BELL POTTER

12 May 2020

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E&C April Newsletter

Lockdowns have consequences too

Bell Potter E&C Coverage

Stock	Rec.	Target
MND	Buy	$11.05
SSM	Buy	$2.80
LYL	Hold	$4.60

Bell Potter Index

Engineering & Construction

BP Engineering & Construction Index

Company	Market Cap ($m)*
BSA (BSA)	110.2
CIMIC (CIM)	7385.0
Civmec (CVL)	197.9
Decmil (DCG)	53.8
Downer (DOW)	2509.6
GR Engineering (GNG)	99.1
LogiCamms (LCM)	26.1
Lycopodium (LYL)	**171.6**
MACA (MLD)	207.7
Monadelphous (MND)	**1049.8**
NRW (NWH)	727.5
Primero (PGX)	41.3
Saunders (SND)	46.3
SRG Global (SRG)	102.5
Service Steam (SSM)	**881.3**
Sthn Cross Electrical (SXE)	110.2
Tempo (TPP)	11.0
Worley (WOR)	4579.4
WestStar (WSI)	11.2

*Market caps as at 11 May 2020

BP E&C Index ($100 at 1 Jan 2020)*

Total Market Cap	**$18.8bn**
Index Price	**$64.47**
1-month price change	**18.6%**
Change since inception	**-35.5%**

*Changes as at 30 April 2020

SOURCE: IRESS, BELL POTTER SECURITIES

Contract awards fall off a cliff in April

A total of $56m of new contracts were announced during April, **representing a 90% fall** from the $543m announced during March. This comes on the back of a highly uncertain economic outlook, and lockdown measures forcing companies to turn their focus away from growth projects.

Producers announce delays and deferrals

Coinciding with the sharp decline in new project awards, has been a swift response from Resources companies to the current economic turmoil and its impact upon commodity prices. While Oil & Gas producers have announced the sharpest cuts, producers across most commodities have announced or at least communicated that material cuts will eventuate.

While many of these cuts have occurred as a result of social distancing requirements (particularly on offshore Oil & Gas rigs), more longer lasting deferrals will take place as a result of potentially very challenging economic conditions. This is to occur across both new construction projects, and maintenance and shutdown activity.

Margins likely to be impacted across our E&C index

In addition to the outlook for Resources work declining significantly, contractors are likely to see their margins materially impacted. This comes as travel restrictions and social distancing requirements cause material operational disruption. A reduction in available work may also result in the tendering environment reversing its recent stabilisation and instead see it become increasingly competitive.

Share market bounces, but don't expect V-shaped recovery

With the share market continuing its rally off of its March lows, it appears that market participants are going to temporarily ignore upcoming economic data and instead price in a V-shaped recovery. This may result in share markets continuing their rally in the near-term.

Though we believe that sporadic economic re-openings, a decline in productivity and an increase in balance sheet leverage put hopes of a strong bounce back in economic activity at risk, leading to an elevated potential for share markets to test their March lows.

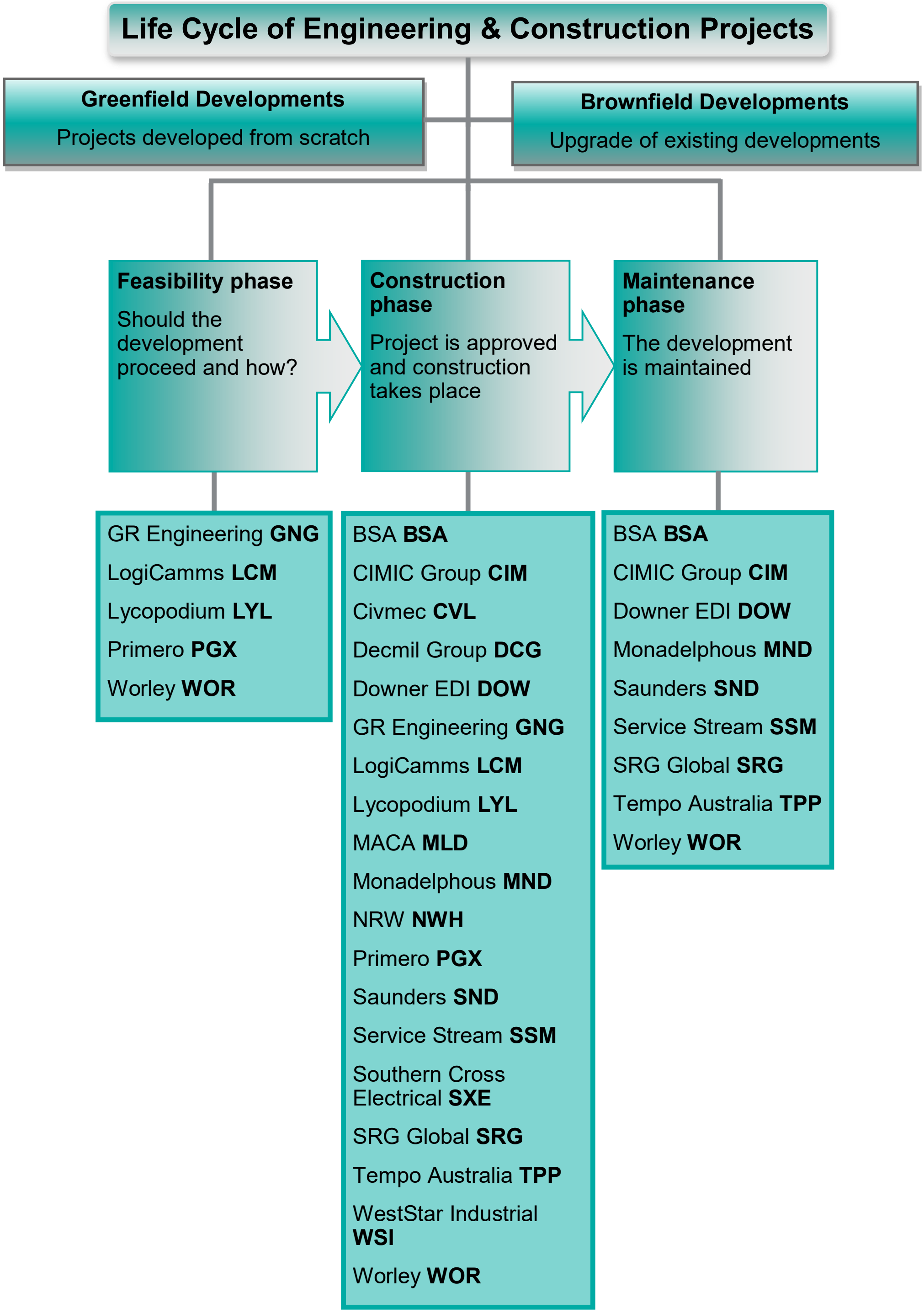
Long-term focus, balance sheet health are necessities

While extraordinary levels of fiscal and monetary stimulus will continue to cause financial market inflation and provide support for asset prices, we believe that a deterioration in underlying economic fundamentals means that betting on a sustained short-term rebound remains fraught with risk.

Investors should thus approach any investments within our E&C index with a long-term mindset, and focus on firms with strong balance sheets (which generally includes a solid net cash position), track record of project delivery and free cash flow generation.

This is important, because the E&C sector was already *not* sustainable *before* the current economic crisis. Any prolonged economic downturn will thus likely see some E&C companies fight for survival.

