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FY20 Half Year Results, Investor Webcast transcript

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Operator: Thank you for standing by, and welcome to the Downer half-year 2020 results conference call and webcast. All participants are in a listen only mode. There will be a presentation followed by a questions 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, ladies and gentlemen, and thank you for joining the Downer team for the presentation of the Downer EDI Limited results for the six months to 31 December 2019. My name's Grant Fenn, and I'm the CEO of the Downer Group. This morning I will take you through an overview of the results, and Michael Ferguson, our Group CFO, will cover the financial position of the company in more detail, and we'll take questions at the end of the presentation.

Well, despite Downer's service businesses performing well, construction losses, as you all know, have driven a disappointing result for the group in the first half of financial year 2020, and resulted in the group reducing its full year earnings guidance by $65 million, after tax. Downer's directors have declared an interim dividend of 14 cents per share for the half.

In early November, at our AGM, I highlighted that our cash performance for the 2020 financial year was not expected to be as strong as it had been in recent years, due to a number of known factors, including the cash impact of Murra Warra Wind Farm; the timing of cash flows from large projects winding down and the timing of cash payments for first Bogie overhaul for the Waratah trains. Additionally, the half has been further impacted by the reported construction losses. We expect cash flow conversion will improve in the second half, and we expect it to return to normal levels in 2021.

Unfortunately, the loss-making construction projects that are now either complete, or almost complete, pre-date a number of changes the group has made to its risk and contracting limits over the past 18 months. During this period, we've been strictly limiting the risk in our construction portfolio, in terms of the type of work, price, terms and conditions, and this has led to a material reduction in construction work in hand.

The strong pipeline of opportunities in our favoured markets continues to drive Downer's work in hand. In total, Downer's work in hand has risen from $43.5 billion, at 31 December 2018, to $44.3 billion at 30 June 2019 and $46.4 billion at 31 December. And, we had $7.5 billion in new contract wins between July and December, largely in urban services. Eighty-nine per cent of our work is in our urban services businesses: transport, utilities and facilities, and all these businesses are strongly placed to win more work in their respective markets. We've provided, for the first time, the profile of work in hand over time, which runs to 2062, with around $1 billion contracted in outer years beyond 2030. And, that profile demonstrates our very strength and stability of our model.

Construction work in hand totals just $5.7 billion or 12% of the group's $46 billion of work in hand. A 63% or $3.6 billion of that relates to low-risk contract forms such as alliances, cost-reimbursable, fee-based or long-term panel arrangements for minor capital upgrade works. These contract forms are collaborative, profitable and enhance the long-term customer service relationship, and we'll continue to pursue these types of arrangements.

The remaining 37% or $2.1 billion of the work in hand is split between scheduler rates; design and construct and EPC style contracts. Around $580 million, or 28% of this $2.1 billion, relates to projects of less than $15 million—i.e. relatively small projects and limited risk—in total. Another 21% relates to projects under $50 million.

To accelerate our shift towards less volatile service markets, we have decided to focus our major construction efforts on areas where we have competitive differentiation. That's in transport, including road, rail and systems; high voltage transmission and substations; telecommunications, water, wind, in the balance of plant. And, what that really means is road systems on the wind farm, the HV, the substations, et cetera. That's not inclusive of the VPC on wind. And also, facilities with Hawkins in New Zealand.

Our engineering and construction business will no longer tender for hard dollar construction contracts in the solar, coal, iron ore and industrial S&P and E&I sectors. Our decision to withdraw from construction of large-scale solar farms is disappointing but inevitable, given that the market has almost evaporated over the past 12 months. As developers, bankers and contractors have all struggled to come to terms with the risk of large-scale loss factors, grid stability problems, connection problems and equipment performance issues. These problems will, no doubt, be sorted out in time, but right now, we don't see a construction market in the short to medium-term that will accept our terms and risk position on these matters that were out. We'll finish those projects for which we're committed.

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Now, with traditional major construction markets in coal and iron ore are also subdued. With little happening in coal and iron ore, projects' time frames are extending. Downer's traditional competitive strength in E&I has been diminished somewhat as most project awards are now multi-discipline, driving more commoditised price and contract terms and conditions. It's been very hard to make money consistently.

