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Operator: Thank you for standing by, and welcome to the Downer Group market update. 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 one on your telephone keypad.

I would now like to hand the conference over to your speaker today, Mr Grant Fenn, CEO. Please go ahead.

Grant Fenn: Well good morning ladies and gentlemen, and thank you for joining us for the FY18 guidance update for Downer EDI Limited. My name is Grant Fenn, and I am the CEO of the Downer Group.

At our results announcement in August, following the takeover of Spotless Group Holdings Limited, we highlighted that then we'd undertake a review of the Spotless business planning setting and target setting process. That review is now complete and we've provided FY18 guidance for the Group this morning.

In this presentation we'll take you through the details of that Group guidance, give you an update on the Spotless and Downer trading for the first four months of the year, and update you on the integration of Spotless into the Downer Group. We'll take questions at the end of the presentation.

So, we have in large parts been pleased with what we've found in Spotless. Underlying earnings for the four months to date have been consistent and predictable, and are broadly in line with our business case. Proximities are expected to exceed our original estimates, and are being identified and delivered as we speak, with about $25 million identified to date in annualised procurement savings alone.

Revenue opportunities are also significant and continue to increase the closer we look. There will be substantial value for Spotless in adopting key Downer management processes, systems, and capability.

On the downside, one long term contract in its relatively early stages has been identified as underperforming by Spotless, and I'll talk more about this later.

So, let's begin with the guidance. As set out in the AFX release this morning, the Downer Group is targeting consolidated underlying net profit after tax, and before amortisation of acquired intangible assets, or NPATA, of $295 million before minority interests. This includes NPATA of $202 million for Downer and $93 million for Spotless. A reconciliation of

NPATA to NPAT is provided on page 7 of the presentation, and Michael Ferguson, our CFO, will cover this in detail later.

As we've discussed over the past months, the appropriate metric to gauge the Group's performance going forward is NPATA.

In this update we've taken the opportunity to upgrade the Downer standalone guidance for 2018 by $5 million to NPATA of $202 million, or NPAT of $195 million. This reflects strong trading to date across all divisions other than mining, and will be achieved despite no contribution from freight rail in the second half of the year following the sale of that business to Progress Rail, which we announced last week.

The Spotless NPATA guidance for 2018 of $93 million, or NPAT of $85 million, is at the bottom end of the range provided by Spotless during the takeover offer. Trading has been strong in the first four months. However, downward adjustments to earnings forecasts of around $10 million have been made to reflect Downer's accounting policies, particularly in relation to non-cash-based earnings.

As part of the review, Downer has also analysed the Spotless balance sheet for the purpose of its purchase price accounting. Our approach has been to assess the balance sheet items for fair value and consistency with Downer's accounting policies. A number of negative adjustments, totalling $79.7 million, have been reflected in the Group accounts and also in the Spotless accounts.

We've taken the opportunity to reduce the level of goodwill in the Laundries business by $40 million. You should not see this as a reflection of our intent in respect of this part of spotless, but simply a prudent action as we review the business and look to improve its performance.

As I mentioned previously, one long-term contract for facility management services at the new Royal Adelaide Hospital has been identified as an underperforming contract since commencing operations earlier this year. The contract is in the first year of a 30-year term. Spotless has resourced the project with a team of senior commercial and operational management to address the issues that have affected the commencement of operations progress, contractual claims and a completed forecasting exercise. This work is expected to take several months. All associated work in progress has been written off and is incorporated in the balance sheet adjustments referred to earlier. It is expected that there will be no earnings from this project recognised in the 2018 financial year.

Whilst we believe Spotless will have the opportunity to claim the majority of the work in progress, it is Downer's view that a more conservative approach is required pending improved project performance, future claim negotiations or litigation. We'll keep the market informed as the project progresses.

The integration of Spotless as the sixth division of the Downer Group is progressing as high speed. Our teams are working closely together across a range of important areas. Customers and markets, bid management, major contract reviews, zero harm, procurement, treasury, insurance, tax, accounting, IT, and of course operations. The joint bidding group, which was formed immediately after the offer closed, is performing very well and we've been shortlisted for several potential projects.

As I mentioned earlier, cost synergies are expected to exceed or original estimates of $20 million to $40 million, and revenue opportunities are significant.

We have made a number of enhancements to the Spotless risk management capability by extending the scope of our project management office, internal audit and legal commercial teams across the Spotless business. Spotless has also implemented our major bid approval processes, including TCC and [Trek].

It's very clear to me that Downer's management processes, systems and capability will be of significant value to the Spotless business into the future.