Engineering & Construction Food Chain



BELL POTTER COVERAGE

Monadelphous **MND**

Lycopodium **LYL**

Service Stream **SSM**

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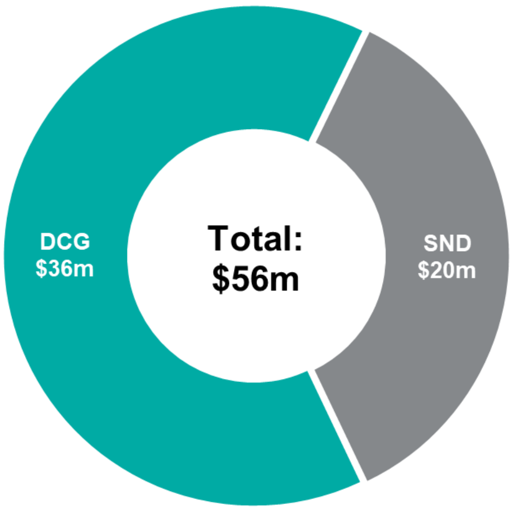
Contracts awards fall off a cliff in April

$56m of new contracts announced

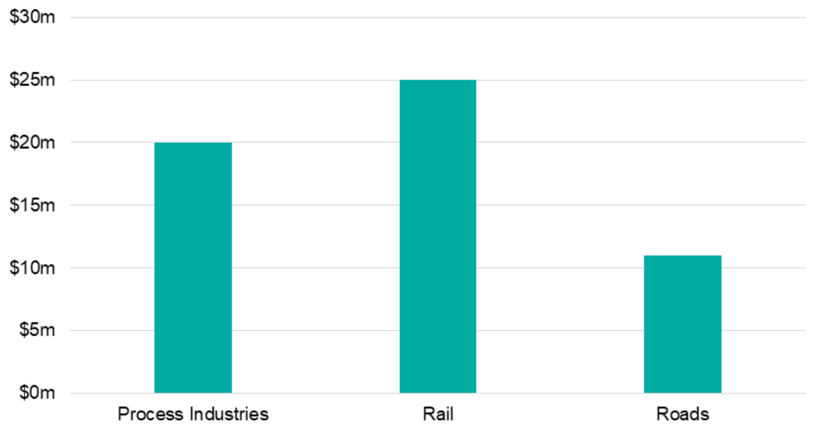
During April, a total of $56m of new contracts were announced by two companies in our index. DCG recorded $36m of Infrastructure awards, while SND announced a $20m contract for the construction of diesel tanks at Sydney's Port Botany. We note that GNG announced an extension to a M&IS contract, but did not quantity its estimated value.

Figure 1: March awards by company



SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

Figure 2: March contract awards by sector

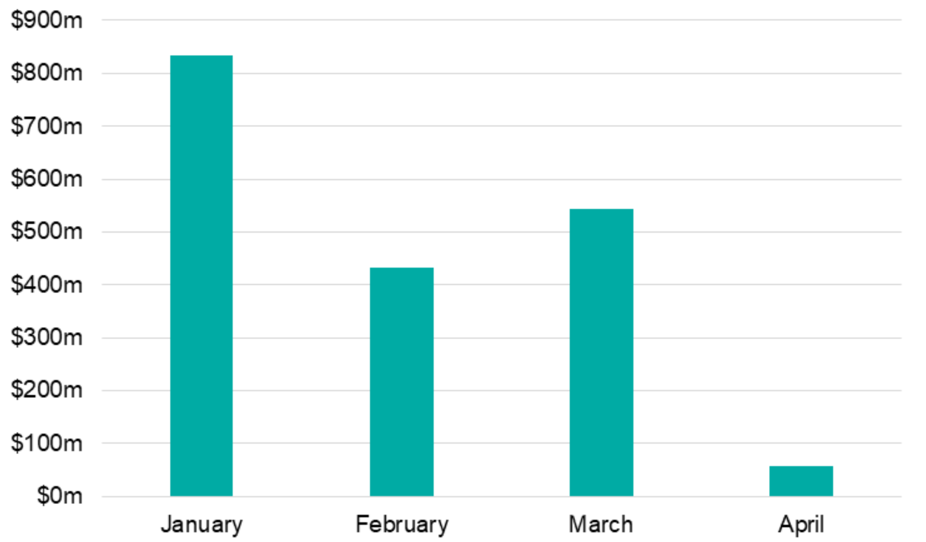


SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

Contract awards fall off a cliff

In light of the economic turmoil being caused by lockdown measures, **contract awards fell off a cliff in April, declining by 89.7% from the level recorded in March.**

Figure 3: Monthly contract awards



SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

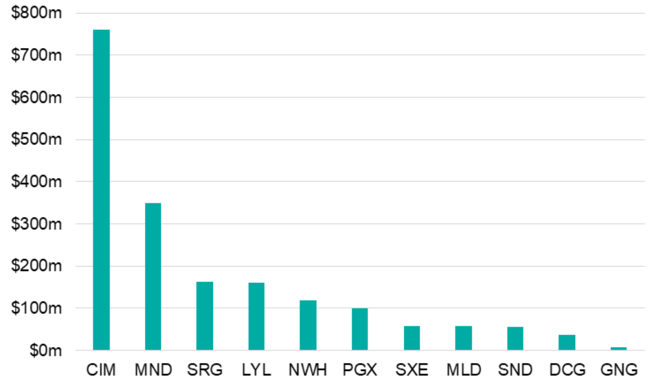
Calendar YTD award totals

$1.9bn of awards announced YTD

Year-to-date (YTD) contract awards to the end of April are estimated at $1.9bn, with CIM currently announcing the most contract awards at $761m. MND, SRG, LYL, NWH and PGX have all announced at least $100m of contracts since the beginning of the calendar year.

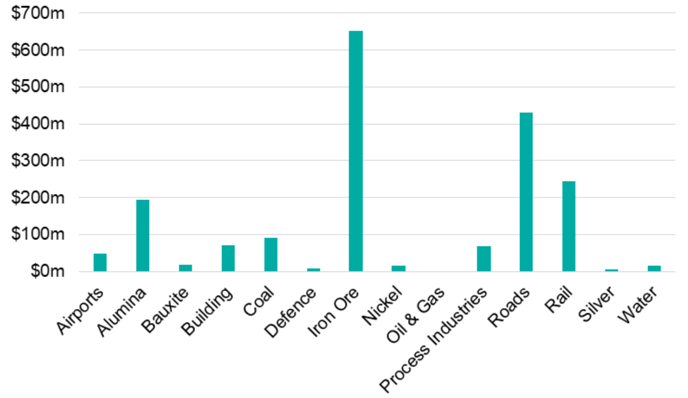
Iron Ore remains the sector with the most activity, where we estimate over $650m of contracts have been awarded in calendar 2020.

Figure 4: YTD contract awards by company



SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

Figure 5: YTD contract awards by sector

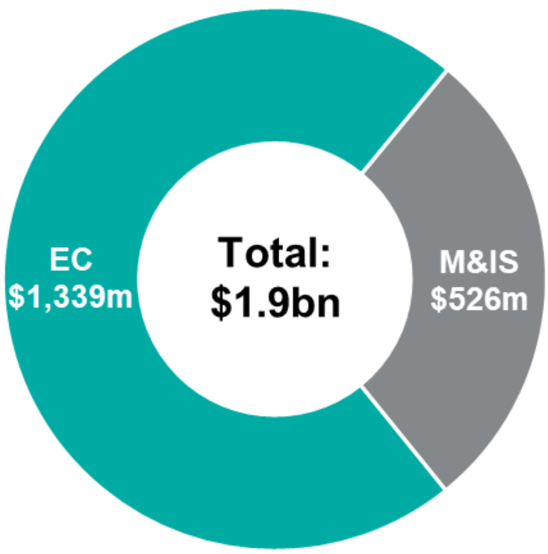


SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

EC comprises bulk of YTD contract awards

After all of the contract awards during April were for EC projects, the total contract split remains weighted towards EC projects.