Downer's service businesses continue to perform well. Group revenue increased 3.3% to $6.8 billion for the half, with transport up 5.7% on strong performances in the road maintenance and transport projects businesses. Utilities revenue grew 16.8% with strong growth in its power networks and water services business. Whilst the renewable construction business revenue grew, this did not flow through to earnings, as you know. The telco business unit in utilities was also down, due to the wind-down of the NBN rollout.

Utilities revenue grew 5.4% with strong growth in the government business, and another good performance in defence. Spotless also saw revenue growth in the infrastructure and construction divisions, formerly Nuvo and AE Smith. However, this did not translate to earnings due to a number of challenged contracts. Building projects in New Zealand performed well during the period. Mining continued to perform well with revenue growth of 8.8%. EC&M revenue reduced by 25.3% due to the impact of the reduction in construction revenue following the completion of Ichthys Power Project, and lower than expected revenue caused by project delays. This was, in part, offset by growing revenue from the asset services business, which continues to perform very well.

Consistent with revenue, the strong earnings performances in transport services divisions and utilities and EC&M and the government services divisions of Spotless has been improving and pleasing. This has been offset in the half by the impact of the write down of projects disclosed in the market update on 23 January and subdued results in the Spotless hospitality and infrastructure and construction businesses.

Downer's forward outlook is particularly robust, given a pipeline of over $200 billion in attractive service opportunities in the next decade. Our market position of 1 or 2 in each market gives us confidence of securing a significant share of these opportunities. Urban services markets in Australia and New Zealand will continue to grow with a range of services, contracts in resources, defence and public transport coming to market. Around $20 billion of weighted opportunities are coming to market in the next 12 months.

Downer's core markets of transport, utilities and facilities look particularly buoyant and support our strategic shift into serviced-based markets. I'll now hand over to our CFO, Michael Ferguson, to go through the financial aspects in more detail. Michael.

Mr Ferguson: Thanks, Grant. Good morning, everyone. I'll pick up from slide 9, outlining the financial performance of the group for the half-year. As we set out in our last full-year results presentation, the first half of FY20 has seen the group's initial adoption of the new accounting standard, AASB 16, Accounting for Leases. The new standard, in essence, requires all leases, including operating leases, to be recognised on the balance sheet.

Further, and from a profit and loss perspective, the new standard replaces operating leases expense, previously included in EBITA, with additional interest expense arising from the lease obligations recognised on the balance sheet, and the amortisation of a right to use asset.

Downer has adopted the new standard on a modified, retrospective basis, meaning that the comparatives have not been adjusted. Accordingly, we have included the impact of the new standard in the table, to allow users to make a like-for-like comparison. With the change percentage referred to in the slide comparing the pro forma pre-AASB 16 column with the prior period. Whilst there has been very minimal impact to the group's reported earnings at an NPATA level—just $1.5 million—the table shows larger variances at EBITA, depreciation, amortisation and net interest expense. Predominantly due to the reclassification of operating leases. A full reconciliation of the AASB impact is included in slide 27 at the supplementary information.

Group revenue, including Downer's share of revenue for joint ventures, increased 3.3 to 6.8%, $6.8 billion for the half-year. Grant has spoken to the revenue performance for each of the segments. EBITA, adjusting for the impact of AASB 16, dropped by 11% to $351.4 million from $396 million. Reported EBITA, after the impact of AASB 16, was $429.3 million. Consistent with revenue, the half has seen strong earning performances in transport and mining, the services division and utilities and EC&M and the government services divisions of Spotless. This has been offset in the half by the EC&M construction performance and subdued results in the Spotless hospitality and the AE Smith and Nuvo businesses.

Depreciation and amortisation, on a like-for-like basis, was slightly up 1.4% to $147.1 million. Group EBITA pre AASB 16 of $204.3 decreased by 18.6%. Non-cash acquisitional and amortisation was $34.4 million, compared to the prior year of $31.4 million, with the increase due to the intangible assets arising from the acquisition of the Downer Mouchel joint venture at the end of the prior corresponding period. That interest

expense includes additional interest of $12.6 million, arising from the recognition of an additional $728 million in lease liabilities on the adoption of AASB 16. Adjusting for this, interest has also benefitted from lower interest base rates and less interest from the unwind of the nRAH provision offset for higher average debt levels.