The acquisition of Spotless continues Downer's transformation to a more stable services-focused business. This journey has included the acquisition of Tenix in late 2014, a number of more recent, smaller bolt-on acquisitions, and the sale of the freight trail business, which we announced last week.

You can see from slide 6 that the mix of business within the Downer Group has changed significantly over the past three years. The revenue contribution from mining and freight rail has reduced from 31% to 14%, and services now make up 86% of the Group. As I mentioned earlier, we’ve upgraded Downer's standalone guidance for 2018.

The balance sheet remains strong, and Downer are targeted a dividend payout ratio of around 50% to 60% of consolidated underlying NPATA. I’ll now hand over to Michael Ferguson will provide more detail on this morning's announcement, including as update on capital management.

Michael Ferguson: Thanks Grant. Good morning everyone. I'll pick up from the consolidated income statement on page 7, and provide some additional detail on the key financial metrics and items included in the Group's FY18 earnings outlook.

You will see from the slide that Downer will now provide guidance and report actual earnings at net profit after tax, and before amortisation of acquired and tangible assets, NPATA, in addition to net profit after tax. The inclusion of NPATA allows us to separately disclose the impact on the Group's results of the amortisation charge arising from the identifiable intangible assets that have been recognised as part of the fair-value purchase price accounting exercise required by the accounting standards.

These assets are recognised when Downer consolidates the Spotless financial statements, and I will summarise these amounts shortly.

As Grant outlined, the Group is targeting combined underlying NPATA of $295 million. In addition to the Downer and Spotless standalone contributions, we are estimating combined synergies of $5 million in FY18. These will be realised through reduced senior executive salaries, initial procurement savings, and other head office savings.

Offsetting this is the impact of the incremental interest and finance costs, also $5 million. These costs relate to the debt drawn to purchase Spotless shares and the commitment fees and other costs associated with the bridging facilities necessary to effect the Spotless acquisition.

Total amortisation of acquired intangibles is $44 million. This includes $7 million relating to other recent acquisitions completed by Downer, including Tenix, and $8 million already recognised in the Spotless financials prior to the acquisition. The purchase price accounting exercise Downer has undertaken as part of the review will see the recognition of identifiable intangible assets relating to Spotless of approximately $430 million. These assets recognise the value of the Spotless brand name, its customer contracts, including the long tail PPP contracts and its relationships.

These assets have very useful lives and result in an additional amortisation charge to be recognised in FY18, of $29 million post-tax. Adjusting for the additional amortisation, consolidated underlying NPAT is expected to be $251 million.

Our guidance also highlights three significant non-recurring items that will impact both the Downer Group and Spotless results, the first being the impact of integration costs. These costs estimated at $5 million relate to the significant integration effort currently being undertaken, including the costs of the transition management office, the purchase price, accounting and valuation exercise, as well as integrating procurement activities and Downer's risk management and reporting systems.

The second item highlights the individually significant items identified as Spotless - as part of the Spotless review and purchase price accounting exercise. These are set out on page 8, and include senior management redundancy costs incurred after 30 June, 2017 as part of the integration, and costs incurred as a result of the acquisition, specifically to extend the debt facilities as a result of the change of control causes in Spotless and additional audit and other advisor costs. These totalled $2.8 million.

Final costs in relation to Spotless's strategy reset is $7.3 million. These include costs incurred to exit unprofitable and predominantly single-source contracts, associated redundancies, legal and other costs.

Other balance sheet adjustments, including the write-down of mobilisation, bid costs and WIP, and other balance sheet items, netting to $29.6 million, and goodwill impairment of $40 million for the Spotless Laundries business.

When we reviewed the carrying value of the Laundries cash generating unit, we identified four contracts rolling over in FY18. Whilst the outcome of these renewals is not known, we have assumed for the purposes of our analysis that one will not be renewed. This has resulted in an impairment in the goodwill of $40 million. These items will be recognised as individually significant items in the standalone Spotless income statement. However, as the majority of these items will not - sorry, the majority of these items will not appear in Downer' consolidated income statement, as they will be recognised as part of the balance sheet fair value accounting exercise, which requires Downer to recognise assets and liabilities at their fair values at acquisition date, with the adjusting entry recognised as goodwill.

The acquisition accounting column on slide 8 separates those adjustments included in the goodwill from those that occurred after the acquisition date.

The final non-recurring item that will impact the Group's FY18 statutory result relates to the loss the divestment of Downer's freight rail business announced last Tuesday. As a result of the transaction, Downer will - had a non-cash write-down of $40 million relating to freight rail, goodwill and legacy assets.

