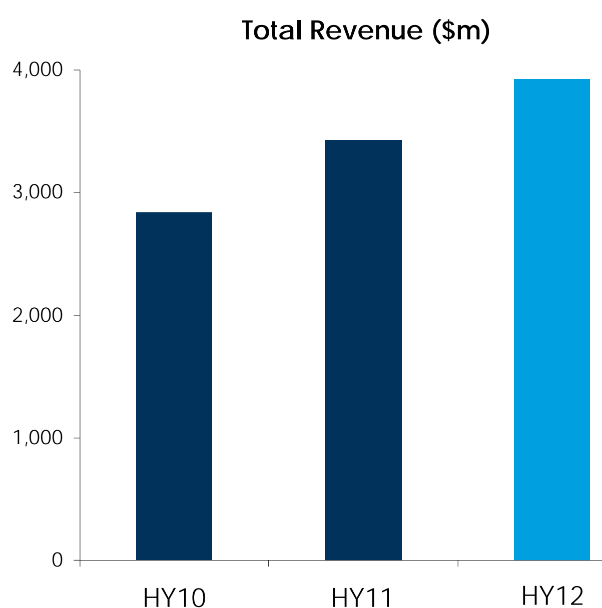
Half Year Report

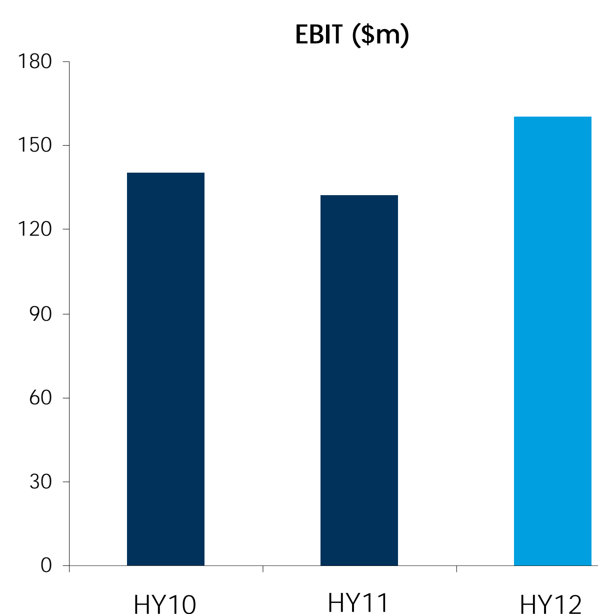
Six months to 31 December 2011

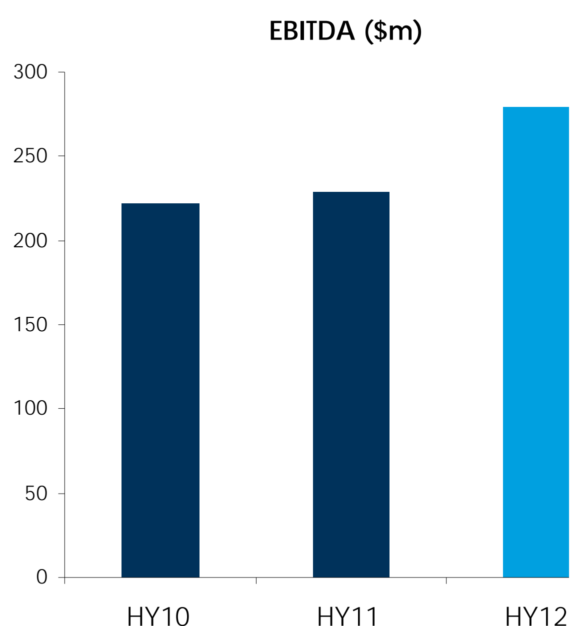
Financial Performance

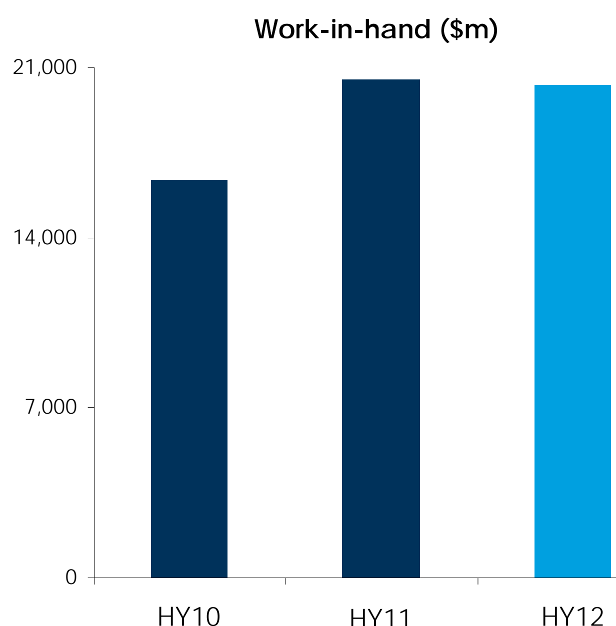
$m	HY12	HY11[1]	Change (%)
Total revenue[2]	3,926.1	3,429.1	14.5
EBITDA	280.1	228.7	22.5
EBIT	160.4	132.4	21.1
Net interest expense	(38.9)	(34.9)	(11.5)
Tax expense	(36.4)	(26.3)	(38.3)
Net profit after tax	**85.0**	**71.2**	**19.4**
ROFE	17.0%	17.2%	

[1] HY11 numbers are "underlying", i.e. excluding individually significant items
[2] Total revenue is a non-statutory disclosure and includes revenue, other income and notional revenue from joint ventures and other alliances not proportionately consolidated.









THE SIX MONTHS TO 31 DECEMBER 2011

Downer made solid progress in a number of key areas during the first half of the 2012 financial year.

Financial performance

Downer reported total revenue of $3.9 billion for the six months to 31 December 2011, 14.5% higher than the previous corresponding period. This growth was driven by Downer Mining which reported a 79% increase in revenue to $1.1 billion and Downer Australia which increased revenue by 8% to $1.7 billion.

The other divisional contributions to Group revenue were: Downer New Zealand $411 million and Downer Rail $576 million.

Earnings before interest and tax (EBIT) was $160.4 million, 21.1% higher than the previous corresponding period. Net profit after tax (NPAT) was 19.4% higher at $85.0 million.

Downer currently has work-in-hand worth over $20 billion comprising the following divisional contributions: Downer Australia $5.8 billion; Downer New Zealand $2.6 billion; Downer Mining $7.0 billion; and Downer Rail $4.9 billion.