Tax expense of $35.5 million reflects an effective tax rate of 28%. The effective tax rate remains below the Australian statutory rate of 30%, due to non-taxable distributions from joint ventures and a lower corporate tax rate in New Zealand. This all equates to a reported net profit after tax and before amortisation, or NPATA, of $115.5 million, which is down 21.1%, and represents 38.5% of the revised FY20 guidance of $300 million NPATA. This represents a lower than traditional first-half split, due to the losses recognised in the period. Taking into account the impact of AASB 16, comparable NPATA would have been $117 million.

Downer's returns on funds employed has increased slightly to 12.6%. The Downer board has declared an interim dividend of 14 cents per share unfranked. Downer has reduced its franking to zero which, in part, reflects the impact of historic tax losses and the timing of Australian tax payments driven by ongoing contract positions. A 14 cents per share dividend is consistent with the 2019 final dividend, and assuming the FY20 final dividend is held at 14 cents per share, will sit within the target apparent ratio range of 50–60% based on the revised guidance.

Slide 10, Summary of Earnings, highlights a number of items that have impacted facilities result and the unallocated or corporate costs. The first item relates to a number of legacy items included in the Spotless result, which relates to contracts and issues prior to the Downer acquisition. This includes the recognition of $23 million in non-cash earnings relating to the resolution of a contract renegotiation at the Royal Adelaide Hospital.

Downer identified in its FY19 result that the proposed resolution would likely see a reduction in the provision amounts recognised to cover the losses through to the contract reset in June 2022. The commercial resolution which provides for additional contract payments 1 June 2022, was finalised during the period, significantly reducing cash losses and the accounting treatment adopted leaves appropriate provisioning to absorb these losses up to the reset date.

Offsetting this benefit, Spotless has recognised losses on the completion of a number of legacy construction contracts in the Nuvo and AE Smith businesses, totalling $8.2 million, as well as some legacy payroll remediation costs as Spotless undertakes a review of the application of its numerous award and enterprise

agreements. Whilst no material issues have been identified, the aggregate of this remediation made during the period, is $3.9 million.

Spotless also continues to incur significant restructure and betterment costs as it invests in improved capability and processes. As a result, total restructuring costs incurred total $2.7 million for the period. Adjusting for the impact of the significant items, the Spotless standalone result, as expected, has reduced compared to the corresponding prior period. This is due, in the most part, to the timing of events in the various hospitality contracts and lower margins on some of the construction contracts. Following the delisting of Spotless—their results have been released today on their website—and a reconciliation of the facilities results, the Spotless result has been included in the supplementary material on slide 25.

The other item included on the summary of earnings schedule relates to the current portfolio review activity being undertaken within the Downer Group. Costs incurred during the period, relating predominantly to vendor due diligence costs and restructuring activities, total $2.7 million in relation to laundries and $3.2 million incurred in relation to mining. These items, in aggregate, have had a net impact on statutory profit of $2.3 million, on a pre-tax basis.

Slide 11 provides an overview of unallocated costs. Unallocated costs totalled $66.8 million and included $42.9 million of corporate costs and $23.9 million of amortisation of acquired intangible assets. These costs are consistent with the prior corresponding period.

Moving on to operating cash flow on slide 12. As we had previously flagged, first half FY20 has seen a number of operating cash flow challenges for the group. This has resulted in operating cash flow, after adjusting for net interest paid in tax, of $19.5 million, with an operating cash flow to EBITA conversion of 4.5%.

The most significant items that have impacted the operating cash flow for the half have been set out on the left of the slide and include:

- the cash outflow for the Murra Warra project
- the cash outflow impact of prior period E&C losses, and current outstanding claims positions
- losses recognised in prior periods in renewable projects
- the impact of cash outflow of the Waratah TLS Bogie overhaul program
- cash flow timing of the major rail projects and the WIP Lock Up as the NBN contract winds down.

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The FY20 recorded cash result also includes the benefit of the changing classification of lease payments from operating cash flow to financing cash flow and interest. This totals $67.1 million. Despite highlights for the causes for the poor cash performance, with the majority of issues arising from specific project performances, adjusting for the impact of these items, conversion would have been approximately 80%.

Downer's services business, in the most part, continued to deliver strong cash flow. And, the second-half performance will improve as the projects highlighted complete. We expect that as these factors resolve, we should see a return to strong operating cash flow performance in FY21.