Finally, some comments on capital management. Consistent with the strong operating performance, the Downer balance sheet remains strong with a diversified debt portfolio and average debt duration of 3.3 years. In addition, the Spotless lenders have agreed to extend the maturity dates of around $600 million of debt facilities, and $180 million of performance bonding facilities, extending the Spotless weighted average debt facility duration to 1.76 years.

There is a high degree of correlation between the Spotless and Downer banking groups, and a detailed review and refinance of the Spotless debt and bonding facilities is planned for Calendar 2018.

Downer is also targeted a dividend payout ratio of between 50% and 60% of consolidated underlying NPATA.

Thank you, and I'll now hand back to Grant.

Grant Fenn: Yes thanks, Michael. Look, that ends the formal presentation. I'd like now to hand back to the call convenor and we'll take questions.

Operator: Thank you. If you wish to ask a question please press star, then one on your telephone and wait for your name to be announced. If you wish to cancel your request please press star, then two. If you are on a speakerphone please pick up the handset to ask your question.

Your first question comes from Craig Wong-Pan from Deutsche Bank. Please go ahead.

Craig Wong-Pan: (Deutsche Bank, Analyst) Good morning. Thanks for taking my question. Just on Spotless, you mentioned that that seems to be performing well, but could you provide any financial metrics, either kind of like revenue growth or margins for that business that you've seen in the first four months?

Grant Fenn: Oh Craig, we're not sort of talking about margins at this point. What I can say to you though is that each month that they've been coming in on the monthly results, it's been exceeding what their budget was. This is outside of those adjustments that we've then made which we talk about in the presentation here. But we think it's pretty good and quite frankly right now it's our most predictable part of our business.

Craig Wong-Pan: (Deutsche Bank, Analyst) Okay. Then secondly on the cost synergies. It's good to hear that that's going to be a higher number than what you initially expected. Could you provide any timeframe for how long you expect to derive the synergies?

Grant Fenn: Yes, that's a good point. It's not - some of these won't be immediately available. I'll point to just one of them. Right now we have a very, very good position with costs relating to light vehicles and Spotless have a lot of light vehicles and if we apply our rates to Spotless then it's quite a considerable benefit. But Spotless vehicles are in leases at the moment and they'll roll off over the next two to three years. So it's going to take some time but there's a number of quick wins which we're applying our rate cards to right now but some other things which are quite material will take a little bit more time.

Craig Wong-Pan: (Deutsche Bank, Analyst) Okay and then just moving to the Downer business. It sounds like most of the businesses have been outperforming or expectations other than mining.

Grant Fenn: Yep.

Craig Wong-Pan: (Deutsche Bank, Analyst) Could you talk to the mining business? Why that's I guess not performing as strongly as some of the other parts.

Grant Fenn: Yes. Look we've highlighted this the last couple of reporting cycles. The mining business is very competitive at the moment. It's quite a tough market. We've talked about green shoots and they certainly are in terms of volumes, et cetera, but we've also talked about sort of the change in the style of contracting which has gone from long term contracts, five years, to almost a position where contractors are now used as surge volumes.

Look, we've got a whole host of things on the table as far as opportunities but right now it's, you know, we did highlight that we wouldn't be in 2018 making as much money as we did in 2017 and that's bearing out. Alright, so it's I guess where we had thought it would be but it's certainly not as good as what we would like.

Craig Wong-Pan: (Deutsche Bank, Analyst) Okay, great. Thank you.

Operator: Thank you. Your next question comes from John Purtell from Macquarie. Please go ahead.

John Purtell: (Macquarie, Analyst) Oh good morning guys. I just had a few questions. Just starting Grant, obviously you've flagged revenue opportunities here being significant. Can you just give us a flavour for sort of some of the main areas where you see that opportunity and again some sort of broad timeframe for realisation of those.

Grant Fenn: Yes John. Look, there's a whole body of work that's going into this at the moment and what I would say to you is that the people that are working on that are just enormously buoyed by the opportunity. Now of course you've got to be good enough to actually win it and it's not, you know, it is a competitive market. But right across the facility management sphere, also resources which Spotless had dropped away from quite significantly, we think that with our involvement now there is significant opportunity in that space.

We think the opportunities in New Zealand are large. The tie up potentially with Hawkins and AE Smith in the building side of things is quite significant. We've got our own operations which we're now looking at how we introduce Spotless into those, including HCMT, Waratah, Millennium, Yarra Trams, et cetera. So from what we can see there is an enormous opportunity. We think that the systems that Downer have, particularly in relation to commercial, TCC and Trek will be enormously beneficial to the tie up and it's for us to make it happen but from what we can see strategically it looks very, very positive.