Operating cash flow was $107.1 million after $83.4 million of cash outflows relating to the Waratah train project.

Downer continued to strengthen its risk and project management processes. More information about Downer's risk management is provided on page 5 of this Half Year Report.

Over $80 million in gross benefits are targeted to be achieved in the 2012 financial year as part of Downer's Fit 4 Business program. Fit 4 Business was launched in August 2010 and is targeting $250 million in efficiency and cost savings across the Group over five years. More information about the Fit 4 Business program is provided on page 4.

Capital Management

During the six month period, Downer financed $112 million in new debt and bonding facilities, refinanced the $260 million Waratah syndicated bonding facility and extended $602 million of existing bilateral facilities.

At 31 December 2011, Downer had gearing of 26.9% (36.8% including operating leased plant and equipment) and total available liquidity of $820 million, comprising cash of $222 million and undrawn committed facilities of $598 million.

The Downer Board decided not to declare an interim dividend. Downer will pay the next dividend on its Redeemable Optionally Adjustable Distributing Securities (ROADS).

Fit 4 Business

Fit 4 Business was launched at Downer's 2010 Full Year Results and is a five year program targeting $250 million in efficiency and cost savings across the Group. It covers a range of initiatives that will:

- improve our productivity through significant and sustainable change to our business models and processes;
- make it easier for customers, partners and suppliers to do business with us – and for us to do business with them; and
- encourage innovation and leverage our skills and scale effectively so we are recognised as an industry leader.