Downer continues to use receivables factoring for a very small portion of its debtor book, in instances where it makes financial sense to do so, after considering client payment terms and relative funding costs. Factoring, as of 31 December 2019, was $137 million, an increase of $23.7 million from June, consistent with the increased revenue from the mining contract to which the factoring relates. Downer does not use reverse factoring of its payables.

Turning to overall cash flow on slide 13. Net capital expenditure was $164.7 million, a reduction of 14% on the prior period. Consistent with prior periods, Downer's mining business and the Spotless laundry business accounted for 60% of total capital. Other acquisitions relate to the third person consideration for businesses acquired in prior periods. Downer also continues to invest in technology with capital being invested in data centre upgrades and productivity improvement platforms across the Australia and New Zealand services businesses.

Financing cash inflow relates to the additional financing in the half, with the net proceeds of $185.7 million, predominantly explained by the additional medium-term note issuance of $200 million offset by the repayment of some residual USPP debt. Total dividends paid of $87.1 million is consistent with prior periods, whilst the group reduced its lease liability by $67 million in the half. Cash out at 31 December was $515 million, which when combined with undrawn facilities of $1.1 billion, provides us with significant liquidity of $1.65 billion.

Turning to slide 14, the Downer Group balance sheet remains strong, with a strong net asset position. However, the impact of the reduced operating cash flow performance for the half, has seen gearing increased 31.3%, from 24.9% at 30 June '19. Improved cash flow performance into the second half and into FY21 will see gearing reduced.

Our group debt maturity profile is set out on slide 15. Weighted average debt maturity has increased from 3.6 years at 30 June ‘19, to 3.7 years, as the group continues to use long-term debt to match the increasing profile of its long-term contracts. The group’s total net debt is $1.4 billion, with $703 million in Downer and $686 million in Spotless. The Spotless net debt has reduced slightly, consistent with the focus on debt reduction for that platform, with Downer debt increasing $378.3 million as a result of the losses and the timing of operating cash. Thank you very much. I’ll now had you back to Grant.

Mr Fenn: Thanks, Michael. In August, we announced a review into our mining and laundries businesses, to be completed in the first half of the 2020 financial year. That review concluded that the owner should exit both the mining and laundry businesses, and this would provide an opportunity to increase returns to shareholders and reduce debt.

The exit process for mining continues with a number of bids being received last week, ranging in price and conditionality. We’re assessing these bids and other exit alternatives, including a demerger, and we’ll update investors on next steps when appropriate. The exit process for laundries also continues with a range of indicative bids being received recently. Again, we’ll update investors on next steps when appropriate.

Downer is focussed on winning and delivering secure, long-term service revenue and leveraging our expertise to drive margin expansion over time. Typically, there’s a ramp up on projects during the engineering, procurement and construction phase and revenue is high, but so is capital intensity and risk. As we’ve discussed today, we participate selectively in this space, identifying those projects that are linked to long-term operation and maintenance opportunities. Downer focusses on the management of assets through their life cycle which can be many decades. The work in this phase delivers long-term, predictable revenue with opportunities for top line growth and the ability to improve margins over time through operational efficiencies and innovation.

We rely on the growing markets and we have high quality customers, and as we’ve said repeatedly in recent times, we particularly leverage to economic and social infrastructure. In other words, where the money is being spent. We continue to increase our exposure to low capital, services-oriented businesses, and we’ll continue to make strategic acquisitions when appropriate opportunities arise, particularly if they fit with our urban services business. That’s transport, utilities and facilities.

This growth will be accompanied by efficient use of capital. We will seek to improve operating margins and ROFI. We’ll continue to focus on strategic capital allocation as well as cost and capital efficiency. We have a

strong balance sheet and credit rating, and this gives us the flexibility to reduce debt and invest in future growth opportunities.

Business growth, combined with efficient use of capital, will see Downer grow earnings per share and dividends per share over time. We'll increase dividends in line with earnings per share, and our payout ratio will remain over 50%. This business will be predictable and reliable.

Finally, I'll confirm our outlook statement. Downer is targeting NPATA of $300 million for the 2020 financial year. Thank you very much, and I now will hand back to the operator and invite you to ask questions.

Operator: Thank you. If you wish to ask a question, please press *1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please *2. If you are on a speaker phone, please pick up the handset to ask your question. We'll now pause a moment to assemble a question queue.

Your first question comes from John Purtell from Macquarie. Please go ahead, John.

