# Full Year Report

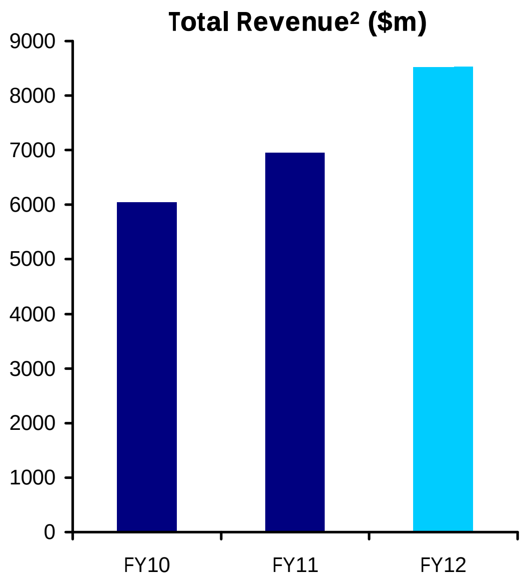
12 months to 30 June 2012

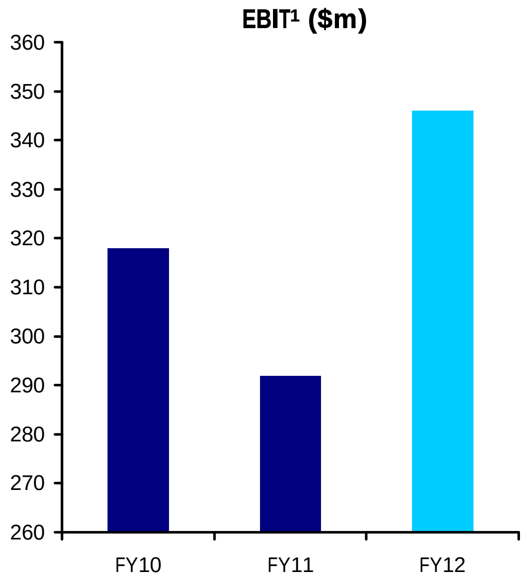
Downner

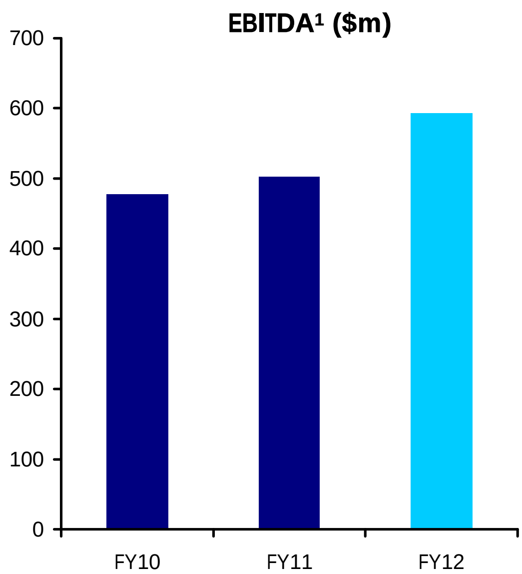
## Financial Performance

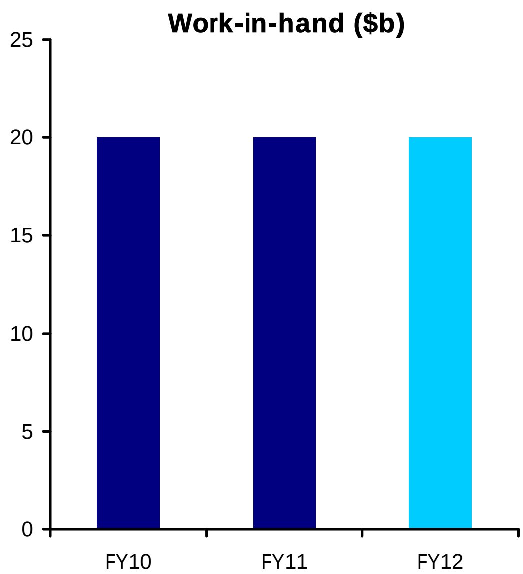
| $m | FY12[1] | FY11[1] | Change (%) |
|---|---|---|---|
| Total revenue[2] | 8,524.6 | 6,960.9 | 22.5 |
| EBITDA | 593.7 | 502.7 | 18.1 |
| EBIT | 346.5 | 292.2 | 18.6 |
| | | | |
| Net interest expense | (69.0) | (64.3) | 7.3 |
| Tax expense | (82.1) | (61.5) | 33.5 |
| **Net profit after tax** | **195.3** | **166.4** | **17.4** |
| | | | |
| ROFE[3] | 17.7% | 15.8% | 1.9 |

[1] 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.
[3] ROFE = EBIT divided by average funds employed (AFE) (AFE = Average Opening and Closing Net Debt = Equity)



## THE YEAR TO 30 JUNE 2012

Downer made significant progress during the 2012 financial year and the strength of the business is clear in the full year result. All Downer businesses continued to win new work and work-in-hand remains high at $20 billion.

Downer's portfolio structure is now well defined with the establishment of Downer Infrastructure in May 2012 (bringing together the Group's infrastructure businesses in Australia and New Zealand) and the completion of the sale of CPG Asia for $147 million in April 2012.

Downer's three divisions – Mining, Infrastructure and Rail – are leaders in their sectors.

Downer Mining performed particularly well during the year, with earnings before interest and tax (EBIT) up 45.1% to $173.5 million. Growth was driven by new and expanded open cut mining contracts and record levels of work in the blasting and tyre management businesses.

In Australia, Downer Infrastructure's EBIT rose by 38.2% to $150.7 million despite the impact of underperforming contracts and wet weather. The Eastern region was particularly strong driven by road infrastructure services and the benefits of blending our engineering services and construction capabilities for resources based projects.

In New Zealand, Downer Infrastructure delivered a much improved performance in the second half of the year, achieving full year EBIT of $29.6 million, more than double last year's EBIT of $11.0 million. The efficiency improvements that have been introduced over the past two years are now starting to show up in the New Zealand results.