Over $55 million in gross benefits were achieved in the 2011 financial year and over $80 million of gross benefits are targeted for 2012. These include:

- a range of procurement initiatives across the Group;
- rationalisation of plant and equipment;
- reducing freight locomotive build cost through process and design improvements;
- supply chain transformation within Downer Rail;
- reducing paving operation costs through improved processes and project controls;
- reducing fuel consumption;
- use of biodiesel and other technology to reduce emissions and improve performance; and
- IT infrastructure transformation.

Zero Harm

An extremely disappointing aspect of Downer's performance over the past three months has been two workplace fatalities on road maintenance sites, one in Australia and one in New Zealand. Notwithstanding Downer's strong commitment and focus on health and safety, these tragic accidents highlight the risks associated with many of the sectors in which Downer operates and the need to be totally focused on achieving Zero Harm.

Downer's Lost Time Injury Frequency Rate (LTIFR) for the six month period was 0.93 per million hours worked. Industry leaders maintain a LTIFR below one per million hours worked. Downer's Total Recordable Injury Frequency Rate reduced from 7.96 to 7.72 per million hours worked.

Downer has been included in the Carbon Disclosure Project's Carbon Disclosure Leadership Index for the past two years and is the only contracting organisation listed in this Index. The Carbon Disclosure Project was established in 2000 and is an independent, not-for-profit organisation sponsored by governments and major investment institutions to accelerate solutions to climate change.

Risk Management

Downer continues to enhance its risk management processes and to standardise its approach to contract bidding, execution and project monitoring across all operations.

Tender Assessment

Depending on the value and complexity of a tender, requests from a division to prepare a tender response are submitted for approval to the Board Tender Review Committee (TRC), Tender and Capital Committee (TCC) or Divisional CEO.

Authority to approve a tender is based on financial criteria. Where the contract value:

- exceeds $250 million, TRC approval is required in addition to TCC endorsement and Group CEO approval;
- is less than $250 million and greater than $30 million, TCC endorsement and Group CEO approval is required; or
- is less than $30 million, approval is within the delegated authority of Divisional CEOs.

Contracts with special risk features (e.g. for non-value related risks such as technology or geographic risk) may be elevated to the TCC or TRC for review and approval as appropriate.

At Divisional and Group levels, the following factors are among those assessed to determine whether or not a tender is endorsed and recommended for approval:

- Safety and environmental issues;
- The industry sector in which the work will be undertaken;
- Financial returns and capital expenditure;
- Compatibility with Downer Group strategy and capabilities;
- Resourcing requirements and availability;
- Previous relationship with the customer;
- The geographical region in which the contract work will be performed;
- Partnering arrangements with other parties;
- Key contract terms and conditions;
- The contract type (eg. fixed price, cost plus, schedule of rates or alliance); and
- Project execution risk.

Project Management

Downer is continuing to standardise its approach to Project Management throughout the project life including procedures for handover, planning, execution and project close-out which are tailored according to the scale and complexity of the project. Those procedures incorporate regular contract reviews including:

- Monthly Project Reviews of all projects carried out by Divisional executive management; and
- Quarterly Project Reviews - undertaken for selected projects generally including those with revenue greater than $10 million. These reviews are carried out by Divisional executive management together with the Group CEO/CFO/CRO and the project manager.

These reviews cover the project's financial, contractual and operational status, project risks and opportunities, current key issues and remedial strategies for improving performance.

Waratah Train Project

The new Waratah Train Project (WTP) team has made a number of significant changes to the program design and focus over the past six to nine months. They are summarised below. Importantly, as part of its planning for the delivery of trains, the WTP team continues to be required to estimate future events and make a number of key assumptions in relation to the revised program.