Mr Purtell: Good morning, guys. How are you?

Mr Fenn: Yeah. Good, John.

Mr Purtell: Just had a couple of questions. Grant, I know you made some comments on this a few weeks ago, but the question is: what are the changes that you're making to ensure no repeat of some of the project issues that we know we've seen in the last 12 months?

Mr Fenn: John, we've made a number of changes quite some time ago, as I said in the statement, or in the presentation I've just given. We made a number of changes around 18 months ago around the types of contracts that we take on, and the contracts that have given us the problem really pre-date that. We've made a lot of changes in that area, which has meant that our work in hand in those risk areas has reduced quite considerably.

But, in addition, what we've done in the last weeks after coming back and seeing the issues that we've have in those further jobs, which we announced in January, we've taken a decision to really focus our attention on delivering for our long-term service customers. To the extent that they need small stuff done, that we concentrate on that. And, in the areas where we have really competitive positions, which are very strong,

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and generally can get much better terms and conditions. And, that is, as we said, in transmission and HV, in buildings in New Zealand, telecommunication, and in wind also.

In wind, the reality of what we do there is the balance of plant. We're doing the road systems, we're doing the substations, we're doing the HV connection work, et cetera. We've taken the very significant step, in fact, of restricting our engineering construction business to the markets of those, and not going forward with solar, coal, iron ore. And, the reality is that when we look at the forward markets there, particularly in solar, as I stated, the market is not there. Certainly, in the short to medium-term. In the longer term, perhaps it is, but it's certainly not there at the moment. If it's not a big move for us to move in this direction from a work in hand and a future pipeline point of view. And, even in coal and iron ore, again, that market is not particularly large and it's taking a long time to come to market. We've taken a really big position here. We've spoken about it, John, and I guess it's there in front of you.

Mr Purtell: Thank you. Just a second question. In terms of the portfolio review, Grant, can you provide any indicative timing for expectations for a definitive outcome on both mining and laundries?

Mr Fenn: Well, John, I guess I could, but I've been wrong before, so I'm not going to. I think when we were back in the AGM, I was hopeful that it would be. Sorry, back in August, we were hopeful that it would be by the end of the calendar year and, clearly, that's not. We're very hopeful it'll be by the end of the financial year.

Mr Purtell: Okay. Thank you.

Operator: Thank you, John. Your next question is from James Byrne from Citi. Please go ahead, James.

Mr Byrne: Good morning, guys. Thanks so much for taking my question. I wanted to focus, firstly, on the cash conversion results on slide 12. It sounded like, in your remarks, that second-half '20 cash conversion would be weak as well. I was hoping you might be able to provide some details on why the timing issues would persist across the June half as well, and if you could remark specifically on some more detail of the unwind of the NBN, I think that would be particularly helpful. Thank you.

Mr Fenn: I'll just touch on the cash flow for the second half. We don't see that as being weak. In fact, that'll revert back to the normal, but for the full year. Obviously, we guided for this in January, but it'll get back to

somewhere between 40–50% conversion. And, we're saying that in '21, it should revert completely. On the NBN, Michael, do you want to give some colour on that?

Mr Ferguson: It relates predominantly to WIP Lock Up and just delays as the backlog of finishing projects are approved and paid. The cash flow profiling is dependent on the final approvement (sic) of the last 10 or 20% of the work. It unlocks the final payment, and there's a fairly material backlog of approving those passing the claims, so we're working hard on reducing that into the second half as well.

Mr Fenn: You shouldn't read into that that there's issues with those claims. It's just that the cash was front loaded in the NBN, and when you get to the end of that then there's a WIP Lock UP for a period of time until all of those are run through the system.

Mr Byrne: I understand. I note also the remarks on provisioning for underpayments. I'm wondering whether you could provide us detail on this review where the underpayments may have occurred and some quantification on how pervasive you think the problem is?

Mr Fenn: We have been going through a review for quite some time now. It's been primarily directed in Spotless. Spotless has got a lot of employees, so we'll be proactive on this. Early after taking this on, it's taken us quite a bit of time to get to where we've got to. We've provided an amount of money for that, which is just under $4 million. We continue to do work there. As all companies in Australia with large workforces, and that continues. We're doing that in conjunction with the Spotless teams and also with their work.

