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FY21 Full Year Results, Investor Webcast transcript

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Operator: Thank you for standing by, and welcome to the Downer Group Full Year Results Investor Briefing. All participants are in listen only mode. There will be a presentation, followed by a question-and-answer session. If you wish to ask a question, you will need to press the star key, followed by the number 1 on your telephone keypad. I would now like to hand the conference over to Mr Grant Fenn, CEO. Please go ahead.

Mr Fenn: Well, good morning everyone. My name is Grant Fenn, and I am the Chief Executive Officer of Downer. And with me is Michael Ferguson, and he's our Chief Financial Officer. So I'll begin with an overview of the 2021 full year results, and then Michael will go through the financials in a bit more detail. And we'll then open up the call for your questions. Now, hopefully, you have the presentation pack in front of you. If not, it's on the ASX and also on the Downer website, and what I'll do as we go through, I'll reference the relevant pages.

So let's move to Slide 2, titled 'FY21 Highlights', and it shows the financial performance for the 12 months to 30 June 2021. Now, these are very pleasing numbers, I think, and achieved in a year of COVID disruption, and I just want to take this time to acknowledge the outstanding efforts of our people as we've continued delivering for our customers over this period. It's been very, very good. Now, our focus on critical urban services has meant that demand has remained strong throughout the year, and that has resulted in the very resilient performance that you see. Underlying NPATA was $261 million, up 21.4% when compared with the prior corresponding year. Underlying EBITA increased by 12.3% to $467 million, and the Group's EBITA margin rose by 0.7 percentage points.

Our cash flow performance was excellent. If we adjust for $79 million of cash outflows from individually significant items recognised as expenses in the prior period, then our cash conversion was 101%. Now, without that adjustment, it was 92%. So either way it was a terrific result. Following our capital raising asset sales and strong operating cash performance, our net debt to EBITDA was 1.5 at 30 June, and our gearing was down to 19%. Perhaps right now is not a bad time to have a very strong balance sheet, but we do intend to lift our net debt to between two and two and a half times EBITDA in line with expectations for a BBB investment-grade credit. Then a $400 million share buy-back, which we commenced in April, will help with that and of course we'll continue to invest in the business and look for accretive opportunities to grow. Earnings per share was up 3.5% from the previous year to 36.6 cents and the Board declared a final dividend of 12 cents per share, taking the full year dividend payout to 21 cents and 57% of underlying NPATA.

If we now move to the next slide, that's Slide 3 talking about our priorities. We have delivered on the priorities that we set out in February at our half-year results. We said we needed to deliver strong FY21 earnings in cash. Well, earnings were up 21%. Cash is 101% of EBITDA. Margins are up 0.7 percentage points and, all in all, a pretty solid financial performance for the year. We said we needed to complete the sale of our non-core assets, and we've made very good progress with $628 million in sale proceeds so far, with $510 million in the bank. We continue to work on the sale of our Open Cut East mining business and its four profitable contracts. Whether, ultimately, we sell Open Cut East or run the contracts out to expiry, we are very confident that appropriate value will be received by shareholders.

We also highlighted that we'd make changes to our corporate structure and improve market focus and reduce costs. The Spotless operations are now fully integrated into Downer and we've merged our Major Projects and Rollingstock businesses to create Rail and Transit Systems. We have also reduced management layers and consolidated functions for better performance. On the capital management front, we've recapitalised the business, reset our target capital structure, commenced our promised $400 million on-market share buy-back and lifted the dividend payout ratio to 60% for the second half, and our intention is to build the dividend cents per share over time.

Our sustainability reporting and performance has continued to improve, as have our external ratings in what's become a very important area. This isn't a stretch for Downer. We are a good corporate citizen and we are getting better at demonstrating that to investors. We also told you that we'd focus on the implementation of The Downer Standard, and I'm very pleased to report we've achieved single quality certification across the Group. Having consistent and effective standards across the delivery aspects of our business is very key to improved project performance and higher margins. This is a significant cultural change program, as much as anything else, and, if well executed, will hold Downer in very good stead into the future.

So I'll now turn to Slide 4, 'Urban Services Transformation'. As most of you know, our Urban Services strategy is leveraged to the long-term, macro-economic trends of expanding population, urbanisation, bigger government, government outsourcing. Now, government is getting bigger every day and service expectations from citizens are always rising. As shown in the pie chart at the bottom of the slide, 90% of our work-in-hand now comes from contracts with governments in Australia and New Zealand or regulated critical infrastructure. And this compares with 56% five years ago, so it's quite a significant change. Our portfolio is now less cyclical, with lower capital requirements and stronger cash conversion. But really importantly, we've got scale, we've got diversity in our earnings and we've got financial strength.

We'll move now to Slide 5, 'Strength Through Market Position and Diversity'. Transport has long been the powerhouse of the Downer Group and you can see here that it contributes a fraction over half of Downer's revenue. And it's in a very strong position in both Australia and New Zealand. A few things that are very key here. We've been very successful in developing new green products that use a high level of recycled or repurposed materials from roads, road sweepings, glass, toner and other waste that otherwise would go straight to landfill. Our local government customers, in particular, really can't get enough of these what we would call high-quality green products. We are also investing in state-of-the-art manufacturing and recycling plants. They are energy-efficient and can blend high levels of recycled material into our product mix. Not only is this more sustainable environmentally, but it's cost effective against virgin materials dug out of the ground. The best quarry is the existing road, but you must have a manufacturing plant able to use it and the technical capability to produce products to specification.