The provision reflects the revised program (Master Program Schedule 11) that provides for the production of trains in five distinct phases:

1. Trains 1 and 2 (in order of delivery from Changchun Railway Vehicles Company (CRC or China)) were delivered early in the project, without their interiors fully installed and have been used as test trains. These will be returned to CRC to be retrofitted to the required standard and will be available for Practical Completion (PC) in late 2013;
2. Trains 3 to 9 (the initial recovery phase) were part of a focused production plan for the initial trains that required significant additional work on the interior fit-out and related areas due to design related production issues, inadequate methods and processes in assembly. These trains were manufactured and delivered to the customer by December 2011 (consistent with the MPS10 schedule developed in June 2010);
3. Trains 10 to 14 have been built by CRC and are currently within the production facility at Cardiff. The construction of these trains has been made to an initial configuration standard using new methods and processes to assist efficient production of the bodyshell and interior fit-out. These trains have been built with an improved level of quality compared to the initial trains, however still require some re-work. The program schedule has been adjusted so that this additional work can be carried out at Cardiff efficiently;
4. Trains 15 to 42 are to be built using a flow-line process that has been implemented in the interior fit-out shop in CRC. Process and design improvements in the bodyshell shop have resulted in the body shells having been built to tighter tolerances that further aids the efficiency of interior installation. These trains are of a higher quality, with significantly reduced re-work and with design changes as a result of testing and development included in the base build. These trains are scheduled to be completed at Cardiff which has recently implemented four new flow lines with four stations, replacing the previous two flow-lines with eight stations. WTP has established a goal of zero re-work from Train 26 from CRC (expected ex CRC in May 2012); and
5. Trains 43 to 78 are scheduled to be built based on a second major configuration freeze following implementation of further design improvements for simpler assembly and higher quality of the passenger areas in the interior fit-out shop. Increased output from CRC will be required to match the targeted delivery program. Investment in two additional flow-lines has been provided by CRC to support the required increase in output. Further acceleration of the flow-lines in Cardiff will also be required although the planning for the reduction in flow-line pulse from five days to four days has already been completed and demonstrated as achievable well within the timescales allowed for in the program.

The revised program (MPS11) is targeting the following delivery milestones, which remain broadly within the "bands" outlined in February 2011:

- Since 30 June 2011, 6 trains have been presented to RailCorp, received PC and are available for passenger service;
- On 20 February 2012, the 7th Waratah train received PC from RailCorp;
- The 'initial recovery phase' for these first seven trains has had an adverse impact on the program schedule in the second half of FY2012. The current delivery schedule provides for the delivery of 6 more trains to RailCorp prior to the end of FY2012 and a further 14 trains (a total of 26 trains) by the end of calendar year 2012; and
- The program initiatives still enable Train 78 to be delivered to RailCorp and enter passenger service before the end of FY2014.

In relation to future train performance, the Director General of Transport for New South Wales has the ability to reassess the reliability performance at the PC of Train 17.

Further information in relation to the Waratah train project, including key assumptions underpinning the manufacturing program, is provided in the Appendix 4D lodged with the Australian Securities Exchange and available on the Downer website.

Board renewal

Downer appointed three new Non-executive Directors to the Board during the six month period. Philip Garling was appointed a Non-executive Director on 24 November 2011. On 16 December 2011, Downer announced the appointment of Kerry Sanderson AO and Eve Howell as Non-executive Directors, effective 16 January 2012.

Operational Review

Downer Mining

Downer Mining performed well during the six month period with revenue growth driven by the ramp up of operations at Christmas Creek, Goonyella and Norwich Park. Downer Mining currently has work-in-hand worth $7.0 billion.

Downer Mining's total revenue for the half year was $1.1 billion, 79% higher than the previous corresponding period. EBIT was 73% higher at $88.0 million with an EBIT margin of 7.8%. Return on Funds Employed (ROFE) rose from 15.4% to 23.6%.