There is a significant pipeline of opportunities for Downer Infrastructure in both Australia and New Zealand. The newly integrated business is already seeing the benefits of scale, increased management depth and technical expertise. This is having a real impact on the opportunities available and our success rate.

Downer Rail's EBIT rose by 1.8% to $76.4 million, in part driven by the close-out of locomotive and passenger build contracts that were completed during the year. On 26 June 2012, Downer announced a new five year agreement with Electro-Motive Diesel that will provide customers with more competitive pricing and improved lead times.

The Waratah Train Project passed a number of significant milestones during the year and, while still a challenging project, now represents a substantially lower risk to the Group. Manufacturing in Changchun is now consistently meeting quality standards and the production rate is now at the required three trains per month. At Cardiff, the manufacturing flow line is now pulsing every four days and will move to three days in February 2013.

Twelve Waratah trains have now received a certificate of Practical Completion and are available for passenger service. Under the current schedule, there will be 23 trains available for passenger service by the end of December 2012 and the 78$^{th}$ train will be delivered before the end of the 2014 financial year. The trains in passenger service have been performing well. More information about the Waratah Train Project is provided on page 7 of this report and also in the Annual Report lodged with the Australian Securities Exchange and available on the Downer website.

Downer has further strengthened its risk and project management processes. A number of legacy underperforming contracts were completed during the year, including the Curragh coal handling preparation plant which achieved Practical Completion in June 2012. More information about Downer's Risk Management is provided on page 6.

Over $85 million in gross benefits were delivered in the 2012 financial year through the 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 Fit 4 Business is provided on page 5.