Figure 6: EC vs M&IS YTD contract split



SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

COVID-19: The key impacts on Engineering & Construction

1

Construction in progress is delayed

For several halves delays have been a recurring theme among construction projects across the Resources, Building and Infrastructure industries. Delays have been exacerbated as a result of the coronavirus. This occurred initially as a result of supply chain difficulties, but more recurring impacts are likely as a result of continuing virus mitigation measures such as travel restrictions and social distancing requirements.

2

Mitigation measures hit productivity

Measures implemented to stem the spread of the coronavirus are having an impact on organisational productivity. Whether it be increased difficulties in transporting staff to and from worksites, rostering changes, or maintaining adequate social distancing during shifts, the decline in productivity is real.

This will cause project delays and/or impact the profitability of E&C contractors.

3

Lockdowns cause delays and deferrals

Lockdowns in and of themselves, and indirectly via hits to economic activity, are causing delays and deferrals. This is occurring across construction projects yet to be awarded, planned maintenance and shutdown activities, and exploration activity.

Construction delays exacerbated

Delays have been a recurring theme, made worse by COVID

For several halves delays have been a recurring theme among construction projects across the Resources, Building and Infrastructure industries. These delays appear to have been exacerbated as result of the coronavirus, due to supply chain and productivity impacts.

Supply chain disruption brings on initial weakness

Some initial delays have been caused by supply chain difficulties, with Rio Tinto and Monadelphous both noting impacts. Rio Tinto has specifically noted difficulties in sourcing long lead fabrication items from China and Europe, while MND has stated supply chain issues have caused delays on large resources construction projects.

Operational changes, travel restrictions to further impact

While supply chain issues should be clearing, ongoing productivity impacts are likely as a result of operational changes. This includes travel restrictions and social distancing requirements. Given that these changes are reducing productivity, there is a substantially increased likelihood of projects running over-time and over-budget.

FMG appears to be suffering some project delays

FMG has noted in its latest quarterly report, that capital expenditure on Eliwana for FY20 is expected to be US$150m below prior estimates, whilst capital expenditure on Iron Bridge is expected to be at the lower end of its US$100m range. FMG has revised its forecast FY20 capital expenditure range lower by US$200m - US$400m, but expects this to be made up in FY21.

This suggests that FMG is suffering some project delays, with work initially scheduled for FY20, now anticipated to slip into FY21.

Figure 7: FMG FY20 capex guidance

Project	Prior (US$m)	Revised (US$m)
Eliwana	700-800	550-650
Iron Bridge	300-400	Lower end of range
Total capex	2400	2000-2200

SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

International developments may prove particularly difficult

International projects that rely on expatriate labour are likely to become extremely difficult to complete. This comes as governments across the globe implement outright travel bans or severe restrictions on international travel.

The difficulties have been noted by Rio Tinto, who has stated travel restrictions have slowed progress at its Mongolian Oyu Tolgoi development. Additionally we have noted commentary from West African Resources, who is unable to rotate expatriate staff from its Burkina Faso located gold development, and Purseus Resources, who notes continued travel restrictions may impact its Yaouré development schedule. This forms a major reason behind our move to a Hold rating on Lycopodium, who is particularly leveraged to international African projects.

Delays exacerbated by coronavirus

The South Flank project is tracking well and remains on schedule for first production in the 2021 calendar year…. Consistent with our operations, the South Flank project continues to implement increased measures to conduct safe operations in compliance with strict health and travel guidelines put in place to help reduce the spread of COVID-19.

BHP Quarterly Activities Report 21/04/20

Total capital expenditure revised to US$2.0 - US$2.2 billion (previously US$2.4 billion), reflecting the timing of expected payments on growth projects.

FMG March Quarterly Production Report 30/04/20

Contractual capital commitments for the Eliwana project are tracking in line with expectations, however the timing of incurred spend and cash outflows has contributed to a revision in FY20 capital expenditure guidance to US$550 – US$650 million (previously US$700 – US$800 million). This timing variance will be incurred in FY21, with total investment in the project unchanged at US$1.275 billion.

FMG March Quarterly Production Report 30/04/20

Fortescue's share of Iron Bridge capital expenditure in FY20 is now expected to be at the lower end of the guided range of US$300 - US$400 million. The Company's share of total investment in the project is unchanged at US$2.1 billion.

FMG March Quarterly Production Report 30/04/20

Overall construction [on our Pilbara replacement projects] is progressing with key personnel retained in Western Australia following the implementation of border controls to limit the transmission of Covid-19.The ramp-up of Koodaideri is still expected to occur in early 2022.

RIO First Quarter Results 17/04/20

All major projects progressed well in the first quarter, but are now being affected by the Covid-19 restrictions. The team is investigating ways to mitigate Covid-19 impacts including those associated with roster changes, travel restrictions and the design and fabrication of long lead items in China and Europe. Whilst it is too early to estimate, the restrictions are likely to have some impact on our progress. Recovery rates may differ across regions

RIO First Quarter Results 17/04/20

The other Pilbara projects remain largely on track including Western Turner Syncline Phase 2 and Robe River Joint Venture sustaining projects (West Angelas C&D and Mesas B, C and H at Robe Valley). Environmental approval of Mesa H is progressing.

RIO First Quarter Results 17/04/20

Progress has slowed [at Oyu Tolgoi] as a result of restrictions placed on the movement of people to contain the spread of Covid-19, including specialist commissioning personnel as well as goods

RIO First Quarter Results 17/04/20

The Company's Engineering Construction division has experienced supply chain issues causing delays on large resources construction projects currently in progress

MND Market Update 01/05/20

It is currently not possible to rotate expatriate staff due to the measures imposed by the authorities of Burkina Faso. The health and morale of site staff and contractors are being assessed regularly and the Company remains in discussion with the authorities regarding rotation of key staff to maintain operations at Sanbrado.

WAF Quarterly Activities Report 23/04/20

On March 21, 2020 authorities in Burkina Faso announced the closure of the country's land and air borders, imposed a 7pm to 5am curfew, and closed schools to prevent the spread of COVID-19. On March 27, authorities declared a state of health emergency, imposing further restrictions

WAF Quarterly Activities Report 23/04/20

Works required to enable the first pour of gold at Yaouré by the stretch target date of late December 2020 are generally on schedule, although it is noted that slippage to the schedule may occur if current government-imposed travel restrictions arising from the COVID-19 crisis are not relaxed in coming months.

PRU March Quarterly Activities Report 28/04/20

Mitigation measures to hit productivity

A range of new measures being implemented

COVID-19 mitigation measures and government guidelines have resulted in producers implementing a raft of additional measures in order to safeguard operations. Examples of measures implemented include:

- Reduced site travel;
- Reducing the number of people on site;
- Strict hygiene practices;
- Extended rosters;
- Airport health testing; and
- Additional flights and bus services to maintain social distancing.