Mr Byrne: Got it. Right. Just one last question from me, just on the mining sale. Correct me if I'm wrong here, but the demerger, effectively a dual-track process, that appears to be new information. I'm wondering how advanced is that demerger process, and why have you chosen a dual-track process? Do you need the bid intention against a trade sale, according to the indicative prices you've received?

Mr Fenn: We could go into the tactics of how you sell an asset like this, but always, the tension is between the people that want to buy it. Also, you're continuing with the business. We've always had demerger in the background as something that we would potentially look to. And, as we come through to finalising what we're doing, we're putting it all in the mix, as to which we think will be better for shareholders.

Mr Byrne: Okay. I mean, I shouldn't necessarily read into that as bids being lower than you might have otherwise expected or wanted?

Mr Fenn: No. We've got a range of bids, and some of them are very healthy on the price side, but there's also a range of terms and conditions and do-ability. All of this is in the pot as we think about what we do here.

Mr Byrne: Okay. And, a remark on how advanced that process is, for the demerger specifically?

Mr Fenn: A lot of the work that we've done is background to the demerger, so it's progressing.

Mr Byrne: Okay. Thanks very much.

Operator: Thank you, James. Your next question comes from Paul Butler from Credit Suisse. Please go ahead.

Mr Butler: Good morning. I just wanted to ask about the facility business. I think we've seen the margin decline there. I think in the prior corresponding period, you had about a 5% margin, and that's fallen to 4% now, if I take the adjusted EBITA number you've provided. What's driving that?

Mr Fenn: As we highlight here, we've had some issues in the construction arms of Nuvo and AE Smith. That's been a particular issue for us since we've taken over the business, and we're dealing with that, of course. Just in this half, we've also had an impact which has – I won't say timing, but it's – just in the hospitality, around the number of events that have been on in our facilities. And, that's not really driven by us, but major events on in various venues. That's dropped hospitality down somewhat.

Mr Butler: If we exclude these construction-related issues, what have you seen for the other businesses in there?

Mr Fenn: We haven't seen margins reducing on individual contracts, no. It's such a competitive market, of course, but I've not seen that. We continue to put investment into the business around winning work and completing, so there is some cost around that, as you'd expect. But, nothing that we haven't expected.

Mr Butler: Going forward, are you targeting further operational improvement in this business? I mean, should we be factoring in margin improvement here?

Mr Fenn: Certainly, over time, that's exactly what we'd expect. We're still in the turnaround phase here. There's no doubt about that. We're still improving this business, and under some of the rocks that we pick up there's further improvement to be done. We can't walk away from that. That's exactly the case, but the services parts of these business are going well and improving every day. We're positive about it, but we're also still in the mode of addressing the issues that we inherited.

Mr Butler: Okay. And, in the utilities business, you also mentioned there were some challenged contracts. Could you give us some more detail on that?

Mr Fenn: In utilities, that would have been the – just excuse me. I'm talking to Michael here with that. Renewables, as we've spoken about previously.

Mr Butler: Right. Okay. And, are these challenged contracts, are they maintenance contracts, or are they construction type contracts?

Mr Fenn: No. Construction. Construction style contracts.

Mr Butler: Okay. What proportion of utilities is construction versus maintenance activity, or service activity?

Mr Fenn: Into the future, it will be very small as we're addressing – the major part of that is solar. As we think about it, we're out of solar.

Mr Butler: Right. And, when you were discussing the ECM business, you obviously highlighted the issue with challenges around grid connections and, I think, you listed a whole range of segments that you're not going to be bidding for work in for now. What areas are you open to taking on work in that business?

Mr Fenn: As I mentioned, I'll just go through those again. Transport—in that business it will be—we're moving the HV transmission and substations into that business. Utilities will be purely services. From a management perspective, that's where that will go. It will be HV transmission and substations. It'll be telecommunication. It'll be wind, et cetera.

Mr Butler: Okay. And, the result in transport looked pretty attractive. Which parts of transport are driving that margin improvement?

Mr Fenn: Our roads business has done very well. It's across, in particular, Australia. Our transport projects business has also improved and going well, and also our Rollingstocks business.

Mr Butler: Okay. Very good. Thanks very much.

Operator: Thank you, Paul. Just a reminder. To ask a question, please press *1 on your telephone keypad and wait for your name to be announced. Your next question comes from Wei-weng Chen from JP Morgan. Please go ahead.