John Purtell: (Macquarie, Analyst) Thank you and just a second question. Obviously you flagged Royal Adelaide Hospital there.

Grant Fenn: Yes.

John Purtell: (Macquarie, Analyst) Can you just talk to in terms of I suppose what you know so far around the risk profile of the contract? Obviously it's facility services as opposed to construction but I'm just trying to get a sense of what the downside case is here.

Grant Fenn: Yes, sure. Well this is a, you know, Royal Adelaide Hospital, for anyone that's looked at this, this hospital, it's a fantastic facility now but has been plagued with a whole host of problems as it's been built. So the start-up of this hospital has been delayed quite considerably and so Spotless has come in to operate the hospital. Spotless does the majority of the work there outside of clinical. So they don't do doctors, they don't do the nurses, but certainly orderlies and et cetera, security, facilities management, et cetera. That's what Spotless does.

When Spotless has taken over and patients did come in there's been a number of problems with the building and the systems et cetera, so what that's meant is that Spotless has had to put a lot of extra people in to deal with those issues. It's now in a position of looking to see how we now take those extra positions out. We've got a team of people from Spotless and also a team of Downer people in there at the moment working through all of the issues and you can see from what we've spoken about this morning we've written the WIP off but there are a series of claims, et cetera and we're working through with the state and with [Selsis], which is the project company there, around all of this.

But it will be a number of months mate before we can fully understand the position here. It's our intention obviously to get things to work here but we'll let the market know as we go a bit further through here. It's a 30 year contract, so we've got plenty of time to get it right but at the same time we've got to get it right because it's important that we make sure that this works. Bendigo Hospital is very similar, albeit smaller, but the Bendigo Hospital was built in 2009, as was this one. That hospital is now operating well and we hope that this one will too.

John Purtell: (Macquarie, Analyst) Got you, but fundamentally Grant, the sort of risk profile nature of it, you're delivering a service as opposed to sort of being on the hook for construction costs and that sort of thing.

Grant Fenn: Yes, that's correct. In fact Spotless has been making good money out of fixing some of those building problems and it continues to make good money out of fixing those building problems. But at the moment we've got too many people in the services side that we've now got to address, dealing with a whole host of the building issues and other issues. So we're now working on that as we speak John.

John Purtell: (Macquarie, Analyst) Just a last question. Just in terms of the outperformance for the Downer base business. Can you sort of just comment on where in particular that's coming from?

Grant Fenn: Yes, transport has been very strong. Utilities is strong.

Michael Ferguson: BC&M.

Grant Fenn: BC&M is strong. EC&M is doing very well. We're making good money out of [Ichthys], still making money out of Gorgon and of course we've got maintenance contracts now with Gorgon and Wheatstone as well as finishing off Wheatstone and they're doing pretty well in the Queensland gas area, so we're happy with that. The rail projects are going pretty well on the passenger side. So all in all, other than for mining, we're pretty happy with the base Downer business.

John Purtell: (Macquarie, Analyst) Thank you.

Operator: Thank you. Your next question comes from Jolyon Wellington from JP Morgan. Please go ahead.

Jolyon Wellington: (JP Morgan, Analyst) Oh good morning. I've got a few questions please. Just starting with cashflow. So you've given guidance for NPATA. Would you be able to give guidance on what level of cashflow conversion you would expect this year relative to last year and also what your year-end net debt number you would expect to be please?

Grant Fenn: Yes, we don't normally give guidance on cash or net debt mate. So we've got a history of coming in with a pretty good cash conversion rate at the Downer business so I'd just work off that at this point. We're still in the throes of working through Spotless's cash position. Michael is going to kick me under the table here but we're just working through exactly where we're at with cash at June versus where we'll be in December, so we're still working through that now.

Jolyon Wellington: (JP Morgan, Analyst) Okay, but there's no sort of particularly large - oh sorry, go ahead.

Michael Ferguson: No, I guess just more broadly on gearing. We flagged about 25% gearing as part of the sort of Spotless bid process and the numbers we're expecting to land somewhere around there. For December there's a slight working capital drag that we're experiencing from [ENRA] and the associate of WIP build up that we'll work through but yes, we'll go through that process and turn our attention to that as we approach December.

Jolyon Wellington: (JP Morgan, Analyst) Okay, that's good. Then just on Spotless. They've got quite a big year of rebids from memory. The number I've got in my head is about 7.5% of sales. Please correct me if that's not right. Can you give any update on where you are with those significant rebids? Have they managed to be secured or are they still out there?