## Financial performance

Downer reported total revenue of $8.5 billion for the 12 months to 30 June 2012, 22.5% higher than last year. Total revenue includes $0.5 billion of contributions from joint ventures. All businesses recorded revenue growth with Downer Mining up 67.9% to $2.5 billion, Downer Rail up 14.0% to $1.3 billion and Downer Infrastructure up 11.7% to $4.6 billion (Australia up 13.6% to $3.7 billion and New Zealand up 4.6% to $0.9 billion).

Underlying EBIT increased by18.6% to $346.5 million and underlying NPAT rose 17.4% to $195.3 million.

Statutory EBIT after individually significant items, including the previously announced write off of the Reliance Rail hedge reserve of $72.5 million, totalled $264.2 million, up from $25.7 million. Statutory NPAT was $112.9 million, up from a loss of $27.7 million.

Operating cash flow was strong at $364.5 million.

A reconciliation of the underlying EBIT and NPAT to the statutory EBIT and NPAT results is shown in the table below.

| | FY12 EBIT ($m) | FY12 NPAT ($m) |
|---|---:|---:|
| **Underlying result** | **346.5** | **195.3** |
| Individually significant items: | | |
| • Goodwill impairment | (18.0) | (18.0) |
| • Profit on CPG Asia sale | 33.6 | 33.6 |
| • Reliance Rail hedge reserve | (72.5) | (72.5) |
| • Singapore Tunnel provision | (20.0) | (20.0) |
| • Legal settlement | (5.3) | (5.5) |
| | | |
| **Statutory result** | **264.2** | **112.9** |

Note: Goodwill impairment relates to Downer Asia and CPG Australia

## Capital Management

During the year, Downer financed $297.6 million in new debt and bonding facilities, refinanced the $260 million Waratah syndicated bonding facility and extended $158.1 million of existing bilateral facilities.

At 30 June 2012, Downer had gearing of 18.6% (29.2% including operating leased plant and equipment) and total available liquidity of $890.2 million, comprising cash of $296.7 million and undrawn committed facilities of $593.5 million.

The Downer Board decided not to declare a final dividend. Downer will continue to pay dividends on the 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 productivity through significant and sustainable change to 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 $85 million in gross benefits were delivered in 2012 through initiatives including:

- the merger and consolidation of divisions and businesses;
- leveraging scale, reducing costs, improving service delivery and developing the supply base through a range of procurement initiatives;
- reducing freight locomotive build costs through process and design improvements;
- plant and equipment management and rationalisation;
- streamlining processes and operational tools to reduce unit costs; and
- enabling IT across Downer and delivering cost savings through an IT Managed Services Agreement with Hewlett Packard.

**Zero Harm**

Zero Harm means sustaining a work environment which supports the health and safety of Downer's people and minimising the impact Downer's business has on the environment. Success in achieving Zero Harm is fundamental to the company's future and remains the highest priority for the Group.

A profoundly disappointing aspect of Downer's performance during the year was the two workplace fatalities on road maintenance sites, one in Australia and one in New Zealand. Downer has implemented a number of initiatives to address the hazards involved with reversing vehicles.

Downer's Lost Time Injury Frequency Rate of 0.93 remained below one incident per million hours worked for the year while Total Recordable Injury Frequency reduced from 7.17 to 6.21 per million hours worked.

**Risk Management**

Downer continues to develop and implement improvements to its risk management processes , particularly in relation to tender assessment and project management procedures.

Tender Assessment

Depending on the value and risk profile of prospective new projects, tenders are required to be reviewed and approved by a Board Tender Review Committee (TRC), the Tenders and Contracts Committee (TCC) or the 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.

In addition to the contract value criteria, projects with special risk features (e.g. relating to design, technology, scope of works, contract terms, counterparty or geographic region) 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;
- Relationship with the customer;
- The geographical region in which the work will be performed;
- Partnering arrangements;
- Key contract terms and conditions;
- The contract type (e.g. fixed price, cost plus, schedule of rates or alliance); and
- Project execution risk and mitigation measures.

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.

