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FY22 Half Year Results, Investor Webcast transcript

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Operator: Thank you for standing by, and welcome to the Downer Half Year Results conference call. All participants are in a 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: Good morning everyone. My name is Grant Fenn and I'm the Chief Executive Officer of Downer. With me is Michael Ferguson who is our Chief Financial Officer. Now, I'll begin with the highlights of the last six months and the priorities for the remainder of the year. Then Michael will go through the financials in more detail, and I'll then discuss the outlook before we open up the call for your questions.

So, let's move the Slide Two – Highlights and Priorities. First of all, it's hard to talk about the last six months' results without acknowledging up-front the impact that COVID-19 and, in particular, Omicron has had on all businesses including Downer and governments. Workflows have been interrupted, supply chains also, and large numbers of employees and sub-contractors absent, and you know all this. There has been a myriad of different regulatory requirements that have had to be navigated. So it's in this environment that we announce today's results. We're all hopeful that, relatively soon, life will return to somewhat normality. I would particularly like to acknowledge the outstanding efforts of our people and our customers, and they've continued to put in an amazing effort, remembering that the vast majority of Downer people don't have the option of working from home. They're out there every day making it happen.

In summary, the results announced today are very good in a tough environment. We've been able to increase our core earnings and back it up with a strong cash conversion in the midst of widespread disruption. And of course, there are ups and downs within the portfolio. Some parts of the business have been impacted more than others, but all are managing their service obligations very well, irrespective of what's been thrown at them. It's also clear to me that in times like these the benefits of our diversification come into their own.

In the half we've delivered 4.4% growth in core earnings. We've normalised cash conversion of 91.2%. Our core revenue has increased by 13.3% which just highlights the inherent growth potential of our core markets. In normal times we should be able to convert a higher proportion of this revenue into earnings. The Group has never been stronger financially with gearing at just 16.5% and net debt at 1.5x EBITDA. We are all but complete on the construction of the new Sustainable Resource Centre at Rosehill – and this will be the most efficient asphalt manufacturing and recycling plant in the country. We continue to fill out our asphalt manufacturing and services footprint with the acquisition of Fowlers Asphalting in Gippsland in Victoria, and we've been successful in resetting the reviewable services at Royal Adelaide and Bendigo Hospitals. Now this is an important milestone as the first long-term Spotless contracts to be reset at their five-year mark.

With our pedigree in power transmission, renewable energy and battery storage, we are seeing substantial customer demand for decarbonisation and new energy solutions across our customer base. And I'll talk a bit more about that as we roll through the presentation. Given the strength of the business, we've decided to increase the interim dividend from $0.09 to $0.12 per share. And we've spent $123million so far in our market share buyback. The program's been suspended since 31 December just because of blackout with the results, but we'll now recommence buying back shares.

Our priorities are straightforward. So, navigating COVID-19 is still critically important and that means maintaining our quality service delivery, working proactively with customers, and minimising the risk in new contracts. On the positive, COVID-19 has accelerated technology development, communication capabilities and infrastructure investment that will drive growth in our markets for the next decade at least. We're setting up the business to take advantage of those changes. We've got to continue to drive our sustainability performance. We're a leader in ESG in our markets and have a lot to be proud of. If you haven't already, please have a good look at our Sustainability Report on our website.

As many of you know, Downer's Urban Services strategy delivers not only lower capital intensity, but also lower carbon usage. The divestments of our Mining and Laundries assets will reduce our Scope 1 and Scope 2 emissions by 35 per cent, or around 206,000 tonnes of carbon dioxide equivalent, in 2023. Importantly, the extensive capabilities we have across our Group, particularly in HV power transmission and power generation, including renewables and battery storage, means we can help our customers decarbonise. The increasing focus on sustainability by our customers, and capital providers, is a real opportunity for us to differentiate ourselves, and we will be slanting the business to the massive decarbonisation effort that is required across the economy.

On value, the challenge is clear. Now that we have finished our divestment with Mining and Laundries, we've got to invest in the right areas for competitive advantage and higher returns, improving our margins through technology and innovation and reduced costs, and of course, making sure that cash is king. And we'll continue to grow. So, the revenue numbers and the increase in revenue in these difficult times shows that we will grow organically through increased customer spend in our market areas, but also through strategic acquisitions, like Fowlers, which we've done in the last six months. And just think for a minute of the size of effort required for the nation to meet its 2050 net zero target. The demand from our customers for decarbonisation solutions has accelerated dramatically in just the last

three months. All of our customers – private and public – have decarbonisation targets. So, what do they do? Who do they turn to? With our suite of technical skills, we are in a prime position to grow our business in what will be a massive transformation effort. Governments can't, or won't, put numbers to what needs to be spent, it's too large, and this all lies ahead of us.

