth initiatives, both organic and through acquisitions.

Valuation: Although Fluor shares have rallied smartly from their March 2009 low, their performance has lagged the broader S&P500 Index and the Industrials sub-sector. In the short-term investors are concerned about the company's outsized exposure to energy, oil prices, and capital spending within the sector. We have a constructive view on energy capex longer-term and believe investors' short-sighted concerns are creating an attractive entry point for investors. The shares are currently trading at 11.5 times consensus earnings estimates for 2009. This compares to a 28 times P/E multiple over the last three years and 24 times multiple over the last 10 years.

Industry Comparables								
Company	Ticker	Price (Nov 10th)	EPS		P/E		EPS Growth	EV/EBITA
			2009	2010	2009	2010	08-10	Trailing
Fluor Corp.	FLR	\$44.38	\$3.85	\$3.54	11.5	12.5	-1%	4.8
McDermott International Inc.	MDR	\$23.59	\$1.54	\$2.02	15.3	11.7	2%	7.5
Jacobs Engineering	JEC	\$44.00	\$2.98	\$2.77	14.8	15.9	-10%	5.9
KBR Inc.	KBR	\$20.20	\$1.74	\$1.68	11.6	12.0	0%	3.6
Shaw Group Inc.	SHAW	\$28.55	\$2.14	\$2.30	13.3	12.4	-5%	4.0
Avg. ex Fluor					13.3	12.9	-3%	5.2

Source: Bloomberg, ScotiaMcLeod Inc.

Downside risks that may affect our outlook include:

Backlog is subject to unexpected adjustments and cancellations: There is no guarantee the revenues projected by the backlog will be realized or profitable. Many of the Company's contracts have termination provisions in them. Poor execution on Fluor's part could lead to a loss of business. The current financial crisis and weakened global economy have affected clients' cash flow and borrowing capacity to support business expansion.

Business is Cyclical in Nature: The engineering & construction business is cyclical and affected by economic downturns. Commodity prices are inherently volatile and the Company's commodity-based segments tend to exhibit greater cyclicity than others.

Potential for Significant Cost Overruns: Fluor is exposed to potentially significant cost overruns relating to about 25% of its revenues. For these "fixed price" contracts, higher than anticipated costs could in some cases lead to losses. Fluor must make a number of assumptions when bidding for new business including: economic conditions, labour and material costs, and equipment rentals. Much of work performed under contract is actually performed by third party subcontractors creating additional project execution and cost challenges.



Focus Stock Report

*The author(s) of the report own(s) securities of the following companies.
None.*

*The supervisors of the Portfolio Advisory Group own securities of the following companies.
None.*

Scotia Capital is a member of the Canadian Investor Protection Fund (CIPF). ScotiaMcLeod is a division of Scotia Capital Inc. (·SCI·). This report has been prepared by SCI on behalf of the Investment Executive. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither SCI nor its affiliates accept liability whatsoever for any loss arising from any use of this report or its contents. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any securities and/or commodity futures contracts. SCI, its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities and/or commodities and/or commodity futures contracts mentioned herein as principal or agent. SCI and/or its affiliates may have acted as financial advisor and/or underwriter for certain of the corporations mentioned herein and may have received and may receive remuneration for same.

The content may have been based, at least in part, on material provided by Credit Suisse First Boston Corporation ("CSFB"), our correspondent research service. CSFB has given ScotiaMcLeod general permission to use its research reports as source materials, but has not reviewed or approved this report, nor has it been informed of its publication. CSFB may from time to time have long or short positions in, effect transactions in, and make markets in securities referred to herein. CSFB may from time to time perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this report. This research and all the information opinions and conclusions contained in it are protected by copyright. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever, nor may the information, opinions, and conclusions contained in it be referred to without in each case the prior express consent of SCI. SCI is a wholly owned subsidiary of a Canadian chartered bank. SCI is a member of The Securities and Futures Authority Limited E&O.E. U.S. Residents: Scotia Capital (U.S.A) Inc. (·SCUSAI·), a wholly owned subsidiary of SCI, accepts responsibility for the contents herein, subject to the terms and limitations set out above. Any U.S. person wishing further information or to effect transactions in any security discussed herein should contact SCUSAI at 212-225-6500.

® Registered trademark used under authorization and control of The Bank of Nova Scotia. ScotiaMcLeod is a division of Scotia Capital Inc., Member CIPF.