These procedures incorporate regular project reviews which include monthly reviews carried out by Divisional executive management and periodic reviews by Group management of selected projects with total revenue greater than $10 million or with a significant risk profile. 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**

A total provision of $440.0 million has previously been provided against the Waratah Train Project (WTP) based on an estimate to complete the contract. The provision was based on program design, manufacture, production and delivery schedules (the program) to complete the contract within the estimated provision.

The WTP team has continued to implement changes to the program over the past 12 months, which 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 assumptions in relation to the revised program.

The provision currently reflects the revised program (Master Program Schedule (MPS) 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 full interiors and have been used as test trains. Train 1 has been returned to CRC to be retrofitted to the required standard and will be available for Practical Completion (PC) in late 2013. Train 2 completes its test train activities during August 2012 and will be returned to CRC before the end of 2012 for retrofit in similar timescales;

2. Trains 3 to 9 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 were 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 rework. Trains 10 and 11 were completed prior to the launch of new flow-line processes in Cardiff in February 2012 and delivered to the customer during April and May 2012 and subsequently achieved PC. Three train sets are currently within the production facility at Cardiff but being worked on a separate flow-line due to the higher levels of rework than following trains. The program schedule has been adjusted so that this work can be carried out at Cardiff efficiently without causing delay to the following trains;

4. Trains 15 to 40 are being built using a flow-line process that has been implemented in the interior fit-out shop in CRC. Continuing process and design improvements introduced progressively at Trains 15 and 24 have resulted in trains of a higher quality, with significantly reduced rework and with design changes as a result of testing and development included in the base build. These trains are then being completed at Cardiff on the new flow-lines that have been in place since February 2012. This has been operating at a four day TAKT time (the time which passes before each occasion that the flow-line is pulsed) since late May 2012 meaning that eight cars come out of production every eight business days. Train 24 has seen rework reduced to below that originally budgeted for in Cardiff for the first time in the project leading to reduced costs of manufacture. Also additional workforce has been applied to the workshops in CRC to deliver output of three trains per month from June 2012; and

5. Trains 41 to 78 are scheduled to be built with further process and design improvements for simpler assembly and higher quality of the passenger areas being progressively

implemented at Trains 41 and 51. Further acceleration of the flow-lines in Cardiff to a three day TAKT time is being planned from Train 41 (in February 2013).

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

- Since 30 June 2011, 12 trains have been presented to RailCorp, received PC and are currently available for passenger service;
- The current delivery schedule provides for a further 11 trains (a total of 23 trains) by Christmas 2012; and
- The program initiatives still enable Train 78 to be delivered to RailCorp and enter passenger service before the end of FY2014.

Further information in relation to the Waratah Train Project is provided in the Annual Report (Appendix 4E) 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 year. Philip Garling was appointed a Non-executive Director on 24 November 2011. Kerry Sanderson AO and Eve Howell were appointed Non-executive Directors on 16 January 2012.

## Operational Review

### Downer Mining

Downer Mining performed very well during the year with revenue growth driven by new and expanded open cut mining contracts and record levels of work in the blasting and tyre management businesses. Downer Mining currently has work-in-hand of $6.5 billion.

Downer Mining's total revenue for the year was $2.5 billion, 67.9% higher than last year. EBIT was 45.1% higher at $173.5 million with an EBIT margin of 7.0%. Return on Funds Employed (ROFE) rose from 19.3% to 20.3%.