Growing chorus of contractors noting productivity impact

Given the large number of operational changes that have been made over the past few months, it would be naive to expect that material impacts to productivity have not occurred. While MND has perhaps been the most aggressive in noting the financial impact, CVL, SND, SXE and DOW have all noted productivity impacts.

Expect margins to be impacted in FY20 and FY21

As a result of the extensive changes to operational practices, we believe margins for most of the companies across our E&C index will be impacted. While some will see a bigger impact than others, any forced adjustment to operational practices is likely to result in at least some margin impact.

Some of these measures, such as rostering changes as a result of restricted interstate travel, may be somewhat loosened over coming weeks as it becomes increasingly clear that there is no widespread transmission of the virus in Australia. Though other measures, such as social distancing requirements, are likely to remain for much longer.

The margin impact is thus likely to continue well into FY21.

Most majors believe production, costs will be maintained

To date it appears that most major Australian producers have noted minimal impacts to their production and cost profile. S32 is one of the few who have announced a drop in production at an Australian operation as a result of the coronavirus, with a 5% reduction in their Australian Manganese production forecast for FY20. The lack of widespread downgrades to production or increases to cost-guidance does not appear to make a lot sense given the major operational changes that have taken place.

But that just means they believe someone else will pay

While there may be some producer cost reduction as a result of lower oil prices, we believe their expectation of robust production and cost guidance is predicated upon an expectation that contractors will be the ones paying for decreased productivity.

This is likely to impact those who offer production based mining services, but also extend to Engineering & Construction providers, with producers likely to try and squeeze contractor margins as opposed to their own. This elevates the likelihood of contract disputes.

Operational changes to hit productivity

Strict health and travel guidelines have been put in place to reduce the spread of COVID-19

BHP Quarterly Activities Report 21/04/20

We continue to take action to reduce the risk of COVID-19 and safely conduct [nickel] operations ... including the reduction in the number of people at our operational facilities and sites through flexible shifts.

BHP Quarterly Activities Report 21/04/20

The COVID-19 situation [at New South Wales Energy Coal] continues to be monitored with preventative measures in place … including reduced site travel, social distancing practices and strict hygiene protocols.

BHP Quarterly Activities Report 21/04/20

WAIO continues to focus on operating safely and has incorporated a series of preventative measures to help reduce the spread of COVID-19. We have reduced the number of workers on our sites, with those not critical to operations working from home.

BHP Quarterly Activities Report 21/04/20

A range of comprehensive measures have been implemented in response to the global COVID-19 pandemic.

FMG March Quarterly Production Report 30/04/20

Temperature and health testing is in place at the Perth Domestic Airport, site aerodromes and Perth offices. A rapid screening process has been recently introduced across the operations.

FMG March Quarterly Production Report 30/04/20

Additional charter flights and bus services have been arranged to ensure physical distances are maintained between team members.

FMG March Quarterly Production Report 30/04/20

We are committed to ensuring robust plans are implemented to prevent the spread of infection to any of our sites, with a temporary extended operational roster introduced to reduce people movement, as well as measures to monitor the health of all team members and support best practice physical distancing at our operations.

FMG March Quarterly Production Report 30/04/20

Of course, most of the quarter was overshadowed by the growing threat of the COVID-19 pandemic, which has required us to take swift and decisive action to protect our workforce, communities and operations.

WPL First Quarter 2020 Report 16/04/20

WPL implemented a temporary operating model to ensure the safety of our people and communities … complying with State Government border controls and travel restrictions.

WPL First Quarter 2020 Report 16/04/20

To comply with expert health and government guidance we have been reducing the number of people at our facilities and working with our contractors, suppliers and communities to implement appropriate health and safety measures to minimise the impact of the pandemic. We have provided additional financial assistance to small businesses and discretionary payments to contractor personnel to assist in transition

WPL Response to market conditions 27/03//20

We are protecting the health of our employees and communities through rapid implementation of health and hygiene controls in response to Covid-19.

RIO First Quarter Results 17/04/20

We have changed rosters at our Iron Ore operations, construction and exploration projects meaning fewer crew changeovers at our sites and in our operations centre to reduce the risk of transmission.

RIO First Quarter Results 17/04/20

Lowered FY20 production guidance at Australia Manganese by 5%, in response to restrictions aimed at containing the spread of COVID-19.

S32 Quarterly Report March 2020 20/04/20

Operational changes to hit productivity

Oil Search established a multi-disciplinary COVID Task Force in February, to prepare comprehensive plans to mitigate the potential impact of the virus on the health and wellbeing of the Company's staff, contractors and the local community and to support business continuity for production from Oil Search's operated assets. During the quarter, the Company commenced a series of measures, including suspending discretionary activities, demobilising non-essential staff from the field, implementing revised field rotations for expatriate staff, establishing quarantine zones in the field and isolating business essential personnel, increasing medical and field supplies and introducing infectious disease protocols.

OSH Quarterly report to 31 March 2020 21/04/20

We have implemented a series of measures to protect the health and safety of our people, including restricting travel and meetings, implementing social distancing measures across all of our sites and making changes to field and office access arrangements.

STO Santos COVID-19 response and business update 23/03/20

The company is continuing to work with all its clients to ensure that operations continue with minimal impact whilst ensuring the safety and welfare of all employees, contractors and customers. We are adapting to the situation and continually looking at better ways to operate, including changes to shift patterns.

SND COVID-19 Update 21/04/20

Our sites are adhering to the required social distancing guidelines which has resulted in changes to our approach to daily operations, for example staggering pre-starts toolbox talks and lunch breaks.

SND COVID-19 Update 21/04/20

The company is aware that some of the above issues have the potential to contribute to reduced productivity and project delays.

SND COVID-19 Update 21/04/20

Distancing measures driving reduced productivity

DOW Macquarie Australia Conference Presentation 06/05/20

Earnings will be reduced in FY20 due to COVID-19

DOW Macquarie Australia Conference Presentation 06/05/20

While many of the measures do come with a cost impact, they are minor compared to the impact that restricted operations could have had on the business

CVL Q3 FY20 Media Release 07/05/20

At operational sites, with SCEE personnel being required to follow client protocols, various changes to working practices have been implemented including social distancing and screening procedures, and roster and shift changes. Whilst overall these have resulted in some loss of productivity, the net impact is expected to be immaterial as SCEE is generally entitled to be compensated

SXE Contract Awards and Coronavirus Update 05/05/20

Margins in the second half of the financial year are expected to be significantly challenged as a result of the extent of the disruption and the impact it has had on the Company's operations.

MND Market Update 01/05/20

Cuts, cuts, cuts … and more cuts

Mitigation measures causing direct disruption

Virus mitigation measures, including travel restrictions and social distancing requirements, are having a direct impact on operations as producers focus on ensuring their production is maintained.

Exploration expenditure is coming under significant pressure as this is viewed as a less essential activity. RIO, FMG, BHP, WPL, ORG and STO are just some examples of companies that have significantly scaled back their exploration activity.

Additionally, maintenance and shutdown activity on offshore Oil & Gas projects has been significantly slashed. While this has been impacted by the decline in oil prices, it also comes as a result of the inability to maintain adequate social distancing and the complexity of dealing with a potential outbreak if one were to occur. WPL has detailed how they have had to reduce personnel numbers, and with MND being a major supplier of services for WPL, they have noted a particular hit in their fly-in, fly-out maintenance and shutdown operations.

New projects, such as those in Iron Ore, may be subject to further award deferrals as a result of a shift in organisational focus towards maintaining producing assets.