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Our strength across the value chain from network management to bitumen importation gives this business significant advantages, as does its network of contracts and facilities in strategic locations, and we will continue to invest in this position. We are also the market leader in passenger rollingstock in Australia, with scale franchise positions in Sydney, Melbourne and Perth passenger fleets. In Sydney, we maintain and overhaul 136 eight-car trains, with a contract term of around 25 years remaining. And, in Melbourne, once manufacturing is complete with the new trains down there, we'll maintain 65 seven-car trains for the next 30 years, with options for the Victorian Government to increase that to 125 trains. These are infrastructure-like positions in critical state government assets.

We've also extended our service offering into public transport operations, as you would know. Through Keolis Downer we operate the largest light rail network in the world in Melbourne, light rail on the Gold Coast and Newcastle, heavy rail on the newly privatised Adelaide network and bus networks around most of Australia's major cities. And there is now an unprecedented level of government investment across our three transport businesses.

Utilities contributes 20% of Group revenue, and we've got a very well-balanced portfolio across power and gas, water and telecommunications. We are the market leader in all three in both Australia and New Zealand, and that's based on strong, long-term relationships with our customers. Over 80% of our work-in-hand is with government or government backed contracts. The topic is often raised across the investment community in any case around the impending issues related to the reduction in NBN and UFB construction volumes as those rollouts have been completed. I'm really pleased with this business that those contracts have rolled off, but we've won significant long-term contracts in each of our businesses in both Australia and New Zealand. So our success in gaining positions on a number of major city water panels has been very pleasing, and our wastewater treatment technology is proving popular as utility owners look to upgrade their facilities. And there is an emerging opportunity to apply our knowledge and skills to help existing customers transition to new energy sources. Increasingly, we are designing and installing renewable power generation on our customers' buildings and estates. Our diverse capabilities are providing increased value to our customers as they look to deal with government and investor pressure to decarbonise.

As with transport, we've made successful bolt on acquisitions in the utility sector and will continue to invest where we see opportunity. We are now managing facilities and asset services as one business, and you can see that this service line contributed just under 30% of revenue in 2021. We are the largest integrated facilities services provider in Australia and New Zealand, with strong positions in a number of government areas, including health, education, defence and social housing. We are the leading provider of asset management and specialist services to Australia's critical economic infrastructure, including the oil and gas power generation and industrial sectors. Our strong relationships in these sectors and our investment in capability means we will also be well-positioned to participate in the hydrogen economy. Our technology partnership with Mitsubishi Power Systems does give us a technical edge.

If we now move to Slide 6, 'Strong Macro Outlook', this slide reinforces the points that we've been making about our strategy, and that is we are in the right spot, given the macro economic outlook and the unprecedented government expenditure in the sectors we are strong in. I'm not going to go through all of the future of the things that we are in. You can read it on those slides and there's lots of other things that you can look to support that.

We'll now move to work-in-hand on Slide 7. Work-in-hand at our core business is a very substantial $35.4 billion, with a long tail. 90% of the work is government-related, split 80/20 between Australia and New Zealand. 91% of our work-in-hand relates to services contracts, with just 9% attributable to building and construction. And only 1% of our $35.4 billion of work-in-hand relates to competitive, fixed-price, lump-sum construction contracts. Our risk controls across work type and contract model are working to significantly reduce construction risk. In both Australia and New Zealand, we are seeing an increase in governments using more collaborative, risk-sharing contract models, such as alliances and early contractor involvement processes. This is increasing Downer's addressable market due to substantially reduced risk. Another issue that has arisen lately in Australia is how companies are managing the risk of labour cost escalation, and that takes us to the next slide.

There was a piece of analysis put out recently suggesting that Downer was heavily exposed to labour price increases and we thought it would be helpful for investors if I address this. And we do that on this slide, Slide 8. Across Downer longer-term contracts typically include mechanisms to mitigate the risk of cost escalation, including labour. Now, as you can understand, this is a critical area of focus for bid teams and management review for bid and contract approvals. It gets a lot of attention. Shorter-term contracts generally involve minimal risk, precisely because they are short-term and prices are current. If we just run through the businesses, though. Within Transport, our longer term maintenance contracts have monthly rise and fall mechanisms, based on appropriate indices to account for movements in costs, but, most importantly, in bitumen and labour. Surfacing jobs on major road builds also have rise and fall mechanisms like this. Within Utilities, our maintenance contracts are schedule of rates or panel based, with labour and other costs reviewed annually or covered by escalation mechanisms. And for facilities, PPPs make up a substantial proportion of the portfolio, and these all have specific labour escalation provisions and major reset opportunities, typically each five years. Our non-PPP facilities contracts with governments include specific labour adjustment mechanisms. And our Asset Services contracts are usually shorter term and cost reimbursable, so the risk is minimal. In short, the risk of input cost escalation isn't zero, but it is limited. Our contract prices adjust and we manage the potential for mismatches very closely.