We'll now move to Slide Three – our management of COVID-19 in the last six months just to give you a sense of how businesses like ours are managing. So, despite the obvious challenges, I am very pleased with how our Management Teams have organised our labour availability, and equally as pleased with how our workforce has responded. On the labour shortages side, we had seen significant variation in the percentage of employees in isolation by Business Unit. Some of those are as low as two per cent, and others, at times, have been as high as 40 per cent, particularly where there's been a high reliance on casual staff. On average, around 10 per cent to 15 per cent are off at the moment isolating for one reason or another. Our business continuity strategies have been generally well-managed with percentage in isolation now stabilising, or declining, in all of those areas, so things are getting much better. Pleasingly, we've had limited impact on our ability to service customers. So, on the customer side, the labour shortages are impacting workflow and delaying new projects. And you can see that as we roll through the individual Divisions, but we think this will reverse as infection rates, as we can see, are in decline.

On workplace management, the compliance effort has been quite complicated with different safe work requirements across each State and Territory. Most States have seen multiple changes in rules, or most days have seen multiple changes in rules and requirements across the States and New Zealand. Unfortunately, it's just something that has to be managed. Thankfully, we are well-versed in managing through change. There is undoubtedly a productivity impact increasing the cost of service. But we anticipate this will be temporary.

Mitigating the ongoing risk of COVID-19 is obviously key. Now we've long established COVID-safe standards, practices and mature continuity plans which have held us in good stead, and we share those and coordinate with our customers. We are proactive with our customers both on the service side, but also commercially. We're focusing in on our supply chain management and are planning as far ahead as we can trying to predict bottlenecks and future shortages. Our workforce is directed to priority works, continuity of critical regulatory roles, particularly where we operate customer infrastructure, and smaller work groups that are more severely impacted by staff shortages. And we're also using alternate contract partners or sub-contractors where we need to. And on the contract management side, customers are generally supportive and are providing KPI relief were appropriate. In a number of cases COVID-related variation claims over the last two years continue to progress.

I would say that the volatility in materials and labour supply and pricing is making it difficult for everybody in the market to commit to costs and program timing for new contracts and this is a key focus for our risk reviews. Generally, the circumstances are requiring a more collaborative approach to risk sharing with customers. Now that's not a bad thing.

Now, given the understandable interest in the prospect of much higher inflation levels and wage growth on the businesses, like Downer, I thought I'd include the following slide, which you may have seen from the last Full Year presentation. I'm not going to go through that slide in detail, but what you'll see is that long-term contracts adjust to the impact of cost increases, including wages. Over the past decade, these adjustments have been generally detrimental to margins due to low movement in CPI and wage indexes in some cases being outstripped by actual costs. Now, I think we're entering a phase where this could turn around where higher CPI and wage indices provide price rises that exceed actual cost increases in some cases. It will of course require close cost and labour management, but in my view, it is an opportunity that we haven't had over the last number of years.

I will now turn to the performance of our three core businesses; Transport, Utilities and Facilities. So, as you know, Transport's the powerhouse of the group, both in Australia and New Zealand, contributing half of the Group's revenue. Revenue was up 14.6%, or $359 million, with strong performances across the Business Units. EBITA was up 15.9% with increased contributions from Rail and Transit Systems, and Projects. Now, the results would have been better but the Road Services business, which was having a cracking half, was unfortunately impacted by terrible weather in the second quarter.

We commenced the operation of Adelaide's Metro Trains and the Region 8 bus contract in Sydney, and both have started very well. I spent some time at the Brookvale Bus Depot last week, and it all looks very good. We're hopeful of being successful in other bus operations being tendered in Sydney at the moment. We've also recently picked up the Transurban CityLink Road Services contract in Melbourne, which is very pleasing. And as I said the new Rosehill Sustainable Resource Centre is in commission. It's a game changer for us being the most efficient asphalt and recycling facility in the country. We've also, as I said, acquired Fowlers Asphalting in Gippsland in Victoria, further strengthening our geographic footprint in bituminous products and services.

Now to Utilities. It contributes 15% in Group revenue and we've got a well-balanced portfolio across Power and Gas, Water and Telecommunications. Revenue was down 5.6%, or $51 million, due to lower volumes and a change in mix away from higher margin, minor capital works. Now these are all COVID-related. We think the change is temporary, but it certainly had an impact on the half. EBITA was down 26.5%, or $12 million, as a result of the mix and volume change with a more significant impact in New Zealand.