Mr Chen: Hi guys. You touched on it earlier. I just wanted to explicitly ask because I couldn't find it in your materials today. Cash conversion guidance for the full year of 40–50% is still applicable?

Mr Fenn: Yes. Sorry, we didn't put it into this because we normally don't guide, but we did in January. We still think that that's where we'll end up.

Mr Chen: Okay. Great. And, then on here, NPATA guidance of $300 million, we know mining is expected to increase NPATA by $15–20 million to $90–100 million for the full year. Can you speak about the increase or decrease in NPATA year-on-year from laundries?

Mr Fenn: No. We're not going into that detail at this point, no.

Mr Chen: Okay. All right.

Mr Fenn: We don't normally break it up at this point during the year. You get to see it at the end of the year, and you get to see at the half-year as to what the result is, with the exception for mining because we came out in January with, also, some movement in the mining position. And, of course, we've got the sale process going.

Mr Chen: Okay. And, just on the factoring that you guys perform, is that on a non-recourse basis, or is that recourse to Downer?

Mr Fenn: Non-recourse.

Mr Chen: Okay. And then, just a last question from me. Are you guys seeing, in any of your segments, issues of potential issues from the coronavirus, in terms of your supply chain?

Mr Fenn: Yes. There's a few areas. We've got a large workforce, so we have a typical mix of staff, which include staff of Chinese background who visit China, particularly around Lunar New Year, so we've had those issues. We're not dissimilar to others.

Of course, we also have a very significant joint venture with CRRC, the world's largest train builder, and we often have technical people both from Downer and from CRRC interchanging backwards and forwards from China. Obviously, that's curtailed at the moment. In China, because of the shutdown of many parts of the country there, in terms of travel, et cetera, some parts of the CRRC's supply chain is challenged at the moment. We don't think it's going to have a significant impact on production of either the Sydney Growth Trains or HVMT, but we watch it very closely and are managing it day-to-day.

Mr Chen: Okay. Great. Thank you.

Operator: Your next question comes from Rohan Sundram from MST. Please go ahead.

Mr Sundram: Hi, Grant and Michael. Can I just enquire as to, roughly, what portion of revenue would have come from NBN, in terms of segment revenue?

Mr Fenn: Yes, you could. But, I don't have it right in front of me here, so maybe that's a question that we can take offline.

Mr Sundram: Okay. Sure. Well, what about with the margin reduction year-on-year in utilities. Was that mix, was that because of NBN coming off, NBN being a higher margin type of contract?

Mr Fenn: That will have some impact, but it's mainly the contracts that we were talking about before.

Mr Ferguson: The pass through of Murra Warra had the biggest impact, and some of the solar losses that were booked previously have gone through it, zero margin. NBN is still profitable, but on lower volumes. There's not been a lot of change to the margin there.

Mr Sundram: Okay. Will there be any contribution from NBN in ’21, or does is complete in full the second half?

Mr Fenn: There’s different aspects of NBN, of course, and there’ll still be a bit of construction. But, it’s now moving into maintenance modes, which we’ll be in also.

Mr Sundram: Okay. Thanks for that.

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

Mr Ryall: Hi there. You answered the first part of my utilities question just then, but I was wondering if you could comment on how long do these renewable issues come for or keep going. And, I apologise if you’ve answered that before, but there’s a bunch of calls going on today, so I came a little bit late.

Mr Fenn: No. that’s okay. I know it’s a fair question and a good one. I’d like to think that it’s solved in a reasonable period, but the grid issues, it’s a very complex answer, depending on where we go with base load power. There’s a whole portion of the market that don’t think that we need to spend a whole heap of new money on transmission, that we have micro grid. There’s other parts of the market that says no, we’ve got to fix our transmission network system up—strengthen it significantly—because of the distributed nature now of power generation on, particularly, solar. Those issues exist. They are real.

The regulators are doing their absolute best to try and make sure that the ability of the grid is maintained. That is proving very difficult, and is impacting on the solar market, and the wind to a lesser degree, very significantly. You see it with farms that have been built: volatile power loss factors outside of what they were expecting. You’re seeing it with connections into the grid, particularly where there’s a lot of solar farms, et cetera. It’s very, very difficult.