Slide 9 summarises the impact of the latest COVID-19 restrictions on the Group. And while we have certainly not been immune, you can see the impact has been relatively limited. The biggest issue for us, and industry in general, has been the restrictions on mobility for our skilled labour and management due to the closure of the national and, most importantly, the State and even Local government boundaries. Now, this has resulted in pockets of industry skill shortage, and where that's happening, increasing competition for experienced blue and white collar employees. This has been particularly acute in Western Australia, and I'm sure you understand that from all of the people you're talking to, and, for us, that is most acute in our Asset Services business. For our Road Services business, July and August is relatively quiet so the impact on the shutdowns in Sydney hasn't been that great. There's been limited impact for Rail and Transit Systems and, while reductions have affected progress on a few projects listed on the slide, that's the extent of it in Transport.

It's important to note that we have got contractual protections in place to extend completion dates and recover the costs of delay. There's been no material impact on Utilities and Facilities, except, of course, for Hospitality. So, in summary, while COVID-19 restrictions have affected us in some areas, the impact has been limited.

So we might now turn to Slide 10 and our sustainability performance. For Downer, what does sustainability mean? Well it's sustainable and profitable growth. It's providing value to our customers. It's delivering what we do in a safe and environmentally responsible manner. It's helping our people to be better and advancing the communities in which we operate. And we continue to improve our sustainability performance and reporting, and today we published our 2021 Sustainability Report. I've got to say that's no mean feat to get that out as quickly as we have, the financial side of the scorecard, given the size and breadth of our business. And I would encourage you all to read the report, and it's got a lot of very good detail and really interesting information that you may not be aware of and it's got a range of case studies in there.

If we move to Slide 11, there is a whole list of sustainability achievements for the year, and they are pretty substantial. I'm not going to go through all of those, but it's worth sitting down and going through them in your own time and couple those back to the Sustainability Report.

If we flip over to Slide 12, it's an interesting slide – these are opportunities coming out of the sustainability area. And we think the increasing focus on sustainability by our customers and the capital providers is a real opportunity for us to differentiate ourselves. We believe we are a net winner in this space. As we highlighted at our recent Investor Day, our Urban Services strategy delivers not only lower capital intensity, but also lower carbon usage. So the divestment of our Mining and Laundries assets will reduce our Scope 1 and 2 emissions by 35% or 206,000 tonnes of carbon dioxide equivalent. The Slide 12 that you've got in front of you identified some of the sustainability opportunities for each of our businesses as well. So in Transport, we expect more investment in recovery and repurposing of materials for roadbuilding and maintenance, and we are already invested in Reconomy, Repurpose It and Reconophalt services, and these offerings are putting us in a very strong position and we are now a major player in waste. We'll continue to develop smart road and rail solutions, and we are already building new infrastructure required to support alternate fuel vehicles. All governments will look to reduce energy use on their transport fleets, and we are working on the production and trial of lower emission trains and locomotives, as well as zero emissions buses.

Our Utilities business will continue to play a role in renewable electricity generation and benefit from the network upgrades required to support higher renewable capacity, including transmission lines, substations and associated connections. And there's also opportunities in energy storage systems, energy efficient wastewater treatment facilities and smart motor technology. And we'll continue to maintain and upgrade existing power generation assets and we are well-placed to play a role in delivering hydrogen-associated infrastructure, as well as carbon capture and underground storage.

In summary, Downer's extensive capabilities provide our customers with a range of sustainable services and solutions. The answers are at their doorstep and they are inviting us in. More broadly on the sustainability front, we are good corporate citizens, as I've said, and our corporate culture is strong. Our workforce is diverse, we support and empower Indigenous businesses, culture and education, and we work very hard to look after our people, including their mental health. I'll stop there now and I'll hand over to Michael to take you through the numbers in a bit more detail.

Mr Ferguson: Thanks, Grant, and good morning everyone. I'll pick up from Slide 14, 'Underlying Financial Performance'. On a consolidated basis, the Group reported total revenue of $12.2 billion to the 12 months to 30 June 2021. This was 8.8% lower than the prior corresponding period, predominantly due to the reduced contribution from the non-core and divested businesses. EBITDA, on a consolidated basis, increased 4.3% to $899 million, with EBITDA margins increasing from 6% to 7%. Depreciation and amortisation fell 3.2%, again predominantly due to the reduced depreciation from Mining and Laundries. Consolidated underlying EBITA rose 12.3% to $467.3 million, and EBITA margin lifted 0.7 percentage points to 3.8%. Net interest expense reduced by 10.2% due to lower debt levels and an improved average cost of funds. The effective tax rate of 28.5% remains slightly below the Australian statutory rate of 30% due to non-taxable distributions from joint ventures and a lower corporate tax rate in New Zealand. The statutory rate for the year of 20.1% reflects the non-taxable gains in capital losses recognised as part of our divestment program.

Downer delivered an underlying NPATA of $261.2 million, which is 21.4% higher than the corresponding period. Return on funds employed increased almost 2% to 12.1%, reflecting the improved financial performance and the impacts of the capital raising and divestments. Our strong earnings in cash performance resulted in the Downer Board declaring an unfranked final dividend of 12 cents per share, taking full dividends to 21 cents per share for the year. As a result of the Group's tax losses and the recognition of capital losses arising from the divestment program, Downer expects to return to franked dividends, either for final FY23 or interim FY24.