On the bright side, we are winning good business in Australia and New Zealand and our customer feedback is great. We've recently been awarded a key three-year Chorus Field Services contract in New Zealand, further extending our leading

market position there. And we're also now converting decarbonisation opportunities for our customers in what we are calling New Energy, and this will grow.

Let's now go to Facilities. Downer is the largest integrated facilities provider in Australia and New Zealand, with strong positions in a number of government areas including Health, Education, Defence and Social Housing. We are also the leading provider of asset maintenance and specialist services to Australia's critical economic infrastructure, including Oil and Gas, Power Generation in the Industrial sectors. Facilities contributes about 35% of Group revenue. Revenue for the period was up 22% driven mainly by COVID-related volumes in Health and Education. And as you know, there's been a lot more work in that area, also industrial maintenance in Australia compared to the prior comparative period and building projects in New Zealand. There was a strong earnings performance from most areas but EBITA was up just 7.5% due to COVID impacts on two areas. Project volumes in asset and development services, and in lower levels of work in power and energy. Again, the impact is temporary, it's COVID-related and the projects will return.

On the positive side, we were awarded the $1 billion New South Wales Police Property Portfolio Capital Works contract during the period and this was very pleasing. I'm also pleased to report that we've successfully renegotiated the Royal Adelaide Hospital contract and the Bendigo Hospital contract, and this is quite a milestone. We've also now exited the majority of our hospitality contracts. And finally, like Utilities, our Facilities business is very well positioned to meet our customers' requirements to decarbonise.

So now to work-in-hand. Downer's work-in-hand is a substantial $35 billion and 92% of this is government-related. The pie chart on the right of the slide shows that 91% of our work-in-hand relates to services contracts, predominantly long-term contracts, servicing critical infrastructure. Around 9% of our work-in-hand is attributable to construction. And only 1% of our $35 billion of work-in-hand relates to what we call

lump sum construction contracts. Of course, we manage the risk in those very, very heavily.

The extended profile of our workbook, as you can see there, also provides stability and confidence and our relative market position is strongly improving. I'll come back in a moment. I'll hand over to Michael, now who will present the financial results and I'll come back a little later to talk about the outlook. Over to you, Michael.

Mr Ferguson: Thanks, Grant. Good morning, everyone. Slide 10 provides a summary of the Group's financial results including statutory and underlying financial performance, cash flow performance, and key balance sheet metrics. I will talk through the detail of each in the following slides, commencing with Group underlying financial performance on Slide 11. On a consolidated basis, the Group reported total revenue of $6 billion for the six months to 31 December 2021. This was 2.3% lower than the prior corresponding period, predominantly due to the impact of the divestment program. Similarly, EBITDA and depreciation have also declined 24% and 30% respectively, due to the impact of the divestment of Laundries and Mining. Underlying EBITA declined 17.8% to $182 million with an EBITA margin of 3%. There is a detailed breakdown between core earnings growth and the loss of non-core earnings set out on the next slide.

Margin reduction has been driven by COVID disruptions and the losses incurred in the Hospitality business. Net interest expense reduced by 11.6%, reflecting lower debt levels and an improved average cost of funds. We expect this to continue to trend down following the successful refinancing of our Sustainability Linked Loan in November. The effective tax rate of 28% remains slightly below the Australian statutory tax rate of 30% due to non-taxable distributions from joint ventures at a lower corporate tax rate in New Zealand. Downer delivered an underlying NPATA of $97.6 million, which is 18.1% lower than the prior corresponding period. Return on funds employed increased 1.4 percentage points to 11.3%.

The Downer Board has declared an unfranked interim dividend of $0.12 per share. While this represents a payout ratio of 87% of underlying NPATA it is consistent with the final FY2021 dividend and considered appropriate given the Group's strong liquidity position at 31 December. Downer expects to return to frank dividends either for final FY2023 or interim FY2024.

Moving now to Slide 12 outlining the Business Unit performance. Downer's core Urban Services businesses delivered EBITA of $238 million, up $10 million or 4.4% on the prior corresponding period. Grant has discussed the performance of the core business in the earlier slides.