But indirect consequences are even bigger

While the direct consequences of lockdowns and mitigation measures are significant, the indirect consequences are even bigger. The chief indirect consequence of these measures is a major decline in economic activity, which is likely to negatively impact the demand for most commodities (with Gold the likely exception).

As a result of a lockdown led economic contraction, producers are understandably looking to aggressively cut costs to support their balance sheets as best as possible.

Capex and maintenance activities being deferred

As a result of these efforts, any discretionary capex and maintenance activities are being heavily cut back. While these cuts are being seen most aggressively amongst Oil & Gas operators, material cuts to FY20 and FY21 expenditure is being seen amongst most materials producers.

This should come of no surprise in the current economic environment, where producers are largely seeing the prices of their commodities materially impacted. This comes as the commodity collapse of 2015/16 also remains relatively fresh in their minds.

Growth projects may be delayed by years

In addition to cuts in operating expenditures, growth projects may in some instances be set back by years. Major potential projects like Scarborough are expected to be deferred by at least 12 months, but depending on the extent of the economic downturn, this could be longer. Any major project approvals would also likely be subject to a slow ramp-up in construction activity.

Future growth projects are likely to be additionally impacted by the major cuts we are seeing in current exploration expenditure.

Cuts, cuts, cuts … and more cuts

Review of all non-committed activities supporting Woodside's growth activities resulting in an approximately 60% reduction in Woodside's 2020 guided investment expenditure.

WPL First Quarter 2020 Report 16/04/20

The major turnaround for LNG Train 3 is now scheduled for September 2020 and the major turnaround for LNG Train 4 has been deferred to August 2021.

WPL First Quarter 2020 Report 16/04/20

We've also had to make tough but prudent decisions to ensure the financial integrity of our business, and these mean our spending in 2020 will be reduced by 50% and a targeted final investment decision (FID) on our Scarborough and Pluto Train 2 developments has been deferred from this year to next.

WPL First Quarter 2020 Report 16/04/20

Total expenditure in 2020 is forecast to reduce by approximately 50% to approximately $2.4 billion. This includes an approximately $100 million reduction in operating expenditure and an approximately 60% reduction in investment expenditure to $1.7 – 1.9 billion.

WPL Response to market conditions 27/03//20

The key impacts of this reduced expenditure are:
• Changes to the planned turnaround schedule at Karratha Gas Plant (KGP) …
• Reduction in the scope for 2020 of life extension activities at KGP
• Deferral of most proposed exploration activities, although some seismic acquisition will continue, reducing overall exploration expenditure by approximately 50% to $75 million
• Delay in Woodside's target FID for Scarborough and Pluto Train 2 to 2021
• Delay in Woodside's target FID for Browse

WPL Response to market conditions 27/03//20

Total exploration expenditure for Q3 FY20 was US$18 million. It is anticipated that full year expenditure will be US$120 million, which is US$20 million lower than earlier expectations due to COVID-19 impacts.

FMG March Quarterly Production Report 30/04/20

Chargeable hours have reduced 2% over the month of March 2020.

WOR Updated response to market conditions 28/04/20

Operationally, as a result of the current economic circumstances, there has been some contraction in the business from customers' delays, deferrals and cancellations particularly in field-based work.

WOR Updated response to market conditions 28/04/20

Headcount has reduced 5% between 31 January and 31 March 2020, primarily in lower margin construction related activities.

WOR Updated response to market conditions 28/04/20

In its Maintenance division, the Company has experienced a material reduction in activity levels, particularly in fly in fly out operations with customers reducing non-essential work, delaying discretionary maintenance expenditure and deferring shutdowns.

MND Market Update 01/05/20

Measures taken by governments and industry across the world to prevent further spread of the virus have impacted the economy, resulting in the delay, suspension, deferral or reduction of services across a range of the Company's projects and worksites.

MND Market Update 01/05/20

The Company's Engineering Construction division has experienced … a number of temporary deferrals to potential new construction awards dates.

MND Market Update 01/05/20

Asset Services – Delays to non-essential maintenance and capital works

DOW Macquarie Australia Conference Presentation 06/05/20

In current tendering activities, SCEE has been notified of some minor projects being postponed but notes that these were in sectors that have been particularly impacted by the crisis

SXE Contract Awards and Coronavirus Update 05/05/20

Two remote projects due to mobilise last month have been delayed for a limited period at clients' request due to location near high-risk communities.

SXE Contract Awards and Coronavirus Update 05/05/20

The current economic uncertainty may lead to some deferral in work volumes in the last quarter of the financial year. As such, the Board feels it would be prudent to suspend the guidance given on 25 February 2020.

BSA Trading Update 16/04/20

Sustaining capital expenditure to maintain safe and reliable operations remains a priority, however the flexibility of our programs across the Group means that some activity is able to be deferred to future years in response to unexpected market conditions.

S32 South32 Acts in Response to Market Conditions 27/03/20

We have acted to protect our strong financial position, reducing capital and exploration expenditure, suspending our on-market share buy-back and commencing a group wide review aimed at delivering a reduction in controllable costs.

S32 Quarterly Report March 2020 20/04/20

Lowering FY20 sustaining capital expenditure guidance, including equity accounted investments, to US$500M.

S32 Quarterly Report March 2020 20/04/20

Cuts, cuts, cuts … and more cuts

The physical replacement of the refinery crane [at Olympic Dam] and commissioning planned for commencement in the March 2020 quarter, has been impacted by COVID-19 restrictions, and completion is now expected by the end of the 2020 calendar year.

BHP Quarterly Activities Report 21/04/20

The confirmed delay of the Scarborough gas development to the 2021 calendar year …. A final investment decision by BHP is now expected to be approximately 12 months later than the original timing, which was from the middle of the 2020 calendar year.

BHP Quarterly Activities Report 21/04/20

The potential deferral of approximately US$200 million non-committed exploration and appraisal expenditure in the 2021 financial year, representing approximately 30 per cent of the average annual exploration spend over the last two years.

BHP Quarterly Activities Report 21/04/20

We have flexibility in our capital and exploration expenditure. We are reviewing our guidance for the 2021 financial year and it will be lower than the current guidance of around US$8 billion. We will provide updated guidance with our full year results.

BHP Quarterly Activities Report 21/04/20

Large and small [oil] producers alike have announced sharp cuts in capital spending in response to the price decline.

BHP Quarterly Activities Report 21/04/20

Capital expenditure is now expected to be $5 to 6 billion in 2020 (down from the previous guidance of $7 billion) partly due to Covid-19 constraints, and partly due to the favourable currency impact from the strong US dollar. Capital expenditure originally planned for 2020 may subsequently flow into 2021 and 2022, and we will provide a further update on capital re-phasing in due course.

RIO First Quarter Results 17/04/20

Strict health and travel guidelines have been put in place to reduce the spread of COVID-19 … [resulting] in the deferral of non-critical activity.

BHP Quarterly Activities Report 21/04/20

We are reviewing proposed FY21 activities and are targeting a deferral of up to 30 per cent of previously planned capital expenditure.

BPT Quarterly report for the period ended 31 March 2020 22/04/20

The initiatives announced today are aimed at delivering approximately US$160M in lower expenditure over the next 15 months to protect our financial position.

S32 South32 Acts in Response to Market Conditions 27/03/20

Origin is targeting a $300 million - $400 million reduction in Australia Pacific LNG upstream capital expenditure in FY2021 compared to FY2020 guidance.