Moving now to Slide 15, 'Outlining the Business Unit Performance'. Downer's core Urban Services businesses delivered EBITA of $523.6 million, up $21 million, or 4.3% on the prior year. Transport delivered EBITA of $250 million, with a strong performance in Roads, offsetting a reduction in Rail and Transit Systems brought about by the completion of the Waratah bogie overhaul program. Whilst the Utilities result has only increased slightly, up 0.4%, it is pleasing that, as the NBN construction nears completion, this has been offset by strong results in power projects, water and telco in New Zealand.

Facilities also performed well, increasing EBITA by 12.1% through good contract performance in defence, government services, health and building, in addition to cost reductions following the full acquisition of Spotless. Facilities margins have increased to 5.6% for the year. Asset Services EBITA of $18.3 million represents a 33% reduction on the prior year and arises from COVID-19 driven decisions to defer shutdown and maintenance work, in part offset by strong performance in power maintenance. The EC&M result relates to the final cost of closing out legacy contracts, while the results for Mining and Laundries represents their earning contributions for the period, including the contributions for those parts that have been sold. Corporate costs rose by 21% to $103 million. Whilst we have reduced our head office costs as part of the divestment program, the benefit of these reductions has been offset by increases in other costs, specifically insurance and IT security costs, which have led to a combined increase of $14 million. FY21 also saw amounts recognised for short-term incentives that were not paid in FY20. Included in Corporate costs is $20 million related to fixed, non-cash amortisation arising from the Group's significant IT investment over the last five years.

This all equates to total underlying EBITA of $467 million, an increase of 12.3%, with a corresponding EBITA margin of 3.8%, up 70 basis points. We've provided more information on the divisional performance as part of the supplementary information to this presentation.

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Slide 16 lists the five items that reconcile Downer's statutory result with the underlying result, four of which are consistent with the first half. The first item relates to the non-cash fair value movement on the Downer Contingent Share obligation liability arising from the options issued as part of the Spotless minority acquisition. These options were granted as part of the acquisition of the remaining 12.2% interest in Spotless, with 2.5 million options, each vesting when the Downer share price reaches $6.38, $6.87 and $7.36. The fair value of these options are required to be recognised as a financial liability at issue date, with the future movements being mark to market through earnings. As a result, we have recognised a non-cash charge of $16.6 million for the full year.

The second item relates to the non-cash write-off of deferred financing costs relating the termination of Spotless' standalone financing arrangements as a result of the refinancing undertaken during the year. The third item relates to the net result of the Mining divestment program, including asset write downs, transaction costs and redundancies. The fourth item relates to the Laundries divestment, including transaction costs and stamp duty. The Mining and Laundries divestments have also seen the recognition of capital losses and other tax benefits of $34 million. The final item relates to the impacts of an accounting policy change in relation to the Group's treatment of cloud-based Software as a Service cost. Following a decision by the IFRS Interpretations Committee, the software configuration and customisation costs, where the customer doesn't control the software, can no longer be capitalised as an intangible asset. This includes many applications used by Downer, including Microsoft Dynamics and Office 365. As a result of the decision, Downer has expensed $14 million of costs in FY21 that would otherwise have been capitalised, with the comparative period and opening retained earnings also restated to reflect the historic impact.

I will now move on to operating cash flow on Slide 17. It is pleasing to report an underlying cash conversion of 101% and a statutory conversion of 92%. Consistent with the Half Year, the statutory cash flow has been adjusted to reflect the impact of items recognised as part of Downer's restructure in FY20, which are funded by the proceeds of the July 21 rights issue. These totalled $79 million for the year and included portfolio restructure and exit costs, payroll remediation costs and the settlement of the Spotless shareholder class action. Cash performance was good across the portfolio and reflects the increasing shift to a high proportion of service-based revenues with stable recurring cash flows. Pleasingly also receivables factoring at 30 June 2021 reduced to $63 million, down from $102 million this time last year and $105 million at the half.

Turning to overall cash flow on Slide 18, the strong operating cash flow performance has resulted in funds from operations of $251.1 million. This also reflects reducing capital expenditure as part of the divestment program, which I'll cover in the next slide. Funds from operations dividends paid has increased as a result of the payment the FY20 deferred interim dividend, in addition to the FY21 interim dividend, whilst the divestment and share issue proceeds have contributed to a strong a cash and balance sheet position at 30 June 2021. Cash held at 30 June was $811.4 million which, combined with undrawn facilities of $1.3 billion, provides us with significant liquidity at $2.2 billion.

Please now turn to Slide 19, 'Capital Expenditure'. Core capital expenditure totalled $154 million, which included several growth projects, including our new Brendale Road Services facility in Queensland, equipment for the City Rail Link JV in Auckland and incremental investment in new equipment and fleet. Non-core net CAPEX of $74.3 million relates to

Mining and Laundries. IT security and upgrade CAPEX relates predominantly to the fleet management system enhancements for the SGT and HCMT rail projects and IT security enhancement. In a climate of increasing cyber risk, Downer has committed to attaining ISO 27001 accreditation, which is the recognised standard in information security management systems. As a provider of services attached to critical infrastructure, Downer sees this as a competitive requirement.

Turning to Slide 21. The Downer Group balance sheet has seen improved metrics in the past year. Net debt in absolute terms has reduced from just under $1.5 billion to $708 million, whilst net debt to EBITDA on a post-SSV16 basis has reduced from 2.6 times to 1.5 times. Similarly, gearing has reduced to 19%. Downer continues to be rated BBB Stable by Fitch ratings.