Consistent with Downer's new structure following the divestment program, and as flagged in our FY2021 full year results, this is the first reporting period, we have disclosed our core business under the simpler Transport, Utilities and Facilities segments. The most notable impact of this change is the inclusion of Asset Services in the Facilities result and the transfer of Downer's Defence consulting business from Utilities to Facilities. We have also adjusted the comparative periods for consistency, with the reconciliation included on Slide 25 of the supplementary information.

Non-core business EBITA resulted in a net loss of $4.4 million for the half. This includes the contribution from the Mining businesses, Open Cut East and Otraco, up to their divestment dates of $8.1 million offset by the loss from Hospitality of $12.5 million. The Hospitality result reflects the significant impact of COVID during the period at a number of venues, most notably the prolonged lockdown affecting the Melbourne Cricket Ground. Included in the result is approximately $8 million of monthly minimum guaranteed customer payments that were paid under the MCG contract that were not incurred in previous lockdown periods. Downer has now completed its contract at the MCG and handed over to the new catering services provider at the end of January 2022. Downer has now exited all but a small number

of hospitality contracts with the remainder expected to be sold or run off before the end of FY2022.

Corporate costs rose by 8.8% to $52 million. Whilst we have reduced our Head Office costs during the half, as part of the divestment program, the full benefit of these reductions has not flowed through the first half as yet. We have also seen continued increases in other costs, particularly insurance and IT security costs.

Slide 13 lists the five items that reconcile Downer's statutory result with the underlying result. The net impact of these items results in the statutory profit exceeding the underlying profit by $1.4 million. The first item relates to the non-cash fair value movement on the Downer contingent share obligation liability arising from options issued as part of the Spotless minority acquisition. The fair value of these options is 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 $5.4 million for the half year.

The second and third items relate to divestment and exit costs and portfolio restructure costs incurred as part of Downer's divestment program, totalling $51.3 million. Divestment and exit costs include the difference between the proceeds received and the carrying value of the divested assets, including an allocation of IT systems and property costs. Portfolio restructure costs include redundancy costs incurred as the Group reduces its management layers and corporate headcount as part of its post-divestment restructure. It is expected that the write-off of these costs will lead to future annual savings of approximately $8 million through reduced amortisation, leasing and employee costs.

The fourth item relates to bid costs relating to Queensland's Rollingstock Expansion Program. $2.8 million in bid costs were incurred during the period and we have highlighted this item as we expect total bid costs to be material for FY2022.

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The final item relates to the compulsory acquisition of land by Sydney Metro at Downer's Rosehill Asphalt and Recycling Facility. The transaction has resulted in Sydney Metro reimbursing Downer on a like-for-like basis for the actual costs incurred on the construction and commissioning of a replacement facility. Downer expects the compulsory acquisition and reinstatement of operations at the new site to be cash neutral in net terms. The replacement facility is expected to be completed by May 2022 with no expected disruption to operations. The $60.1 million after tax gain during the period is reflective of the difference between the historical written-down book value of the existing facility and the reimbursement of costs for the replacement facility and relocation costs.

Turning to cash flow on Slide 14. Total operating cash flow was $270.4 million, resulting in a statutory cash flow conversion of 85.1%. Adjusting for the remaining payments recognised in FY2020 and funded as part of the July 2021 capital raising, underlying conversion was 91.2%. Pleasingly, Downer's portfolio transformation continues to drive lower capital intensity, with net capital expenditure for the core business of $65.2 million. Downer has also invested $22.8 million in IT-related capital, with just over half of this focus on improving Downer's cybersecurity. Total funds from operation were $78.7 million. Below funds from operations proceeds from divestments totalled $247.6 million for the period, whilst the repayment of borrowings relates to the early repayment of Downer's medium-term note due March 2022. Cash applied to the share buyback program was $99 million. The Group also acquired Fowlers Asphalting during the period.

Cash held at 31 December was $676.7 million, which when combined with undrawn facilities of $1.4 billion, provides us with significant liquidity of $2.1 billion. As Grant indicated, Downer's balance sheet is in good shape with net debt to EBITDA of 1.5x well below our target range of 2 to 2.5x. The successful refinancing of our Sustainability Linked Loan during the period and prudent debt management has seen our weighted average debt duration extend from 3.8 years, at 30 June 2021, to 4.2 years. We have included further details on cash flow, debt maturity and balance

sheet in the supplementary information on Slides 21 to 24. Thanks very much. I'll now hand back to Grant.