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

- Christmas Creek, Pilbara, WA (Fortescue Metals Group): mine infrastructure, drill and blast services and load and haul of overburden and iron ore. This is a six-year contract awarded in August 2010 and valued at approximately $3 billion. Following the ramp up period, the contract is now performing well;

- Goonyella Riverside, Bowen Basin, QLD (BHP Mitsubishi Alliance (BMA)): load and haul of prestrip material and drill and blast services. Initially this was a five-year contract, beginning in July 2010 and valued at $2.0 billion, for the supply of contract mining services at both Goonyella Riverside and Norwich Park. In April 2012, BMA announced it would cease production at Norwich Park indefinitely. Since then, Downer's Norwich Park fleet has been redeployed to other BMA mines, including Blackwater and Saraji;

- Boggabri, Gunnedah Basin, NSW (Idemitsu Australia Resources): drill and blast, mine planning, and load and haul of both overburden and coal. This five-year agreement commenced in December 2011, with base case revenue valued at approximately $900 million over the duration of the contract; and

- Karara, Pilbara, WA (Karara Iron Ore Project): mine infrastructure, drill and blast services and load and haul of waste and ore. This contract commenced in February 2012 and has total estimated revenue of approximately $570 million over six years.

Downer's blasting and tyre management businesses continued to win new contracts and contract extensions and reported solid revenue and earnings growth. In April 2012, Downer secured a three-year blasting services contract with Jellinbah Resources valued at around $90 million. The underground business also continued to perform well and is actively pursuing new opportunities.

In July 2012, Downer announced it had been awarded a long-term rolling contract with TEC Coal Pty Ltd, a wholly owned subsidiary of Stanwell Corporation Limited, to provide mining services at Meandu Mine in South East Queensland. The contract, which has an initial term of five and a half years, will commence in January 2013 and have a value in the range of $600 million to $800 million.

**Downer Rail**

Downer Rail reported $1.3 billion revenue for the year, an increase of 14.0% on last year. Approximately $376 million of this revenue related to the Waratah train project. EBIT was 1.8% higher at $76.4 million resulting in an EBIT margin of 5.9%. ROFE was 16.3%, down from 17.8%.

Downer Rail's performance was affected by a decline in locomotive orders compared to the previous year, fewer positive project close-outs and margin pressure driven by customer demand for lower prices and the increasing threat of offshore competition. In this challenging environment, Downer Rail continued to win new business including:

- An order for 19 new locomotives by Fortescue Metals Group for use in the Pilbara. The total contract value is over $73 million including the provision of the locomotives and service and support activities over five years. The first locomotives are expected to be delivered in August 2012;

- A $292 million contract for the supply of locomotives to BHP Billiton Iron Ore in the Pilbara. This is a five year contract beginning in the second quarter of 2012, with an option to increase the total value to over $400 million; and

- A rolling stock supply contract to design, build and deliver 17 new PR22L locomotives to TasRail, Tasmania's State owned rail company. The total value of the contract is over $60 million, with the first new locomotives to be delivered in mid-2013.

During the year, Downer Rail mobilised several new passenger projects including Queensland Rail's Sunlander Tilt Trains and the WA Public Transport Authority's Transperth rail cars. Both are being manufactured at Downer's Maryborough rail facility.

Downer continues to build its partnership with French company Keolis, one of Europe's leading public transport operators. The joint venture currently operates and maintains the Melbourne tram system, Yarra Trams, and will also operate and maintain the Gold Coast Light Rail, which is currently under construction and scheduled to open in 2014.

Downer Rail has accelerated the development of its maintenance and asset management capabilities. It is the largest provider of outsourced freight maintenance services in Australia, with a national network of over 20 maintenance centres. It provides customers with frontline maintenance, locomotive overhauls, remote help desks and derailment recovery and repair services.

In June 2012, Downer announced that it had signed a new five year agreement with Electro-Motive Diesel (EMD). Downer and EMD, which is owned by Progress Rail, a Caterpillar company, have worked together for more than six decades supplying and maintaining locomotives in Australia.

Under the new agreement, EMD will manufacture all locomotives for the Australian market with Downer continuing to sell EMD locomotives and after-market products, including spare parts. EMD will manufacture the locomotives at one of its new low cost overseas facilities. This new model will ensure Downer has a sustainable locomotive business as it exits high cost manufacturing and concentrates on sales, repairs and maintenance as part of its Whole of Life Asset Management offering to the market.