What that’s meant is there’s very much a hiatus of anything coming to market here. And, when we look at it, we look at the risk position that we’re prepared to take, particularly around connections, which we’re not going to take. We had to do the connection work on cost-reimbursable and, certainly, that’s not bankable, or certainly hasn’t been to date. Not bankable from the financiers, and the developers don’t want to take the risk, so why would the poor old contractor? We’ve been there before, so we’re not doing that.

And then, I think, you've still got a series of issues with equipment, particularly inverters. But, I'm sure that that will be solved, and it will be solved as fast as they can because it's very important, but when I look at the next couple of years, I think it's very challenged. I should say, that's why we're focussing our attention into an area that we are market leaders very much, and that is transmission, substations, et cetera because there will be—if we get this right and to get our grid available for uptake of further renewables—that's the work that needs to be done. We're very good in that market and that's where we're focussing our attention.

Mr Ryall: Okay. Understand that, and I'll refrain from political comment on it as well, but in terms of your specific utilities business, obviously, the various renewables contracts have been quite a big drag on your margin in this period. What I'm trying to do is get a sense of how long you think you'll be having revenue at the almost zero margin, as opposed to not having so much business, and that margin pressure going away?

Mr Fenn: Yeah. Sure.

Mr Ryall: Is that isolated for this year?

Mr Fenn: Yeah. We're just about out it. Whilst we've still got a couple on track, I don't expect those to go poorly, and we've got good risk positions on those. We've got Bango Wind Farm and that'll be finished in May '21. But, I expect those to be profitable, or that to be profitable. We've got Limondale. That'll finish in June of this year. Again, we expect that to be profitable. Chichester, which is a large HV substation and also a solar farm. The solar farm's about over a $100 million there, I think. That'll finish in May '21. Again, the connection risk there is that that particular system is not on the grid. It's on its own grid, so the connection risk there is not large. And, that'll be finished by May '21. Very short-term and we expect to make money off those.

Mr Ryall: Could you just comment then, just while you talk about Chichester. The opportunity, I would have thought is, as you say, the ones that don't require connection, and are then built for specific customers or groups of customers in remote areas. Does your ability to win that business go away if you sell your mining services business?

Mr Fenn: No.

Mr Ryall: Or does it get impacted?

Mr Fenn: Well, at the moment, I've said, there are not too many of these, can I just say, for a start. We're not talking about a big number of things that aren't connecting into the grid. The biggest issue in solar is our risk positions, not the market position at the moment. There is no market position because there's no one closing solar deals, not very significant.

Mr Ryall: Okay.

Mr Fenn: The crossover of our contract mining division, particularly with the construction, is not substantial.

Mr Ryall: Okay. Great. That's all I had. Thank you.

Operator: Thank you, Scott. Your next question comes from Alex Karpos from Goldman Sachs. Please go ahead.

Mr Karpos: Hi team. Good morning. Just a quick one to start. You've detailed the issues on Nuvo and AE Smith and Spotless in the period. Can you just give more colour there, any specific projects that were driving this, or any other factors to be aware of?

Mr Fenn: These are large-scale. All these are building projects where they've taken a position to construct a mechanical —electrical in some cases—conditions on buildings now. I'm not suggesting that Nuvo and AE Smith aren't good at their jobs. They are, but certain things have happened in these particular buildings. There's been a lot of changes, and what that means is, actually getting revenue out of your clients in those situations is tough. We've got Royal Hobart Hospital. There's two or three others.

Mr Karpos: Got it. And, dovetailing off that, how long should we expect to impact the way our margins to Spotless and longer run, should we still expect to get that roughly 5% margin rate?

Mr Fenn: I expect these issues to be closed out, certainly, in this financial year. We are working very hard so that we don't repeat these Spotless, and this part of Spotless doesn't repeat it. We could be doing very well in other parts of Spotless. We've got to curb these issues, and there's a lot of effort. We've put a lot of very, very good Downer people into these businesses, and we also have other people coming in to make sure that the business is a very good performer, rather than what's happened in the past.

Mr Karpos: Got it. Thanks. That's it for me.

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Operator: Thank you, Alex. Thank you. We are now closing the question and answer session. I will now hand back to Mr Fenn for closing remarks.

Mr Fenn: Thank you, Rachel. Thanks very much for coming on. I know it's a very big and busy day of the results, and if you have additional questions that you want answered, please come through to our investor relations team with Michael. For those of you that are at the various one-on-ones, we'll see you shortly. Thank you.

END OF RECORDING (50:09)