Mr Fenn: Thanks, Michael. So, the key messages and outlook. With the arrival of Omicron, it's been a tougher six months to navigate than we expected in August 2021. Despite the challenges, Downer has delivered solid earnings and strong cash conversion for the first half of 2022. Our market positions and diversity give us strength that others don't have and confidence through to the other side of COVID-19. Our brand and our relationships are very strong. The financial capacity of the Group has never been so robust with gearing at just 16.5% and net debt to EBITDA of 1.5x. In August 2021, we predicted that our core Urban Services revenue and earnings would grow in FY2022. In the first half our core revenue was up 13.3% and earnings were up 4.4%. But the impact of Omicron on the supply chain, work volumes and mix, is difficult to predict and presents risk for the second half, so we will not be providing specific earnings guidance. We'll do our best to manage that risk with our customers and we'll provide an update at our Investor Day in April. So, thank you, and that's the end of the formal presentation. And I'll hand over to the moderator to organise the questions. Thanks.

Operator: Thank you. If you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star then 2. If you are using a speaker phone, please pick up the handset to ask your question. The first question today comes from Rohan Sundram from MST Financial. Please go ahead.

Mr Sundram: *Hi guys, thanks. Grant I'll start with a question just on the environment. Labour supply issues and COVID impacts aside, how would you describe activity levels in the half? Taking onboard your comments would you expect material improvement in the second half, and are you seeing that pick up from rising government spend in your activity?*

Mr Fenn: What I'd say for particularly the second quarter, so this is the second part of the first six months that we've just seen, Omicron, just the impact of that on customer outflow of work, et cetera, had quite an impact. But I sense from each of the businesses, that that's starting to turn around and we see it on own business. So, the issues related to absenteeism because of COVID, et cetera, and isolation, seem to be changing. So, there's no issue with the underlying demand for services. It's really being able to get it out the door, and I think that's starting to come back is what we're seeing.

Mr Sundram: *Thanks, Grant. And one final one for Michael. Post the reset in the Royal Adelaide contract, are you able to provide indications around the cash burn? Monthly or annually for that contract?*

Mr Ferguson: Post the reset?

Mr Sundram: *Yeah, post the reset.*

Mr Ferguson: Yeah. It'll be cash positive for us.

Mr Sundram: *Okay, thank you.*

Mr Fenn: We should see normal returns off the back of those resets.

Mr Sundram: *Thanks, guys.*

Operator: Thank you. The next question comes from Adam Martin from Morgan Stanley. Please go ahead.

Mr Martin: *Yeah, good morning, just around the labour shortages, can you just elaborate on that a bit more? You talked about it varying quite a bit. Can you just talk through why*

it does vary a lot and just give us some context around some of the Business Units, please?

Mr Fenn: Yeah, sure. So, where you've got a more significant number of casual employees it seems to be more pronounced in those areas. So, if we will look at Utilities, which has been our most impacted, outside of Hospitality, in the metering services that's where, at times, we've been 40%, short of where we would normally be. Now, of course, we rearrange our work, et cetera, to manage that, but it's generally where that's the case. And it can be more acute, where you have smaller work crews. So if you think you've got work crews, maintenance work crews on whether it be power lines, or whether it be even pavements when you've got six or seven people, and two or three are out, then that's where the impact has been. But generally, we've been managing this very well. So, as I say in the presentation, we've not really seen service degradation from these. We've been able to manage in large part with our customers to make sure that everything's run well. And, of course, as I make clear there, it is starting to turn, and that started two or three weeks ago. So, we've stabilised, and those issues are declining.

Mr Martin: *That's good context. Second question, just regarding the Transport Division, you've called out I think customer volumes across the Eastern States. Can you just give a bit more context on that as well and just whether there are signs of that improving over the next six to 12 months?*

Mr Fenn: So, Transport generally was very good. So, I called out there that our Road Services business was having a cracker half, but it did get impacted by a lot of weather, which we've all been experiencing in the second part of the half. That's just been the case of it and that's been in the Eastern States. Now all that will return, the work doesn't go away, it's got to been done. So, if we end up with a good period between now and the end of June, that will be great. Our Rollingstock business did well, and our Projects business did well in there. So, it wasn't disruption, it was really weather in those areas.

Mr Martin: *So that should really improve going forward assuming the weather's not too bad going forward? Is that your sense?*

Mr Fenn: Yeah, our Road Services business is doing very, very well, and we were in for a very, very good half. We don't call weather out very often – we probably had seven or eight full years where we've not been calling weather out – but it just was such an issue for us. It's off quite a bit as a result of that, so we'll just see what happens in the second half.