ORG Operational and Financial Update 06/04/20

Exploration activities are likely to be affected by Covid-19 restrictions including the ability to move people and gain access to sites. A further update will be provided in July.

RIO First Quarter Results 17/04/20

Investment expenditure for 2020 has been reduced by approximately 40%, by either suspending or deferring discretionary activities not related to safety, value or reliability.

OSH Quarterly report to 31 March 2020 21/04/20

The current exploration program in the Beetaloo Basin has been temporarily paused due to COVID-19. The joint venture is targeting a recommencement of Stage 2 activity in the second half of the 2020 calendar year

ORG Operational and Financial Update 06/04/20

FID on Barossa has been deferred until business conditions improve. Barossa remains an important project for Santos due to its brownfield nature and low cost of supply.

STO 2020 First Quarter Activities Report 23/04/20

2020 full year investment expenditure guidance has been reduced by approximately US$300 million. Forecast capital expenditure going forward from April 2020 is expected to be in the range of US$200 – 300 million.

OSH Quarterly report to 31 March 2020 21/04/20

Oil Search has decided to delay the FID date for the Pikka Unit Development.

OSH Quarterly report to 31 March 2020 21/04/20

On 23 March, Santos announced financial measures in response to the lower oil price environment, including a US$550 million (38%) reduction in 2020 capital expenditure, a US$50 million reduction in cash production costs and a target free cash flow breakeven oil price of US$25 per barrel.

STO 2020 First Quarter Activities Report 23/04/20

Forecast capital expenditure in the base business in 2020 has been reduced by $200 million whilst maintaining production.... Discretionary expenditure and exploration programs have been deferred where appropriate…. Forecast major growth capital expenditure has been reduced by $350 million, reflecting re-phasing in expenditure for the Barossa and PNG LNG expansion projects.

STO Santos COVID-19 response and business update 23/03/20

Don't expect a V-shaped recovery

There is no V-shaped opening

With financial markets rebounding on expectations of a V-shaped recovery, there are several reasons as to why this may prove optimistic. Firstly, while we saw an almost immediate downturn in economic activity as lockdown measures were imposed worldwide, there is no immediate re-opening. Instead, we are seeing a gradual and prolonged lifting of restrictions. Some measures, like social distancing, may linger for extensive periods of time. How then, can it be possible to have a V-shaped recovery, when we are having a slow and staggered re-opening of the economy?

Productivity to be materially impacted for some time

While many businesses are being allowed to reopen around the world, this is not being done without restrictions. The most prominent of these restrictions are social distancing measures. The impact this is having on companies in the Engineering & Construction sector has already been discussed. Other areas, such as restaurants and entertainment venues will be even more heavily impacted by these measures.

As a result of reduced productivity and the ongoing forced partial or complete closure of certain businesses, it is simply not possible for economic growth to return to its previous level any time soon — these measures have resulted in a reduction in the economy's productive capacity that is likely to be material.

The proposed cure is simply more of the disease

In an attempt to save the economy, countries the world over are simply pumping out more of the disease - debt. It is debt that caused the GFC and it is debt that is causing the current crisis. While the lockdowns have certainly brought this to a head, the reasons why the lockdowns are so damaging, is that economies are swimming up to the tops of their necks in debt. For an economy that was instead built upon solid foundations, on savings, on being encouraged to live within ones means, would not be on the verge of complete collapse from an 8 week loss of income.

And don't forget, the world economy was on this very precipice. With corporate bond markets ready to implode, it is only the extraordinary stimulus and liquidity measures being provided that have prevented a collapse. While these measures may help temporarily, they simply represent more of the disease that got us here.

Who said zombies aren't real?

One consequence of these extraordinary measures, is that many companies that should have failed, will not (at least temporarily). This is exacerbating the already very real problem of zombie companies. These are consistently unprofitable companies, who do not have the capacity to invest for growth, and who only keep their highly indebted heads above water because of artificially low interest rates. Such companies do not grow productivity and suck up capital from those who can, reducing an economy's growth potential.

Recovery likely to be a slow, long grind

Given that the worldwide economy is now significantly more leveraged than the already high levels from two months ago, aside from a likely initial blip upwards as lockdowns end, any significant recovery to our prior economic levels and beyond, is likely to be a slow, long grind. This slow economic recovery could be far worse than the GFC on account of the massive further increase in debt that is now in the system — many more companies have just become zombies.

What it means for the E&C sector

There is a real chance that markets retest March lows

Given the high level of doubt that exists in achieving a V-shaped economic rebound, there is a significant likelihood that markets may be getting too optimistic about the prospects of an economic recovery. This optimism appears to be growing by the day, with each piece of increasingly negative economic news brushed aside, and stories of fear replaced with FOMO.

With ASIC recently issuing a warning to retail investors following a surge in new account openings and trading frequencies, this should provide a clear indication of the exuberance that has began to gradually take hold of markets over the past month. It is clear that most financial participants are not fearful right now, but greedy.

If the economy does not vastly turn around in the 2nd half of 2020, the nerves of many who assumed a V-shaped recovery would occur, are likely to be tested, setting the stage for a re-testing of market lows.

The biggest counterweight to retesting market lows (which is also the key reason behind why the market has been so strong), is the extraordinary amount of stimulus and financial liquidity being injected into the system. Therefore even if economic conditions are to remain anemic, it is possible that enough inflation will be injected into financial markets so that they are able to maintain their current levels in nominal terms.

More stimulus will come, may benefit those in Infrastructure

Given that this stimulus is likely to not only continue, but grow in size, E&C companies with exposure to Infrastructure will likely have numerous opportunities to further grow their order books, particularly those with a strong ability to deliver projects in Roads and Rail. Perhaps we may also see upgrades to the electricity grid, while additional work may also become available for those involved in Defence. Companies like CIM, SXE, DOW and DCG will thus likely have numerous opportunities to grow their order books.

Though even with potential tailwinds in Infrastructure and calls for work to be fast-tracked, it is unlikely that major projects can get up and running immediately. These will still require vast levels of planning, which simply takes time. More immediate opportunities are likely to be smaller in scale, and potentially provide good work for Tier 2 and Tier 3 contractors.

We note that if Infrastructure spending is conducted heavily on a global scale, demand for commodities like Iron Ore, and their prices, may remain somewhat resilient. This may help to limit the depths of producer cut-backs across certain commodities and make any cuts less long-lived. This may benefit certain mining services companies.

Don’t expect a short-term rebound, need long-term focus

Despite some of these potential positives, investors would be playing a dangerous game by betting on a short-term rebound in the Engineering & Construction industry. This is a very cyclical industry, and it will be impacted heavily by any prolonged economic downturn.

While at some stage economic conditions will improve, the demand for commodities and their prices will rise (indeed, the current slump in investment is likely to fuel the next boom) and low interest rates will likely continue to stimulate construction, this is unlikely to happen immediately. Investors thus need to maintain a long-term time horizon, as it may take years for these changes to occur, as opposed to months.

What it means for the E&C sector

Remember, industry not sustainable and some may fail

Our caution is further predicated on the fact that returns across the industry were rather weak *before* the coronavirus and it has been this way for a significant period of time. Given that the industry was not sustainable *before* all of this turmoil, the situation is likely to become particularly precarious for many. We thus see the potential for multiple E&C companies to fail within the next 3 years.

Given this outlook, it remains paramount that investors maintain their focus on companies with strong balance sheets, and a proven track record of consistently delivering profits, strong cash flow and sustainable shareholder returns.

