THE AUSTRALIAN

Contractors are reeling as mining giants slash costs

STEPHEN BARTHOLOMEUSZ THE AUSTRALIAN MAY 22, 2013 12:00AM

IT'S no great shock that the big contracting firms have been revising their earnings across the past week. What has shocked the market, however, has been the extent of the cuts to their forecasts.

Transfield Services became the latest of a string of contractors to slash its guidance for this year, from a range of $85 million-$90m to $62m-$65m.

Last week, contracting heavyweight WorleyParsons said it expected to earn $320m-$340m this year, well below the market consensus expectations of a profit of more than $370m.

UGL, having previously forecast earnings of $150m-$160m, slashed its guidance to a profit of $90m-$100m. The far smaller Coffey International, which had been forecasting a second-half profit at least in line with the $23.7m earned in the first half, now says that is unlikely.

The scale of the earnings revisions has produced a dramatic sharemarket backlash. Transfield shares plummeted more than 20 per cent after it released its downgrade.

Since last week's announcements, WorleyParsons' shares have fallen about 19 per cent, UGL's nearly 30 per cent and Coffey's 26 per cent.

The Transfield price fall wiped about $150m from its market capitalisation, taking the loss of market value since February to about $1 billion. WorleyParsons has lost about $1bn of market value in a week and about $2bn since February.

UGL has lost the best part of $500m since it revised guidance and nearly $800m in the past three months, while Coffey's market capitalisation has tumbled from about $115m to about $40m across that period. It is obvious from the earlier declines that the market was expecting their performance to deteriorate and it is also obvious from the response to the confirmations of those declines that the extent of the downgrades was far worse than expected.

The reasons for the downgrades are equally obvious. The contractors are at the sharp end of the abrupt truncation of the resources boom.

Not only has the big pipeline of future projects - several hundred billions of dollars' worth - that was in sight a year ago evaporated, but previously approved projects are being pulled or scaled back and the miners are focusing ferociously on their costs, with contractors obvious and easy targets.

They are losing contracts, the scope of contracts is being reduced and they are being pressured into reducing their margins.

The big pipelines of work and the fat margins available at the height of the investment boom when there was more demand for their services than supply have disappeared at a rate that has taken the contractors and the market aback.

Rio Tinto is talking about reducing costs by $US5bn within two years. BHP Billiton says it has already carved $US1.9bn of annualised costs from its cost base, and Xstrata is dumping projects and warning that much of the Australian coal industry is "under water" and will have to slash costs simply to survive. Little wonder that the contractors are early victims of the intense focus on costs and capital. The only response for the contractors is to do as Transfield is doing and cut its own costs and workforce.

Transfield said it was bringing forward a previously foreshadowed cost-reduction program, which would produce a further reduction of 113 positions.

Disconcerting for the contractors would be the realisation that there is still an unprecedented amount of mining investment occurring on projects that were committed to and started before commodity prices began diving last year. That investment will peak later this year, then start to subside quite rapidly.

The boom times for the miners, and their contractors, are over.

Stephen Bartholomeusz is a commentator for Business Spectator. For more commentary, visit **www.businessspectator.com.au** *(http://www.businessspectator.com.au)*