Mr Martin: Ok. *That's all from me. Thank you.*

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

Mr Visen: *Hi, morning, Grant, Michael. Thank you for taking my question. I just wanted to get some more clarity on guidance. Both core earnings and revenues were up, year-on-year. So, is it fair to conclude that your guidance on your increase of earnings, and revenues still holds?*

Mr Fenn: I think you can imagine, as you roll through into these presentations, and the words that you put them have all been well worked. I think what I've got there is really what I want to say, and that is that the facts are that our first half has been a good performance in the core business. So, we've had good revenue growth. The revenue growth in here just shows, in those core areas that we often talk about growth here, there is a lot of organic growth, there is a lot of money being spent here. There's no doubt about it. Omicron has had an impact, there's no doubt about that either, productivity wise. Now, just how all of that comes together for the second half we've put in those outlook statements. So, I don't want to go any further than that, other than to say that, of course, there's risk depending on what happens. And it's been a volatile situation over the last number of months and let's hope it's not in

the next six months. But you'll have as good of an idea as I do on the volatility of government decisions and the like. So, we'll see where we go.

Mr Visen: *Thank you Grant. Thank you.*

Operator: Thank you. The next question comes from Andrew Hodge from Credit Suisse. Please go ahead.

Mr Hodge: *Morning, gents. I just got a couple of questions, first one just around the reconciliation from the portfolio restructure. And, just talk me through, I just figure bid costs for a contract are an underlying part of the business. I just want to understand why you've excluded those as a reconciliation.*

Mr Ferguson: I think it's just the size of them. So the majority of all the Downer bid costs that we spend across the Group, which is obviously many, many millions of dollars has flowed through the underlying result, where we're bidding this major rollingstock program, it's going to have a material amount of bid costs. It's unusual to any other project that's going on in the Group. We're just flagging that the impact of that on the full year is going to be much higher than $2.8 million.

Mr Hodge: *Ok, great thanks. And then just in terms of the portfolio restructure costs, I think you alluded to it, but can you confirm that all of those were in businesses that are outside of what you consider the core Urban Services business?*

Mr Ferguson: Yeah. And the corporate restructure that we've done to right-size the business to deal a more refined portfolio.

Mr Hodge: *Thank you. And then just one final question just in terms of the buyback, $100 million in the half consistent with the previous half. So, I guess, just going forward, we figure you do $100 million for the next couple of halves to finish out the stated level that you've got in the market.*

Mr Ferguson: Yeah, so somewhere around there. The volumes vary, depending on our decisions to buy and diligence in the business and all of those things. But that would be a reasonable run rate assuming that there's not something more accretive that we would apply some of those funds to.

Mr Hodge: *Great. Thank you very much.*

Operator: Thank you. Once again, to ask a question, please press star 1 on your phone. The next question comes from John Purtell from Macquarie Group. Please go ahead.

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

Mr Fenn: Hello, John.

Mr Purtell: *I just had a few questions if I can, the first couple for Michael. Just in terms of the amortisation add back, it's a fair bit less this period. So, what was driving that and is that now a go-forward level?*

Mr Ferguson: Yeah, it'll diminish slightly, I think from here, John, but the majority of that, a number came about following Spotless. So, we allocated the intangibles to customer contracts and brands and whatnot. And the front end of the significant amount of that that was allocated to the contracts on foot, has wound out over the five years or so, between now and then. So, there was a big step off for the first round of the intangibles that were attached to those contracts that we acquired.

Mr Purtell: *Thank you. Second question. The $12 million lost there in Hospitality, you obviously flagged that you've exited a range of contracts, so should we expect to see a much lower loss in the second half?*

Mr Ferguson: Yeah, so we're out of the MCG from January, so there'll be a little bit of drag into the January results. And then the biggest contribution to that, John, is the minimum

guaranteed payments that we are required to pay whether the contract operates or not. So, there's about $8 million of that relating to the MCG in the half. We've been fortunate enough to have that relieved, during previous lockdowns; we weren't for this period. So, they will go and there will be trail losses which we would expect to be minimal in the second half.

Mr Purtell: *Ok, Thank you. And just the final one. Grant, you mentioned that you're entering a phase where CPI rises potentially allow for some pricing improvement, maybe, on top of inflation there. But really two parts to the question. Firstly, the contract structures that you have in place, which you've called out, have good CPI recovery. Are they working as they should, based on everything you're seeing at the moment? And secondly, that opportunity that you see, is that more around a more rational environment in terms of labour being a bit scarcer. So, the participants such as yourselves are pricing that a bit more rationally?*

Mr Fenn: First, on the contract structures, you don't enter into long-term contracts without being covered for cost increases. You'll see in that slide that I put up there, the very vast majority, in fact all of the longer-term contracts, have these types of mechanisms. And they range from general CPI to other more targeted indices. And on the wages, similarly, sometimes wages will go up by CPI, and sometimes they'll go up by wages indexation, and that's a matter of negotiation at the times that the contracts are formed. So, all of them adjust the prices to these things.