Moving to Slide 21. Downer's Sustainability Link Loan has extended our debt duration and achieved a more balanced debt maturity profile. Our weighted average debt duration is now 3.8 years, compared with 3.4 years in the prior corresponding period. This is partly driven by current borrowings of 30 June of $296 million. This includes a $250 million medium-term note issue maturing in March 2022, which will be repaid from our existing facilities and cash. Downer will also look at opportunities to refinance the maturities falling due in FY26 during the FY22 year to provide a smoother refinancing symmetry. Downer is in compliance with all covenants at 30 June 2021.

The next slide, Slide 22, provides a pro-forma overview of the impact of the divestments to date on our key metrics. Downer continues to consider capital allocation in the context of its first priority, being the maintenance of our BBB investment-grade credit rating. This includes targeting a net debt EBITDA range of between 2 and 2.5 times. At 30 June 2021, we are comfortably below this range. The Board has declared a total dividend of 21 cents per share and we will continue the on-market share buy-back announced in April. This sees us well-positioned for growth. Thanks very much, and I'll now hand back to Grant.

Mr Fenn: Thanks very much, Michael. The Downer business has again proved its resilience with solid earnings, strong cash conversion and high levels of work-in-hand. Our end markets are essential services in Transport, Utilities and Facilities, and our position in those markets and their diversity gives us strength and reliability. Our brand and our relationships are strong. We expect our core urban services to continue to grow in FY22, both in revenue and earnings, but we are cautious of the changing nature of the COVID-19 pandemic and the ongoing restrictions and we'll not provide specific earnings guidance for FY22. We will have more to say at our AGM in November, and that will be with four months of operations under our belt. So, thank you, that's the end of the formal presentation and I'll now hand back to the operator for questions.

Operator: Thank you. If you wish to ask a question on your phone, please press star then 1 and wait for your name to be announced. If you wish to cancel your request, please press star 2. If you are on a speakerphone, please pick up the handset to ask your question. Your first question comes from James Redfern with Bank of America. Please go ahead.

Mr Redfern: Hi, Grant. I've got three questions, please. The first one, just in relation to the sale of Open Cut East, maybe if you could talk about the book value of the business and I guess the level *of interest you've had in that business in relation to a divestment, please. And I've got two more, thank you.*

Mr Fenn: Yes, we've got interest, certainly. Michael, I guess, can talk about a book value in a moment, but we've got interest there. But coal assets aren't easy to sell at this point in time, but we'll see how we go.

Mr Ferguson: Yeah, book value is about $180 million.

Mr Redfern: Okay. Thank you.

Mr Fenn: Whilst we're still working on that, I wouldn't be concerned, as investors, because in our view, running those contracts out is also going to return value to shareholders. If we look at the two major contracts there, finish in '22 and so they'll be cash positive in '22, be profitable and then you sell the gear. And then there's the smaller contracts roll on for a couple of years after that, but they are very small in comparison. So I wouldn't be too concerned about that, but we still work on the sale as well.

Mr Redfern: Okay. Perfect, thank you. The second question is in relation to the Royal Adelaide Hospital contract. It hasn't been talked about for a while and I note the contract is due to be reset in June next year. So maybe just wondering if you'd please provide some commentary around the monthly cash flows from that contract, the scale and also whether they are positive or negative and just thoughts around the reset next year in June please.

Mr Fenn: Yes, so cash flow, it's positive and we've been, over the course of the last six months, working with South Australian Health on what's called the reviewable services there on the reset and we're very hopeful that in the relatively short term that will be finalised and that project will be profitable for us.

Mr Redfern: Thanks, Grant. And the last question from me, you're talking about potential further bolt on acquisitions. I mean, the core business for Downer is performing really well and the balance sheet is strong, which is great, so just wondering if you could please talk to where you think Downer should or could grow in terms of its core businesses please?

Mr Fenn: Well, look, it is in the core and we do a fair bit in the core, but it's in Transport, it's in Utilities and it's in Facilities, so it's in Transport, it's around Facilities and geographic position and, in some cases, it might be a particular product in a particular area and we'll pick up businesses and we've been doing that over the last bit. In Utilities, it's been related to water, gas, and with particular technical skills that we can take national, and we continue to look at that. In Facilities, similarly, it's looking at businesses that might be able to give us a technical edge as we look forward into the future sustainability-wise. I haven't got a long list here, but we are on the search for growth opportunities, that's for sure.

Mr Redfern: Okay. Great. Thanks, Grant.

Operator: Thank you. Your next question comes from Rohan Sundram with MST Financial. Please go ahead.

Mr Sundram: *Hi, guys. Just a few from me. I might start with the construction book and the work-in-hand, which looks to be about $3.2 billion. Can I just confirm, is that comparable to the last disclosure in early '20 of around $5.7 billion, which is a big reduction.*

Mr Fenn: Yes, so that's right. Yes.

Mr Sundram: *Cool. And the same for the fixed price, which looks to be about $350 million. Maybe ballpark, how much of a reduction is that on the last disclosure in early 2020?*

Mr Fenn: Oh, a lot. Yes, we've dropped out of various markets there, so, yes, it's a significant reduction.

Mr Ferguson: I think it's just a reflection of the decision changes that we've made as part of the restructures that we announced last year.