Grant Fenn: Working hard on it. Alright, so we're just, you know, this is a business that bids and wins and loses contracts as you roll through, as is the Downer business, so it's nothing unusual to that. We've got no reason to believe that we won't be successful in the vast majority of those. This business has a renewal rate of around about high seventies on renewal of contracts.

Jolyon Wellington: (JP Morgan, Analyst) Okay and then just on the Royal Adelaide Hospital. You've sort of talked about what's going - they're going on these- said it was a sort of cost over run to deliver the service. Is this - would you expect this to be a unique problem within the Spotless portfolio? I'm just wondering if there's any risk that some of the other longer term contracts could also fall into this trap or do you think that this is just very specific to that contract?

Grant Fenn: Yes, so the work in progress is more to do with the building being delayed and Spotless being required basically to mobilise and then they had to demobilise and there was a series of costs that were associated with that, for which they only get partly compensated. Alright, so that's been a large part of the WIP build-up, but right now yes, the costs are exceeding the revenue whilst we've had to put more people in than we would like. So now the operation is, or now the fix, is to get those systems working and that extra labour out.

No, look, I think we've been through the rest of the projects and they all look as if they're working. This I would point to as start-up issues, right and we will understand further as we go along over these next few months as to how quickly we can address those.

Jolyon Wellington: (JP Morgan, Analyst) Okay, are you able to negotiate the contract to the extent where you have cost overruns or is it fixed price?

Michael Ferguson: Oh look, it's a hard contract. There is a full team of people working on a whole host of avenues here around addressing the issues here. So I'll just leave it at that.

Jolyon Wellington: (JP Morgan, Analyst) Okay, great. I'll let someone else have a go. Thank you very much.

Operator: Thank you. Once again if you wish to ask a question please press star then one on your telephone and wait for your name to be announced. Your next question comes from Rohan Sundram from Citigroup. Please go ahead.

Rohan Sundram: (Citigroup, Analyst) Morning Grant and Michael. Just a few questions. Firstly with the Spotless guidance, can I just confirm that that is a pro forma 12-month number? When you report in February will you also be reporting pro forma numbers on Spotless or should we think about the - what's the partial contribution given the timing of the consolidation?

Grant Fenn: No, so we'll - the numbers for Spotless are our full year 2018 forecast numbers. We got to the change in control position at 27 June, 2017 so we'll see the full consolidation of the results for the full year. The minority interest amount as we get - I think we were at 67% at 30 June, 2017 and then we creeped up to 88% when we closed the offer on 29 August, 2017. So we'll report the underlying numbers as they're presented there. Then there will be a minority interest elimination of - starting at whatever - 23% for the first two months, closing at 12% for the remainder of the year.

So when you look at the slide on page 6, adjusting from the statutory amount will be an amount affecting the minority interest elimination which, you can see from those numbers, we don't expect that to be material.

Rohan Sundram: (Citigroup, Analyst) No that clarifies that. Thank you. Just on Royal Adelaide Hospital, just to confirm when you say no earning recognised, I'm assuming it's loss-making this year. So is that all going to be reported below the line, just to confirm that?

Grant Fenn: I think as we go through and do our work - what we've done now is take out all of the accrued that we had built up or that we had identified as part of our review. Part of the work that we are undertaking now is to look at the remaining period of the contract to the extent that we expect it to be a break-even contract during 2018 and beyond. We will start revenue recognition again at that point similar to the rest of the long term contracts in the Downer business. But it's just too early to call what that number will be. So our approach at this stage is to show no earnings.

Michael Ferguson: Yes, I should say it's not unusual for these long term contracts as we saw with Waratah and the TLS 3:08.1] to build WIP at the beginning of these contracts. In this case we think it was excessive. We have too many people in the operation so we've got some work to do on that. But it's not unusual for WIP build-up which is then worked off over the 30 years.

Rohan Sundram: (Citigroup, Analyst) Thank. My last question is on the freight rail business. Are you able to confirm whether that was generating earnings or whether it was profitable? Or if you're not comfortable to say that, is it lower margin than I guess the average rail margin?

Michael Ferguson: No, it was generating earnings.

Rohan Sundram: (Citigroup, Analyst) Okay, great. Thanks guys. Appreciate it.

Michael Ferguson: Thanks.

Operator: Thank you. There are no further questions at this time. That does conclude our conference for today. Thank you for participating. You may now disconnect.

Grant Fenn: Thank you.

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