Now, with low inflation, low wage growth over the last periods, that's been quite difficult to manage. So, you're constantly under the hammer to make sure that you're getting more efficient in the way that you operate, et cetera, during periods of low-price increase. And I'm really just saying here that with a higher CPI, and likely higher wage index we will see higher prices now for our services. What that does mean though, is that you've got to manage your costs. And often the basket of costs that we actually have is different to CPI. So, you're managing those things, and also the basket of wages is different to CPI. And you've also got potentially three-year

Enterprise Agreements that won't get renegotiated for quite a period. So, it's those arbitrage positions that really, I'm talking about here. And I'm hopeful that whilst it's been difficult over the last number of years with low index increases that may change. But of course, it's got to be managed.

Mr Purtell: *And just a final one, if I may. Just harking back to a few of the earlier questions. So essentially, Grant, you're viewing a range of these impacts as temporary. Is that the correct read? And in terms of your ability to source labour and retain labour in a tighter environment, you feel comfortable around that?*

Mr Fenn: Absolutely. I do think this is temporary. It's hard right now when you're putting results out over the past six months, it's hard to look forward. But if you look forward, we look at the opportunity that's being created here. There's that much that's going on in our markets. If we hadn't had the Omicron, and we were all sitting back here in July, without that, and we thought we were through, everyone's vaccinated, then we wouldn't be sitting here talking about the issues. But we will get through this and the underlying demand for the services and the amount of money that's being spent, is very positive.

Now the cost to serve and the issues around labour and supply chain, they will ease. It's already easing on the labour side, and I think the supply chain will ease as well. So, it is temporary, and we can already see that in what's going on. So, I'm very positive, I'm not negative at all. In fact, I'm very positive and I do believe that a lot of the changes that have occurred with COVID are a net benefit, so it's going to drive our markets over the next decade. And we're right in the thick of where we should be.

Mr Purtell: *Thank you.*

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

Mr Ryall: *Hi, there. Thank you very much. Grant, I was hoping to focus on the Utilities Division, please. Could you just talk a little bit more – reconcile, maybe – that comments about the mix changes that has impacted earnings, the fact that you think that's temporary, but then cross-checked with the work-in-hand, that's the only Division where work-in-hand has fallen quite significantly between the end of fiscal 2021 and December? So, can you talk about that firstly?*

Mr Fenn: So, in Utilities we do a lot of maintenance work, so this is maintenance on poles and wires. We do a lot of work in Telco, a lot of work in Water right across the country. So those contracts typically have a base maintenance level. So, you're doing certain things out across the operations to maintain that. But coupled with that, you have a lot of, what we call, small capital works and they're sometimes not that small. And they're typically higher margin parts of that work.

Now, you get that work, because you've got your base contracts, and you're sitting on those panels. We've seen with Omicron in particular as the issues of that, and it's not really our issues but certainly in the flow of work, we've seen that mix change, so less work in that minor capital works across most of that, and in particular in Water. So, what that means is that it's temporary, it will change as labour shortages, particularly in our clients and also our own, subside, which we think will happen relatively soon, but that's the situation. And it's not just in Australia, it's also in New Zealand. We've seen the same impact. So, a lot of the Water authorities, off the back of government positions on workers have pulled back quite significant. And they've done it specifically to support the COVID push.

Mr Ryall: *But then reconciling that with the work in-hand fall as well?*

Mr Ferguson: Yeah, if I can jump in on that one, Grant. The segment reallocation we did, we put the Defence Consultancy Business out of Utilities into Facilities, and so there's been a work-in-hand transfer. We can come back to you with the details of it, but that's part of the reason as well.

Mr Ryall: *Oh, right. Okay.*

Mr Fenn: Yeah, so our Utilities business is going very well. Now I know it's been down in earnings by that amount, you'd say, "Oh, gee, it's not that well," but they are not permanent issues, they will be temporary. We're winning very good work and our customers are telling us we're doing a very good job. So, I'm very happy with the way that business is going.

