Why WorleyParsons is set to benefit from the oil & gas cycle

February 2019 – Blake Henricks, Deputy Managing Director & Portfolio Manager

Worley Parsons is an Australian engineering company that specialises in global oil and gas projects. In this article, I explain why Worley Parsons is set to benefit as the oil and gas investment cycle turns positive. I'll outline our investment thesis in Worley Parsons, focusing on three key areas:

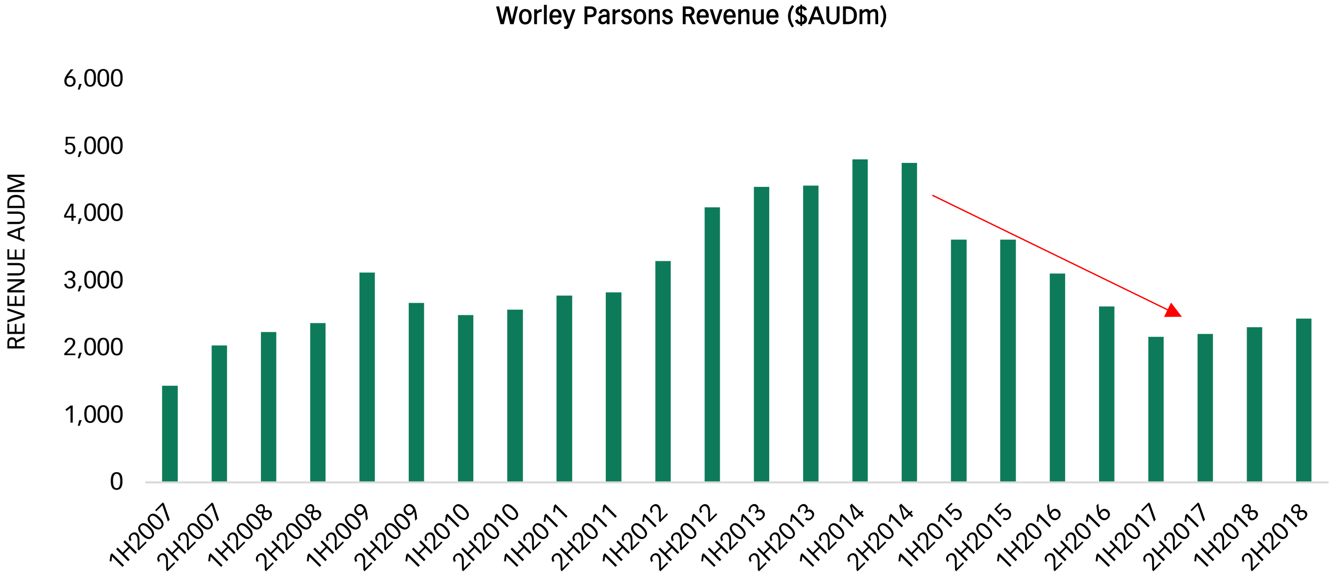
1. The oil and gas investment cycle
2. Cost-out initiatives
3. Worley Parsons valuation

The article will provide you with a deeper understanding of 'What Matters' for Worley Parsons and why I believe it is a material opportunity for our investors.

1. The oil and gas investment cycle

At the peak of the oil and gas cycle in 2014, oil soared to US$115 per barrel. The subsequent collapse in the oil price to below US$30 per barrel in 2016, resulted in significantly reduced capital expenditure (capex) in oil and gas projects globally, as major energy producers focused on protecting balance sheets.

As shown below, the reduction in oil and gas expenditure significantly impacted Worley Parsons' revenue, which fell 50% from their peak in 2014.



Source: WorleyParsons Financial Data

After four years of underinvestment, we believe we are at the bottom of the oil and gas investment cycle. Our research indicates that investment in oil and gas projects needs to return to meet global energy demand. Worley Parsons is set to benefit from the return of the oil and gas cycle. Pleasingly, early indicators are looking strong. Over the past 6 months, Worley Parsons has won many contracts giving us confidence that the worst is behind us.

2. Cost-out initiatives

Worley Parsons has embarked on significant self-help initiatives over the past few years. A disciplined focus from management has led to a reduction in costs of around $500m since 2016. For a business that made $299m of EBIT on FY18, the cost-out has been material.

In addition, Worley Parsons announced a transformational acquisition of US based Jacobs' Energy, Chemicals and Resource business in 2018. Jacobs is also a global engineering firm, with less oil and gas exposure. The acquisition provides attractive synergies and strong EPS accretion for shareholders. Importantly, the purchase was conservatively funded and positions Worley Parsons as a market leader in its key categories. Once the acquisition settles, expected early to mid-2019, the purchase provides shareholders with a more diversified, stable earnings profile and gives Worley Parsons the scale and capabilities to bid on some of the largest energy projects around the world.

3. Worley Parsons valuation

Worley Parsons is incredibly undervalued. Today, it is trading close to a market multiple on FY20 earnings, when factoring in synergies from the recent Jacobs acquisition.

The recent 30% fall in oil price in late 2018 and the near doubling of shares on issue has caused the Worley Parsons' share price to underperform in the short-term. In our view, the market has incorrectly assumed that lower oil prices will cause a sustained lower level of investment in oil and gas projects. Whilst lower oil prices may cause a pause in 2019 capex, investment in global oil and gas projects needs to return over the medium term for global oil supply to keep up with demand. At this point in the capex cycle, Worley Parsons is incredibly undervalued.

Conclusion

After four years of underinvestment, the oil and gas cycle is turning positive. Worley Parsons is well positioned to benefit as the market leader in oil and gas engineering. In our view, Worley Parsons is significantly undervalued at this point in the cycle. With significant earnings leverage and a compelling valuation, Worley Parsons will be a material opportunity for patient investors.