Downer Mining is making solid progress on all its projects, including:

- mine infrastructure, drill and blast and load and haul of overburden and ore at Christmas Creek in the East Pilbara region of Western Australia for Fortescue Metals Group. This is a six-year contract that was awarded in August 2010 and is valued at approximately $3 billion;

- load and haul of prestrip material and drill and blast services at Goonyella Riverside Mine, and load and haul of prestrip material at Norwich Park Mine (both in the Bowen Basin, Central Queensland) for BHP Billiton Mitsubishi Alliance. This involves five-year extension and expansion contracts, awarded in July 2010 and jointly valued at approximately $2 billion;

- drill and blast, mine planning, and load and haul of both overburden and coal at Boggabri open-cut coal mine in the Gunnedah Basin, New South Wales for Idemitsu Australia Resources Pty Ltd. This five-year agreement commenced in December 2011 and the value of the contract revenue will depend on the mine's production output, which has yet to be finalised. The base case values revenue at approximately $900 million over the duration of the contract; and

- mine infrastructure, drill and blast, and load and haul of waste and ore for Karara Mining Limited, an incorporated joint venture between Gindalbie Metals Limited and Anshan Iron & Steel Group Corporation (AnSteel), at the Karara Iron Ore Project in Western Australia. The contract commenced in February 2012 and has total estimated revenue of approximately $570 million over the six year contract.

Downer's blasting and tyre management businesses continued to win new contracts and contract extensions and reported solid revenue and earnings growth during the six month period. The underground business also continued to perform well and is actively pursuing new opportunities.

Downer Mining maintained its overarching focus on continuous improvement of its Zero Harm performance. This includes improved safety results as well as being an active part of the solution to climate change through delivering emission reductions for its customers' mining operations.

Downer Mining continues to implement a range of indigenous employment programs, including through successful partnerships with its customers and government authorities.

Downer Rail

Downer Rail's performance in the six month period was solid, although delivery of new locomotives and passenger cars was lower than the prior corresponding period. Downer Rail continues to win the majority of new passenger and locomotive contracts in Australia.

Downer Rail is facing increasing competition from global players and this is putting pressure on both revenue and margins. Downer Rail is implementing a range of efficiency and cost improvement programs to ensure it remains competitive, including initiatives to reduce locomotive manufacturing lead times and costs.

Downer Rail reported $576 million total revenue for the half year, down 13.8% from the previous corresponding period. EBIT was 10% lower at $42.9 million with EBIT margins rising slightly to 7.5%. ROFE fell 9.1 percentage points to 16.0%.

Demand for resources, particularly coal and iron ore, drives demand for Downer Rail's narrow and standard gauge locomotives however this demand is returning to more sustainable levels.

Downer Rail's current major locomotive customers include QR National, Pacific National, SCT, BHP Billiton, Fortescue Metals Group, TasRail and Genesee Wyoming, Australia.

In December 2011, Downer Rail (in partnership with Progress Rail USA, a subsidiary of Caterpillar) was awarded a rolling stock supply contract to design, build and deliver 17 new PR22L locomotives for TasRail, Tasmania's State owned rail company. The first new locomotives are expected to be delivered in mid-2013 and the total value of the project is over $60 million.

Downer Rail is also a leading provider and maintainer of passenger rolling stock. In July 2011, Downer (in a joint venture with Bombardier Transportation Australia) was awarded contracts to supply and maintain passenger rail cars for Western Australia's Public Transport Authority. Downer Rail's other passenger customers are Queensland Rail, RailCorp (NSW) and Metro Trains Melbourne.

Yarra Trams, the operator of Melbourne's tram network, continues to operate successfully. The consortium behind Yarra Trams is KDR, a partnership between Downer and Keolis, an international transport solution provider. A Downer Keolis joint venture is also a member of the GoldLinQ Consortium that was the successful proponent to operate the first light rail system on the Gold Coast in Queensland (scheduled to commence in 2014).

Downer Rail currently has work-in-hand worth $4.9 billion.

Downer Australia (established from 1 July 2011 by merging the Australian Engineering, Works, Emerging Sectors and CPG Resources businesses)

The establishment of Downer Australia has delivered a range of benefits, including an increased focus on key customers and markets and significantly improved project and risk management practices.