Mr Fenn: We've not been building – we're not in the mech-elec game in mining, building large pieces of mining infrastructure. We are very niche in what we do.

Mr Ferguson: And we're focused - we're concentrating very much on contract terms.

Mr Sundram: *Sure. Thanks, guys. And the last one from me is thanks for your commentary around labour markets. To what extent has it impacted your ability to attract and retain labour during the last six months?*

Mr Fenn: Oh, look, Downer is a market leader, so people want to work for us, but that doesn't mean that we don't have a whole heap of competitors trying to pick up the best people in the market. I mean, that's what we face. It's not that this is new, but it's a little more acute where you've got issues around not being able to cross borders,. So it can become acute in specific areas. WA is one.

Mr Sundram: *Has it impacted your ability to start a new project or are you still able to find enough numbers to commence work?*

Mr Fenn: No, it hasn't impacted our ability to start, but I've got a particular case in Western Australia where it's very difficult for us to put the people on there that we need to put on there. The skill base just isn't there. It's in Asset Services, that's been the business that's been most affected. Most of our businesses are national and the great thing about that is that we are able to apply terrific skills and skill base across all of Australia and, in fact, across Australia and New Zealand. Now, for the most part, that works. When you've got lockdown situations which, again, for the most part, even over the last couple of years have only been sporadic, it does impact us, and right now it impacts us, but that won't be there forever and we get back to having the competitive advantage that we have.

Mr Sundram: *Thanks, Grant.*

Operator: Thank you. Your next question comes from Wei-Weng Chen with JP Morgan. Please go ahead.

Mr Chen: *Hi, guys. Thanks for taking my questions. Just a few from me on Transport. So the first one was you made $150 million of EBITA in Transport in the second half '21. So that was a big increase on the prior half. What was the reason for the increase? And then, secondly, can this be sustained going forward? Is this a $300 million a year business now?*

Mr Fenn: Oh, look, that's a very good business, it's volumes and it's across roads, rail and transport projects, so there is a fair bit moving in there, but the Roads business has done very well for the period. It'll continue to grow, in our view.

Mr Chen: *Yes, okay, but there was a 50% half on half sort of increase there, so I was just wondering if you could give some additional colour on, I guess, why there was that big increase?*

Mr Ferguson: It's a seasonal business, particularly in New Zealand, so I wouldn't run-rate $150 million.

Mr Chen: *No.*

Mr Ferguson: But it's certainly improved and it's had a strong year, but particularly in New Zealand, that's a second-half skewed business.

Mr Fenn: And you've got a lot of stuff going on. Just think about what's going on in the infrastructure space and this business is tied straight to it.

Mr Chen: *Yeah. Okay. Thank you.*

Mr Fenn: When I talk about money being spent, Government is spending a lot of money and this is a business that benefits off the back of that and that's at State Government and Local Government levels.

Mr Chen: *Yes. Okay. Thanks. And then – I think I know this, I'm not sure if it's coincidence or not – but every two years for the last six years, there's been a bit of a sharp increase in Transport margins, so the second half '17, second half '19 and '21. I know there is an element of lumpiness when it comes to things like bogie overhauls, et cetera. Is there something going on that occurs every two years, or is that just a coincidence?*

Mr Ferguson: I think it's a coincidence. The only sort of relative point I could give was the second half '20 was very COVID-19 impacted so that's, yes, from '20, '21, but we've not done that biannual analysis, so I couldn't comment.

Mr Chen: *Yes. All good. And then just on labour pressures, what we're hearing out of WA is that cost pressures are, I guess, one factor, but almost a greater factor is the impact of high turnover on productivity, et cetera. Can I maybe get you to speak on that perspective in terms of turnover? Are you seeing anything there?*

Mr Fenn: Oh, look, what I spoke about before, turnover is part of it. You don't want to lose your best people, and when you do that impacts you. For us, the biggest issue here is just the extra effort in making sure that your people are settled in your business and not thinking about other things, moving to others. I mean, we've got very good people in our business. We are the place where others go to get people in our industry and so we are constantly under

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Relationships creating success

attack here. There's no doubt about that, and we manage it very well because we are an employer of choice. As I said, there are pockets, Western Australia is one of them, and people are moving. There's movement between maintenance workers into construction because construction, particularly, generally pays more. So you've got those sorts of things, but, look, at the end of the day, you've just got to manage it, and we do.

Mr Chen: *All right. That's all from me. Thanks so much.*

Operator: Thank you. Your next question comes from Scott Ryall with Rimor Equity Research. Please go ahead.

Mr Ryall: *Thank you. I hope the home schooling in the background is not too loud. I was wondering if you could comment on Slide 12 of your presentation please where you've gone through the different sustainability opportunities. Grant, in your initial remarks you talked about customers not being able to get enough of the green transport products that you produce and certainly we've looked at those in quite some detail, but at the same time, and we obviously don't see all the moving parts, your transport margins are a bit softer this year than they were last year. Could you just comment across those three Divisions, what are the opportunities also for margin growth as you sell more of these sustainability products please? Do you think that should see margins increase over time, we're not talking massively, but just, on average, just is that a tailwind for you?*

Mr Fenn: Well, the two parts of the business really on the sustainability front is on the Roads-side and also on Rail and Transit Systems. So in Roads, already our position in what we call the circular economy provides us with a very good competitive position. So you're already seeing that in the business and we are investing in new plant that can basically produce higher levels of recycled material. We are still waiting at the State Government level for specifications to change. When that does, we'll be the net beneficiaries of that. So we've already got sort of maximum limits of glass, toner, recycled asphalt, et cetera. Now, these will move, the specifications. Less specifications at the Local Government level, and all the Local Governments want to be seen to be doing their piece on the sustainability front. Roadways are a very large part of their spend patterns and so these products are very, very strong. So in Roads, that's where it is. We use a lot of aggregate from millings from existing roads, unlike our competitors who are quarry owners. We don't want to be using virgin aggregate. It's very beneficial for us and we get benefit from that because the stone is already coated in bitumen. So, that's already in our numbers, but it will go a lot further as specifications change.