Who cuts and who maintains?

Only 3 companies maintain guidance and pay a dividend

Of the 19 companies in our E&C index, only 3 of them have maintained their guidance and paid their interim dividend.

SSM's essential services focus means that most of its business is likely to continue trading through this period relatively unscathed. With a strong history of cash flow generation and only a minor net debt position at 1H20, it is of no surprise that its dividend was paid.

With much of MLD's revenue production focused, its revenue guidance has been maintained. The bigger question will be its margins. Importantly, the company also has EBITDA guidance, which it has not withdrawn.

With GNG being in a notable net cash position, it is not overly surprising to see it pay an interim dividend. It is also positive to see that its revenue guidance has been maintained. Though the real test for GNG will be its FY21 revenue outlook and whether its study pipeline converts into projects or is instead deferred.

SSM best placed to navigate downturn

Of all the companies in our index, SSM is the best placed to navigate this downturn on account of its essential services focus. SSM's extensive work for NBN Co and increase in nbn network demand as individuals are forced to remain home, may mean SSM is a net beneficiary of lockdowns. SSM's strong track record and history of solid cash flow generation also stands it in good stead.

We note that SXE has maintained its guidance, and continues to grow in Infrastructure markets. With the company having a very solid net cash balance, SXE may be better placed than many of its peers to deliver acceptable returns in the current environment.

It is positive for DCG that its guidance remains. A successful sale of its Gladstone Accommodation village for a material sum will help to improve its balance sheet and further opportunities are likely to arise in Roads. Though we note that this remains very risky until its contract disputes are settled.

Figure 8: Company guidance and dividends

Company	Guidance?	Dividend?	Commentary
BSA	Withdrawn	Deferred	Business tracking to internal forecasts at end of March. Sees potential for the deferral of some work volumes in 4Q20.
CIM	Maintained	n/a	NPAT guidance of $810m-$850m. Not due to go ex-dividend until June.
CVL	n/a	n/a	Believes it will benefit from in-house Australian manufacturing capability, but notes some cost impacts.
DCG	Maintained	n/a	FY20 revenue guidance of $475m - $525m and positive 2H20 profit. No dividend on account of large 1H20 losses.
DOW	Withdrawn	Deferred	DOW has seen productivity impacts, hits to New Zealand operations, Spotless, Asset Services, Mining and Yarra Trams.
GNG	Maintained	Paid	Revenue guidance of $200m - $220m. No Covid related update provided.
LCM	n/a	n/a	No specific financial guidance and no dividend declared.
LYL	Withdrawn	Paid	Revenue and NPAT guidance withdrawn 25 March, noted little impact at that time but envisaged further impacts.
MLD	Maintained	Paid	FY20 revenue guidance of $770m and EBITDA of $104m-$110m maintained.
MND	Withdrawn	Paid	10% revenue growth guidance withdrawn, current run-rate for flat YOY revenue. Seeing delays, deferrals and margin impacts.
NWH	Maintained	Deferred	FY20 revenue guidance of $2bn. Market update stated deferral of interim dividend, but did not specifcally withdraw guidance.
PGX	Maintained	n/a	FY20 revenue guidance of $195m and 2H20 EBITDA margin of 6-8% maintained.
SND	Maintained	n/a	Expects revenue to grow in 2H20 and FY21. Notes operational changes have the potential to reduce productivity.
SRG	Withdrawn	Deferred	Impacted by level-four NZ shutdown, continuing operational delivery of most other services.
SSM	Maintained	Paid	Guidance for 2H20 EBITDA from Operations to be in line with 1H20 maintained.
SXE	Maintained	n/a	FY20 revenue guidance of $420m, stronger 2H20 profitability. Some loss of productivity, project delays and deferrals noted.
TPP	n/a	n/a	No financial guidance or dividend.
WOR	n/a	Paid	No specific financial guidance, but have reduced headcount by 5% and chargeable hours have fallen by over 2% in March.
WSI	Maintained	n/a	Noted at its 1H20 results that it had a $25m order book for 2H20, this guidance appears to be unchanged.

SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

What this means for our coverage

MND requires a long-term focus

While remaining Buy rated on MND on account of the valuation support from a large share-price fall, as is the case across most of our E&C Index, we have stressed that a long-term focus is necessary.

Demand for many of MND's services is likely to fall materially in FY20 and FY21 on account of company's seeking to defer any discretionary expenditure in order to reduce costs and strengthen balance sheets during this time of turmoil. In addition to a decline in demand, the reduced operational leverage and significant disruption to operations as a result of coronavirus mitigation measures, is likely to result in a significant hit to margins.

Though we do note that one day the economy will recover, and so too will commodity prices, with the current deferral of projects likely to aid this recovery. Once this occurs, demand for MND's services will once again rise. With a solid net cash position, strong track record and market standing across both its EC and M&IS services divisions, MND is thus in good stead to recover and deliver material upside over the long-term.

LYL's international focus creates a lot of uncertainty

Our Hold recommendation remains in place on LYL on account of its significant International focus, which has seen the majority of its workflow come out of Africa in recent years. While these projects have largely been exposed to Gold, where prices remain strong, travel restrictions are likely to make projects in these jurisdictions, which somewhat rely on expatriate labour, extremely difficult to complete.

While LYL also has a strong track record and cash position, on account of the very high level of uncertainty surrounding its core business, as well as its share price remaining relatively resilient, we maintain our Hold recommendation.

SSM the best placed in our E&C index to navigate turmoil

In contrast to MND and LYL, who are both exposed to very cyclical industries, SSM's essential services focus across Power, Water, Gas and Telecommunications mean that the company is likely to prove resilient against lockdowns and economic turmoil. This has seen SSM maintain its market guidance and pay its interim dividend.

On account of a strong track record of cashflow generation, consistent operating performance which regularly sees long-term contracts renewed, and a healthy fully-franked dividend yield, we maintain our Buy recommendation and $2.80 price target on SSM.

Share price performance

Shares rebound in April

After falling 30% in March, the simple average return of the companies in our E&C index rebounded to post a 16% rise during the month of April.

Figure 9: Share price changes to 30 April 2020

	1-month price change	12-month price change
BSA (BSA)	-3.4%	1.8%
CIMIC (CIM)	6.0%	-51.3%
Civmec (CVL)	-4.8%	-7.0%
Decmil (DCG)	73.1%	-76.2%
Downer (DOW)	39.9%	-46.1%
GR Engineering (GNG)	-2.9%	-31.3%
LogiCamms (LCM)	0.0%	-17.6%
Lycopodium (LYL)	**8.6%**	**-6.4%**
MACA (MLD)	14.8%	-28.6%
Monadelphous (MND)	**9.9%**	**-40.4%**
NRW (NWH)	35.9%	-42.0%
Primero (PGX)	22.2%	-44.3%
Sanuders (SND)	26.3%	45.5%
SRG Global (SRG)	18.2%	-25.7%
Service Stream (SSM)	**8.0%**	**-16.7%**
Southern Cross Electrical (SXE)	0.0%	-15.4%
Tempo (TPP)	-8.8%	-52.9%
Worley (WOR)	46.3%	-37.2%
WestStar (WSI)	8.3%	-43.5%
Simple average	**15.7%**	**-28.2%**