**Downer Infrastructure**

Downer Infrastructure was established in May 2012, bringing together the company's infrastructure businesses in Australia and New Zealand. This is allowing Downer to optimise performance, deliver better results for customers and implement change more effectively. It will also deliver a range of benefits across Zero Harm, Risk and Project Management and the business' key business systems.

<u>Australia</u>

In Australia, Downer Infrastructure reported total revenue of $3.7 billion for the year, an increase of 13.6% compared with the previous year. EBIT was 38.2% higher at $150.7 million, despite the impact of onerous contracts including the Curragh coal handling and preparation plant (CHPP). EBIT margin was 4.1%, while ROFE rose from 14.4% to 18.5%. Downer Infrastructure in Australia has work-in-hand of $5.7 billion.

Downer Australia was awarded a number of new projects during the year, 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 demolition, design and construction contract for a new transmission line with Western Power, valued at more than $175 million;

- an electrical services contract for the supply, installation, testing and commissioning of high and low voltage power to the new Victorian Comprehensive Cancer Centre Project South Facility, valued at more than $85 million;

- An electrical and instrumentation contract with BHP Billiton Iron Ore, valued at $71.7 million. Downer is responsible for both Greenfields and Brownfields transmission line and substation works to provide power to a new mine at the client's Jimblebar operations in Western Australia;

- A number of electrical and instrumentation contracts with customers including BHP, Rio Tinto (including a framework agreement) and FMG;

- As part of a joint venture with Leighton Holdings, Downer won the Regional Rail Link Package F Contract (West Werribee Junction works), the last of six work packages on the Victorian Regional Rail Link. The $43 million contract will see West Werribee Junction designed and constructed. The $4.3 billion regional rail link will create dedicated tracks for trains travelling from Victoria's largest regional cities (Geelong, Ballarat and Bendigo) which will free up metropolitan lines. Downer also won a Tie Renewal contract for Metro Trains Melbourne in the Glenn Waverley area. The two contract awards are valued at approximately $50 million; 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 completed the sale of its CPG Asia business to China Architecture Design and Research Group on 30 April 2012 for $147 million.

New Zealand

In New Zealand, Downer Infrastructure delivered a much improved performance in the second half of the year. However, New Zealand continues to experience difficult economic conditions compounded by ongoing seismic activity around Christchurch. The New Zealand business continues to adjust its resources appropriate to market conditions. The closure of the UK business is now well in hand.

Total revenue was $0.9 billion, up 4.6% on last year. EBIT was $29.6 million, more than double last year's EBIT of $11.0 million, and EBIT margin improved to 3.2%. ROFE rose from 4.2% to 12.1%. Downer New Zealand has work-in-hand of $2.8 billion.

Downer is a member of the Stronger Christchurch Infrastructure Rebuild Team (SCIRT) that is rebuilding 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.

During the year Downer also 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 has a strong presence in the New Zealand market and is a key supplier to councils across the country. During the year, Downer secured the following contracts:

- A four year contract with Auckland Transport for Road maintenance services to the south western area of Auckland. The contract, valued at NZ$130 million, can be extended by two years plus a further two years giving the contract a potential value of NZ$260 million;

- An open space management contract with Auckland Council worth NZ$70 million over five years, plus a three year and further two year option;

- A facilities management contract with Auckland Council worth NZ$24 million over three years, plus a four year option; and

- Two five year contracts with the Christchurch City Council for road maintenance services for the south and east areas of Christchurch with a combined value of $70m; and

- A NZ$40 million construction contract to build the Wiri Maintenance and Stabling Depot for Auckland's new electric trains.

**Downer Group Outlook**

There is, at the current time, an increasing level of uncertainty around the level and timing of Government and private sector investment in infrastructure in both Australia and New Zealand.

That said, Downer is well positioned in terms of the percentage of work already secured that will impact on the year ahead.

Accordingly, Downer expects to deliver EBIT of around $370 million and NPAT of around $210 million for the 2013 financial year.