If we look to Rail and Transit Systems, that's all about smart solutions, whether it be how the existing fleets currently run, and that's in tuning, air-conditioning, et cetera. It's the creation of hybrids. We are very much a leader in Australia on development of hybrids, and by that I mean diesel, electric and batteries and we are already very much in discussion with State Governments about how we can supplement that onto existing and new fleets and we are also looking at where the topography works, what can we do in locomotives, the generation of power through braking. These aren't new things, we've been doing them - well, the world has been doing them in vehicles, passenger vehicles for a long period of time, but in locomotives now and we're getting real traction there. So it's pretty interesting stuff. Some of it will take longer and others we're right in the middle of it now. You're not going to see a lot in infrastructure projects, apart from the products that we use to build stuff, but that's very much shorter-term and we'll be using the recycled materials as much as we can.

Mr Ryall: *Okay. And Utilities and Facilities?*

Mr Fenn: Well, Utilities is all about new energy. So they touch transmission lines, power distribution, solar, wind, facilitation of powering of EVs for fleets, buses, et cetera. So they are already in the middle of that as well. Their customer base is now requiring solar in their estates. On the buses they're looking at having provision for quick charging of electric buses. We will see, in the very, very near future, no more diesel buses being purchased, they will all be electric. All that stuff has got to be done. Fleets of vehicles, we've got a massive fleet of vehicles, and it won't be very long before our fleet will be electric. As soon as the capability increases there and you can imagine the effort that goes on and that comes through Utilities. And on the Facilities side, they're very similar. So we've got a bit of a crossover between Facilities and Utilities. Our Facilities customers will require effort from our Utilities business. There's also smart building IT solutions to reduce energy. On the PPPs where we're doing lifecycle asset management, in many cases we're also looking after the energy consumption. So I could go on for a long time, but we're right in the thick of this. We've got a technology partnership with Mitsubishi Power Systems which helps us on the technology front on power generation. So it's a very interesting space, which is why I say the whole push, particularly on the decarbonisation, we are very much a winner out of that going forward.

Mr Ryall: *Okay. And then the only other question I had, I was wondering if you could comment on the STI scorecard please, particularly the people scores. It seemed like most of them hit reasonable scores, apart from people employee engagement. How is that measured and what have you got in place to turn that around please?*

Mr Fenn: Yes, so those scores typically – well, they do come off employee engagement requirements. So some parts of our businesses haven't hit what we required as targets and in all cases we have plans to improve where we're good and improve those areas that are scoring less to improve as well. It's not been the easiest period through this either, I've got to say. So that's the way that works. It's off engagement scores.

Mr Ryall: *Okay. But what are the strategies to turn that around?*

Mr Fenn: Well, it depends. Each business is different, this is a big place. So what we require is each of the businesses to deal with the individual responses – where we've been good, where we also need improvement. We put plans together and that's how it's dealt.

Mr Ryall: *Okay. I'll leave it at that. Thank you. That's all I have.*

Operator: Thank you. Your next question is from John Purtell with Macquarie Group. Please go ahead.

Mr Purtell: *Good morning, Grant and Michael. How are you?*

Mr Fenn: Good, John.

Mr Purtell: *We just have three questions please. The first one is for Grant. You mentioned that you are seeing more collaboration and risk sharing renew projects. I mean, it's taken a long time, but do you think that the wheel is finally starting to turn on risk-sharing and that potentially opens up more opportunities for you on the transport and infrastructure side?*

Mr Fenn: Well, look, the fact of the matter is that the major players in this space have lost a lot of money, and continue to lose a lot of money over major transport projects. So I think just as a matter of actually getting projects done, the Government has to share risk in a more appropriate way. That's just the situation. So we are very pleased to see the Government putting out its 10-point plan a couple years ago and now following through. And we are seeing, on the major projects which are more difficult to price and estimate, that they are coming to market more collaboratively. I think the politicians have finally been able to break through at the bureaucracy level and we are seeing that for sure, and we are seeing it across the States. It's not just in one particular jurisdiction. We are seeing major projects in Victoria, Western Australia and New South Wales coming to market that way. It will be interesting to see whether it flips back when we're not doing as much in six or seven years' time when there perhaps isn't as much infrastructure built. What happens then? But, certainly now, it's very good and the market opportunity for us has grown as a result. We wouldn't be in a number of the projects that we are currently in without that risk sharing. Essentially the alliance style stuff has opened the market to us for a greater share.