SOURCES: IRESS, BELL POTTER ESTIMATES

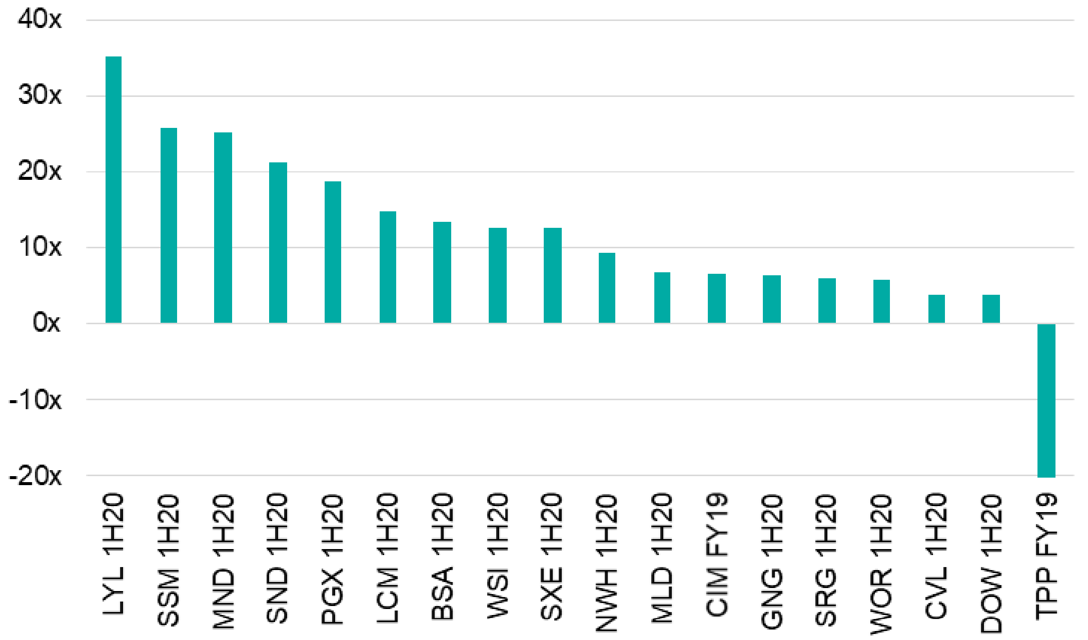
Those hit hardest rebound the most, including DCG

Many of those that suffered particularly large share price declines over the past 12-months were some of the best performers during the month, including DCG, DOW, NRW and WOR.

While DCG's share price saw a sharp rebound from its March low, its shares still ended April 76% below their level from 12 months earlier.

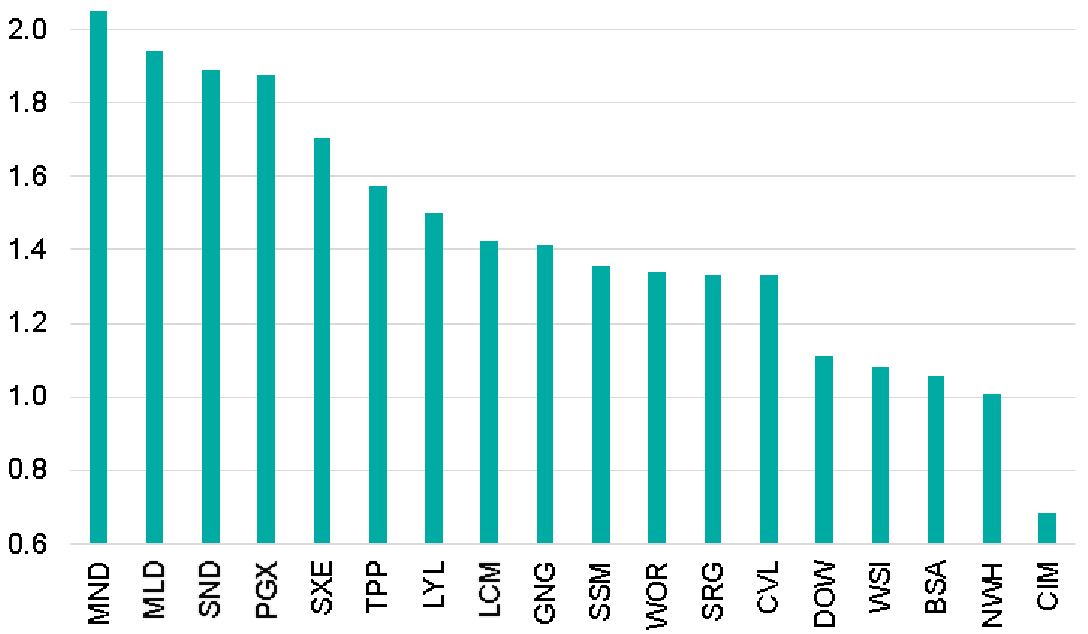
Appendix: Balance sheet metrics

Figure 10: Underlying EBIT/Finance costs (including AASB 16 finance costs)



SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

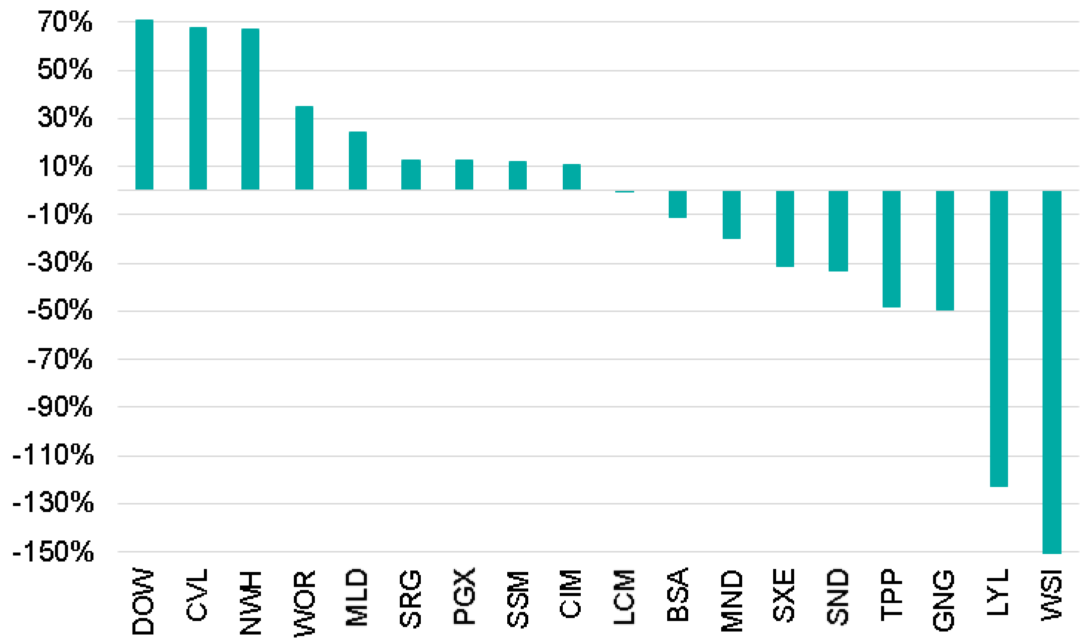
Figure 11: Current assets/current liabilities at Dec 2019



SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

Appendix: Balance sheet metrics

Figure 12: Net debt (cash) (including AASB 16 leases)/equity at Dec 2019



SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

Figure 13: Notable net cash balances/1H20 operating revenue (TPP CY19 rev.)

SOURCES: COMPANY DATA, BELL POTTER ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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Steven Anastasiou, authoring analyst, holds a long position in MND.