Matthew Stevens

WorleyParsons joins contracting sector's gallery of shame

PUBLISHED: 21 Nov 2013 PRINT EDITION: 21 Nov 2013

Gift Article: 100

Andrew Wood, CEO of WorleyParsons, says the companyô cash flows can be ôlumpyô. **Photo: Jim Rice**

Matthew Stevens

A hopefully temporary evaporation of trust between investors and WorleyParsons has left one of the petroleum sectorô partners of choice the newest nominee for the troubled contracting sectorô post-boom gallery of sharemarket shame.

Until maybe 18 months ago, life in the contracting space had been tootling along very nicely indeed for the better part of this new century. But when BHP Billiton recovered management control of contracted assets more than two years ago, then followed that with Project Reset, a move to squeeze more competitive pricing from its external operators, the good times stopped rolling.

The miserable irony for the contractors is that for the past 25 years they have been the gateway to productivity gains as the resources sector turned to them to deal with archaic industrial relations.

The modern productivity challenge requires more intricate and discrete solutions and, as a result, asset owners are looking to recover management to allow the development of their own efficiency solutions.

But I digress, and probably unfairly to WorleyParsons given it has so little in common with the contract miners that have fallen victim to this trend. Worley is a far more conventional professional services business, whose model has proven a paradigm of reliability. Until Wednesday, that is, when it delivered itself a stunning rabbit punch in the form of a very material revision of profit guidance.

Since August, Worley has consistently said that FY14 would see it outperform last yearô net profit after tax of $322 million. Twice in just more than a month this most resilient and reliable of our global contractors has reaffirmed that commitment.

But just 42 days after promising growth at its AGM and 36 days after affirming that commitment at an investor day, Worley has discovered that commercial life is tougher than it had anticipated. As a result, profit could fall up to 20 per cent short of last year’s NPAT.

Soft punishment

That news earned the contractor only slightly disproportionate punishment from the market as its share price was rapidly and viciously pruned by 25.89 per cent. In total, some $1.34 billion was wiped from Worley’s market capitalisation as its share price fell $5.43.

To measure how disproportionate that reaction was, consider that the projected shortfall in profit forecast represents a maximum of 25¢ a share, which means the market is valuing lost earnings on a multiple of 21.5. But on the best of days, Worley trades on a multiple of something nearer 16.

But, as Newcrest management can tell you, this is not a market that welcomes disappointment, particularly missed profit guidance.

Not that there is too much else but missed guidance and the market’s prompt and material price discounting that links these two situations. That said, it will be interesting to get some guidance from ASX about its contentment with Worley’s changed outlook. It has to be said that the triggers for this revision seem general enough to have been identified maybe a little while back.

The understanding is that the worse than expected numbers emerged from a routine quarterly review process. But surely there were other lead indicators that should have identified that the key professional services business had hit hard times in Australia, Canada and Latin America; that the cost reduction program was going slower than anticipated by the previous profit outlook; and that the US, southern African and European business units were not throwing off enough cash to offset declines in those other markets.

Certainly, Worley’s ASX listing officer was asked to provide comfort that company has met its listing requirements. And our understanding is that ASX is comfortable with the quality and timeliness of Worley’s disclosure, though it will keep a quiet watch on how the situation pans out over coming weeks and months.

‘Lumpy’ cash flows

Meanwhile, Worley chief executive Andrew Wood is left just that little bit bewildered by the level of fuss generated by his quite necessary disclosure. Wood says neither of the reassertions we mentioned to him were made without caveats or observations about the difficult trading conditions experienced over the opening two months of FY14.

Wood says shareholders were told at the AGM that July and August has seen underperformance on targets and that had resulted in a sensible downgrade of profit expectations by his analysts.

While their numbers were still based on the promise that Worley would outperform FY13, the level of growth was tempered. But not enough to reflect a reality that became apparent to Wood, his senior executive and his board only over recent days.

The Wood narrative is that the company’s cash flows can be lumpy and there was every reason to bank on a balancing recovery of momentum through September and October. But, in preparing quarterly cash flow statements, the firm numbers from September and October showed that had not happened and the forecasts prepared on the back of those numbers suggested there was no way Worley could expect to hit forecast. With that the board was informed, market disclosure made and share price belting received.

The quality of that thrashing says first that the market was totally surprised by the downgrade. This, ironically, is good news from a regulatory point of view because it means ASX and its ilk are satisfied about the integrity of the Worley’s process.

The nature of the re-rating of Worley says too that the market has either worries about the quality of the company’s explanation or that it has lost confidence in the longer-run predictability of Wood’s numbers.

For his part, Wood is as surprised as the market by the circumstances that forced his embarrassment and by the intensity of its reaction to his unhappy news. “It is not as though this business is in anything like serious trouble,” he told me on Wednesday. “It is not. We did $322 million last year. We said we were going to grow off that. We cannot hit that now. But we are looking at somewhere just sub-$300 million.

Wood rejects any suggestion that his team was tardy in identifying the slower than expected start to the financial year, that he should have taken a more conservative number to the market on the back of the July-August data, that WorleyParsons had been too optimistic about recovery through the balance of the first half, or that his much more positive second half outlook is anything but achievable. “Look, I think it has been a slower start (to FY14) than we expected essentially. The September-October numbers made it certain we would be unable to offset the shortfalls created by trading in July-August. And the forecast made it clear the second half was not going to see us catch up enough to meet our original target.ö

Woodôs misery highlights, surely, the danger of giving any sort of profit guidance in the first place. There is no legal obligation or listing rule that makes it necessary to indulge this risk and a lot of clever, successful and well-supported companies donôt.

READ NEXT:

- **WorleyParsons downgrade wipes $130m from chair’s stake**
- **WorleyParsons punished for disappointing forecast**

Peever replaces Argus at AFIC

David Peever has joined another special club by being invited to replace recently retired Don Argus on the board of Australian Foundation Investment Company.

Peever is one of those quiet achievers who is so much a part of the story at Rio Tinto and its Australian forebear, CRA Limited. He is a charming man with a ready smile and a spine of tungsten when it comes to promoting commercial or national interests.

Like the recently re-hipped Argus, Peever is a bit of a cricket nut. The Rio man is on the board of Cricket Australia, which continues to grapple with the reformation of the great game recommended by Argus and his committee of five.

But it is Peever the miner who AFIC wants. It needed a direct swap for Argus given that some 24.5 per cent of its portfolio is held in resources stocks.

The Australian Financial Review

Create an alert

Click on the links below to create an alert and receive the latest news as it happens

Companies	Worleyparsons Ltd , BHP Billiton Plc , Newcrest Mining
People	David Peever

Today's Paper

This is the modal description

Submit ×