Mr Ryall: *And then can I just ask a follow on then? Talk about the significant and growing opportunities in energy transition and decarbonisation, which, absolutely, I get the tailwind there, but when do you think in the Australian and New Zealand market, this actually becomes a meaningful work-in-hand and earnings opportunity for Downer? What's the kind of timeframe you're thinking about? I know, you're well positioned and all that sort of stuff, but I'm just wondering when it becomes tangible.*

Mr Fenn: It's different, depending on the Business Unit. So, if we look in our Transmission business, it's already becoming, so there's a lot of transmission work that's starting to come on deck. There's a lot of stuff that we're bidding and that will just get bigger over time – and we're talking there's billions of dollars of projects. I don't know whether you saw in the paper this morning, we've got quite a quite a push that it's too slow. So that will be very quick. In our customer base, whether it be in Facilities or in Utilities, we're already seeing a lot of attention being taken to reducing their carbon footprint. Now what we really mean here is that they're using their estates to generate power. So already now we're starting to build solar farms, et cetera, on our Utilities customers' and Facilities customers' estates.

Now, that's early days. If you think about the fleets, we're starting now to be developing electric vehicle facilities, and we're doing that with Keolis Downer in our bus (contracts). All of this is to come. We're at the start of this. Just exactly how quickly it moves we'll need to see. We've got to build the transmission and the power infrastructure first, I guess, there's no doubt about that. But it's starting to

happen. In three years', time, I'd like to think it's a significantly larger part of our business than it is now. It certainly will be in our Projects business in transmission.

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

Operator: Thank you. The next question comes from Nathan Riley from UBS. Please go ahead.

Mr Riley: *Good morning. Just picking up on the core Urban Services revenue growth – 13% revenue growth there in what sounds to be a very, very tough half – but can you just give us a sense of what level of revenue couldn't service just given your own labour availability challenges? Trying to get a sense of the underlying run-rate and growth there absent any of the challenges around labour that you've seen?*

Mr Fenn: Look, I haven't done the alternate position, but if you look at Utilities, we're down $51 million in revenue there for a start. We would've expected an increase. We've had weather impacts in our Road Services business, and we would have expected more out of that, so that's just for start.

Mr Riley: *Got it. Ok. And the extension of that you've obviously had a pretty challenging margin outcome there and that's a reflection of the productivity challenges you've faced with both your own lower labour availability, and also client availability. But as you say, as the workers do come back to work, is there anything that gives you cause for concern around your ability to recover on the margin front? Is there anything permanent around productivity or the cost base, which gives you some concern?*

Mr Fenn: Look, there's nothing that I could point to, but it will require management. We need to get back to making sure that all of our operations are as efficient as they can be. That's just the way it will need to be and that will be where the pressure is applied.

Mr Ferguson: And, Nathan, the Hospitality result had a pretty significant impact on the margin, so that business did about $90 million of revenue for the $12.5 million dollar loss. So that's a 20 to 30 basis point explanation as to the difference in margin period to period.

Mr Fenn: Even in Facilities our Asset and Development Services, it's got a lot of revenue and it was impacted very significantly. It's a business that does a lot of small work, particularly in air-conditioning. And it suffered very significantly with lockdowns, just productivity-wise, and that will return. So that will improve.

Mr Riley: *And finally, this is a question around corporate overhead, but I think it also extends to business overheads at the second level. Michael, you called out there there's been some inflation around IT and IT security and also some insurance charge inflations. I think that's probably masking a little bit of cost reduction in that corporate line, but are you at a level now, post the divestments that you've undertaken, where it's appropriate to maybe go and have a look at the overall cost base?*

Mr Ferguson: Yeah, we started doing that, Nathan, and we're still providing transitional services to the majority of the divested businesses. So, we're recouping some of that, but we're not recouping all of the costs of that. We've done some reduction at the corporate layer, but I suspect in the second half once the majority of these transitional services are behind us; we'll look at that again. And then there's a few IT security costs, and cyber insurance and the like, are going up pretty significantly, and they're obviously critical costs for the business. There's been a little bit of turnaround, or negative impact, for us – the way you account for some of these IT projects now with the expensing of it you save some amort, but we've had a bit of a turnaround or a negative impact of that as well. To answer your question, we're certainly going to continue to look very closely at overheads.

Mr Riley: *Thanks for taking the questions.*

Operator: Thank you. At this time, we're showing no further questions. I'll hand the conference back to Mr Fenn for closing remarks.

Mr Fenn: Thanks very much for the interest Downer's results, and please, if you have further questions, if you can pass them through to our Investor Relations team, and we'll do our best to answer them as soon as we can. So, thanks very much.