Mr Purtell: *Thank you. And the second one, for Michael, we obviously saw a decent step up in Corporate costs in the second half, how do you see Corporate costs profiling into next year and maybe some of the moving parts within that?*

Mr Ferguson: Yes, as I said, John, we had some pretty big step ups in insurance costs, particularly D&O and some of the other liability covers in the year and with our increased IT security costs and the STI accrual. We still think there's a little bit of work to do on the total Corporate costs, but I think, yes, so a full year there they're trending about where they'll be.

Mr Purtell: *Thank you. And just a final one, a similar question on CAPEX, Mike, as far as do you see a sort of similar CAPEX overall for next year or does it drop down with the sale of non-core assets?*

Mr Ferguson: Yes, I think the reference point, John, we call it out in the cash flow is the core CAPEX in the period, which was $154 million. There's a little bit of growth in that. Yes, we generally set the business plan around maintenance capital which is about $130 million, and then whatever growth on top of that we consider on a business case basis. As Mining trails out, we expect the core to stay there or thereabouts to where it is this year and the non-core will slowly go down.

Mr Purtell: *Okay. Great. Good result. Thanks.*

Operator: Thank you. Your next question comes from Nathan Reilly with UBS. Please go ahead.

Mr Reilly: *Hi. Thanks, Michael, just a follow-up question to that around the CAPEX, is it a similar situation with your lease payments around the core business for next year?*

Mr Ferguson: Yes, we think so. Yes, the modelling that we've done for '22 sees that pretty consistent. Yes, that's in the most part property. About half of that number is the property portfolio around the Group and that's reasonably set. And then, yes, the rest of it is split between light vehicles and other plant which ebb and flow relative to volumes, but we've put the core number in there specifically to sort of guide to what we think that's going to be going forward.

Mr Reilly: Yes. That's super-helpful. And then I guess the next question, just with respect to your operating cash flow conversion or your underlying operating cash flow conversion at that 101% mark, if we were to back out Mining, would it have been a similar cash conversion?

Mr Ferguson: Yes. Mining in itself wasn't the highest cash converting business that we had for the year, so the majority of the service businesses performed very strongly. It's proportionate.

Mr Reilly: Okay, and I think if we exclude Mining that suggests your core businesses were generating conversion greater than 100%, is that the take-out?

Mr Ferguson: Yes… and some of the working capital release proceeds, for Mining specifically, have gone into that number and that's been offset by the reduced factoring. So the business is ranged in conversion from sort of 70% to 120%. Yes, that's not unusual for us.

Mr Reilly: Yes. Got it. And when we're looking at your reported cash conversion there, the businesses in wind down, being Laundries and Facilities, was that a drag on your cash conversion?

Mr Ferguson: No, not really. No. I mean, the way the mechanics work for the exit is we got the cash for the periods that we owned it, so the divested businesses, we just had a proportion of contribution for the businesses that were in wind down. Yes, we made the provisions in FY20 and so that forms part of the adjustments that we made as part of the bridge between 92% and 101%.

Mr Reilly: Perfect. And, Grant, final question, just with respect to that stronger Transport result, is it fair to say that you are seeing some of the benefits of the recent infrastructure budget allocations around road maintenance projects in the regions and also around metro networks coming through and that's driving some of the uplift in your volumes there?

Mr Fenn: Look, it's always very positive. We play in the space of major roadbuilding, as far as surfacing goes and asphalt in the road space, but we're not a major player. It's more because generally there has been more spent, whether it be Local Councils or whatever, and we benefit very significantly from it. Why are we able to do that? Well, we have been investing in better plant, better equipment and we've got a broader geographical footprint. So, if you like, our franchise in this area is very strong. We've also focused on products – and our products are proving very helpful. So, there's a range of things that we do and we're focused in on a couple of areas where we've dropped off over the last decade or so and that's helping as well.

Mr Reilly: Got it. Thanks for taking my questions.

Operator: Thank you. Your next question comes from Shaurya Visen with Goldman Sachs. Please go ahead.

Mr Visen: *Hi, Grant, Michael, thank you for taking the question. I have quick one for you on the costs. You have mentioned the assignment of Corporate structure and cost base, so I was just wondering when you think that gets for you reflected in your operations and are we already beginning to see some of it, which is sort of reflecting in high margins? Thank you.*

Mr Fenn: Yes, look, you'll see – when I say you'll see, what I really mean is that the majority of those will be coming through in, well, part of it in '21, but also in '22. So you'll see that. A number of these changes have been made in June/July, so you'll see benefit into '22.

Mr Ferguson: You're seeing in the Facilities result the benefit of the amalgamation of Spotless after the take-out of minority and so that's reflected in the increased margins in the Facilities business. We've got some savings in Corporate, as I've just talked to, which we've seen some offset, but, yes, we'll see that improved through '22 because we are still providing transitional services to a lot of the divested businesses and so we're recovering some, not all, of the costs of those services and so we've had to keep the cost base at a level that allows us to continue to do that, but there's no drop-off through the first half of 2022. We expect we'll be able to rationalise further.

Mr Visen: *Thank you.*

Operator: Thank you. We have reached our allocated time for questions. I will now hand back to Mr Fenn for closing remarks.

Mr Fenn: Well, thanks very much for taking the time to get on the call. If you have further questions, please send them through to Michael Sharp and we'll do our best to answer them as quickly as we can. Thank you very much, and hopefully you have a good reporting season. Thanks.