Downer Australia reported total revenue of $1.7 billion for the six months, an increase of 8.0% on the previous corresponding period. EBIT was 3.0% lower at $58.6 million, primarily due to onerous legacy contracts including the Curragh coal handling and preparation plant (CHPP). EBIT margin was down 0.3 percentage points to 3.5%. ROFE fell 5.7 percentage points to 15.1%.

Downer Australia currently has work-in-hand worth $5.8 billion.

Downer Australia was awarded a number of new projects during the six month period, including:

- an alliance contract with Xstrata Coal for the development of a CHPP at the Ravensworth North Coal Project in New South Wales. The contract has a total value of more than $400 million and the scope of work includes the design, procurement, construction and commissioning of the CHPP as well as low voltage power supply and reticulation and high voltage transmission supply and relocation;

- a four year contract with FOXTEL to provide installation and maintenance services for FOXTEL's satellite and cable customers in Adelaide, Brisbane, Melbourne and Sydney. The value of the contract is expected to exceed $200 million over the four years;

- through a 50:50 joint venture with Clough, a contract valued at around $600 million with Fluor for the construction of pipelines, compression facilities and associated infrastructure relating to the Fairview component of the Santos GLNG project located in the Surat Basin, Queensland;

- through a 50:50 joint venture with Clough, a contract valued at approximately $200 million with CSBP Limited to provide project management, engineering, procurement, prefabrication, construction and pre-commissioning for the Ammonium Nitrate/Nitric Acid Plant Number 3 (NAAN3) at Kwinana, Western Australia;

- a number of electrical and instrumentation contracts with customers including BHP, Rio Tinto and FMG; and

- road and rail maintenance and civil construction work across the ACT, New South Wales, Queensland, Tasmania, Victoria and Western Australia.

Following a review of the CPG consultancy businesses, Downer announced on 14 December 2011 that it had signed a Share Sale Agreement with China Architecture Design and Research Group to sell CPG Asia for A$147 million. Completion of the sale is expected around the end of the first quarter of the 2012 calendar year. CPG Australia and CPG New Zealand remain part of the Downer Group. The review did not include Downer's resource-focused consultancy businesses – Snowden, QCC and Mineral Technologies – which became part of Downer Australia on 1 July 2011. These businesses performed well during the six month period and have a strong pipeline of opportunities.

Downer New Zealand

Downer New Zealand continues to experience very difficult economic conditions, compounded by general uncertainties around ongoing seismic activity around Christchurch. There has been a significant reduction in expenditure by Central and Local governments and the marketplace remains very competitive with pressure on revenue and margins in all sectors.

Total revenue was $411 million, down 4.4% from the previous corresponding period. EBIT was 8.6% lower at $7.8 million and EBIT margin was down slightly to 1.9%. ROFE fell 3.2 percentage points to 16.4%.

Downer New Zealand currently has work-in-hand worth $2.6 billion.

Downer New Zealand is a key member of the Stronger Christchurch Infrastructure Rebuild Team (SCIRT) that will rebuild Christchurch's earthquake-damaged roads, sewerage, water supply pipes and parks. SCIRT is expected to undertake works valued at more than NZ$2 billion over five years and Downer will carry out approximately 20% of this work.

Downer New Zealand secured an initial one year contract with Chorus, New Zealand's largest telecommunications utility provider, to install ultrafast broadband (UFB). Downer New Zealand is also working with Chorus and Vodafone on the Rural Broadband Initiative.

Downer Group Outlook

Downer's operational outlook is strong and we confirm our previous full year guidance of underlying EBIT of around $340 million and NPAT of around $180 million.

As a result of the restructure of Reliance Rail, Downer will transfer the equity accounted Reliance Rail hedge reserve of $72.5 million via the income statement to retained earnings. This transfer will have no impact on cash, equity, net assets or underlying earnings but will negatively impact full year statutory earnings.