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Downer Group Finance Pty Ltd

22 September 2020

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Issuer Outline

The Issuer is a wholly-owned subsidiary of Downer EDI Limited (Downer, Company). Downer is an ASX-listed engineering and services firm providing engineering solutions across a number of sectors to clients throughout the Asia-Pacific region, with a market capitalisation of AUD2.9bn as at 21 September 2020. Downer is an ASX 100 company that also owns Spotless Group Holdings Limited (SPO).

Downer is relatively well diversified by sector, across the mining sector as well as a range of other segments that places it well to participate in the country's likely significant infrastructure investment over coming years. With a focus on larger infrastructure type projects, Downer concentrates on three core divisions: mining, infrastructure and rail.

Downer employs approximately 56,000 people across more than 300 sites, primarily in Australia and New Zealand but also in the Asia-Pacific region, South America and Southern Africa.

Security
AUD500m 3.70% Apr 2026

ISIN
AU3CB0262673

Currency
AUD

Type
Senior unsecured

Key Financials (AUDm)

LTM (30 Jun)	2020
Revenue	12,743
EBITDA	539
Net Interest Expense	112
Total Assets	8,673
Cash	589
Debt	2,836
Adj. Net Debt/EBITDAR	3.9x
Interest cover	5.9x

Source: Company reports, S&P Capital IQ

Key Terms

Coupon Type	Fixed	Amount Issued/Outstanding	AUD500m/AUD500m
Rate	3.70%	Minimum Amount	AUD10,000
Frequency	Semi-annual	Denomination	AUD10,000
Domicile	Australia	AU Withholding Tax Exempt	Yes

Key Dates

Issue Date	29 April 2019	Maturity Date	29 April 2026
Call Dates	From 28 February 2026 @ 100.00		

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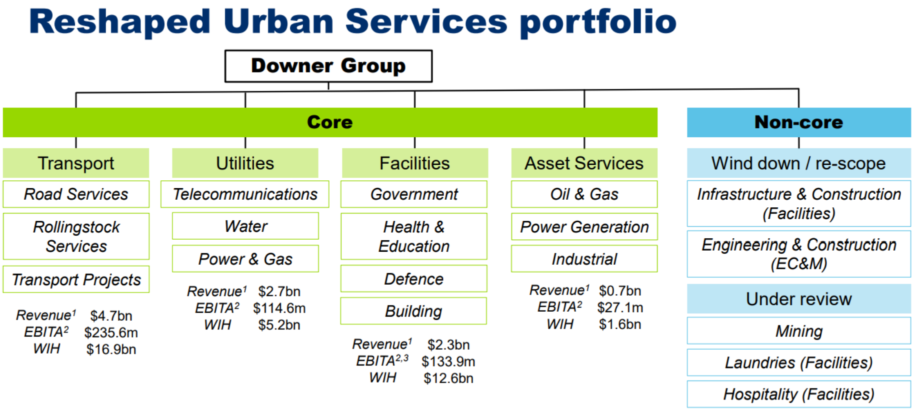
Strengths

- The combined Downer group is the largest diversified-services group in Australia and New Zealand, which can offer end-to-end service capabilities from design & construction to ongoing operations & maintenance. While Downer's focus on this end-to-end service delivery was historically in the transport sector (but with continued success, including the operations of Yarra Trams in Melbourne and G Link trams on the Gold Coast), the acquisition of Spotless in 2017 has provided greater opportunities, in particular for social infrastructure PPP's.



- Downer's financial profile has improved after the Spotless acquisition in the financial year ended 30 June 2018. Further, Downer's Spotless acquisition has continued its portfolio transformation away from the cyclical mining and engineering, construction and maintenance sectors towards the infrastructure and civil sectors. The recent AUD400m equity raising in early FY21 has enabled Downer to lift their ownership of Spotless to 100% (which will unlock synergies not previously available when its ownership was marginally below 90%). Proceeds were also used to repay more than AUD250m of debt.
- As at 30 June 2020, the Group had total liquidity of approximately AUD1.86bn, consisting of AUD1.127bn of undrawn facilities and AUD589m of cash available. Pro forma post equity raising, this increased to more than AUD2bn, with net debt to underlying EBITDA at about 1.4x and gearing below 30%.
- On 20 April 2020, Downer announced it had extended the maturity dates of AUD130m of bilateral debt facilities that were due over the next 12 months to the 2022 and 2023 financial years. Following this, Downer has no debt maturing in FY20 or 1H21 with the next maturity of AUD200m in 2H21 (which represents only 6% of Downer's total debt portfolio).
- Government-related revenue has increased as a proportion of Downer's total revenue base, as the Australian economy shifts away from the resources sector and the government prioritises infrastructure spending. It is expected that substantial government outsourcing will drive growth in social infrastructure opportunities across most Australian States in health, education and other government services. Fitch continues to expect government infrastructure spending to be the primary source of major new opportunities for Downer group over the medium term.
- Given Downer's operations are heavily weighted to government and critical infrastructure, demand for the Company's services are expected to remain strong despite the current COVID-19 pandemic. Downer maintains a solid financial foundation and strong pipeline of ongoing work. Further, Downer is undertaking a number of cost reduction initiatives given the current environment.

Risks

- In FY20, Downer reported a significant fall in earnings in its Facilities segment, FY20 EBITA in this segment decreased by 39% yoy (~AUD66m), to AUD104m due to the significant impact of COVID-19 on its Hospitality business. Further, COVID-19 also reduced volumes in Downer's Laundries business as elective surgery activities were restricted. Headwinds in this segment were partially offset by increased activity in Government contracts, including additional cleaning activities.

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- Downer has earmarked a number of segments as non-core and is actively seeking to divest those. This includes in particular the Laundries business (which was part of the Spotless acquisition) which Downer has been trying to sell for many years. The prospects of a rapid transaction are relatively low, especially since the Australian Competition & Consumer Commission recently indicated competition concerns. The sale of Downer Mining has also been protracted, and was put on hold as a consequence of COVID-19 for what some indicate are material valuation differences between Downer and potential bidders. Long delays in the divestment of these segments will continue to be a distraction to management, at a time when part of the business have been impacted by COVID-19.
- Fitch commented that additional large, debt-funded M&A may pressure Downer's rating at a time when it has little headroom within its negative rating guidelines. However, the rating agency does not expect significant M&A in the short term, as Downer remains focused on integrating Spotless and taking advantage of any opportunities the acquisition provides.
- Being involved in general large and complex contracts (especially PPP contracts), Downer and its subsidiaries are evolved to elevated contractual & legal risks. Under traditional PPP contracts, equity and debt financiers seek to transfer significant risks to the contractors and operators. This risk transfer has led to significant losses in the past, including on the NSW Waratah train contract in New South Wales or the Royal Adelaide Hospital Contract in South Australia.

Other risks

- Call risk: A decision to call the bonds ahead of the maturity date depends on a number of factors, including the relative cost of entering new debt financing, the company's liquidity position, and the availability and attractiveness of new funding opportunities at the call date.
- Duration risk: n/a
- Interest deferral/cancellation: n/a
- Non-viability trigger: n/a

Summary

The Downer 3.70% senior unsecured notes maturing 29 April 2026 suits investors seeking a stable, moderate return from an investment grade Australian corporate.

References

- Downer Investors Relations website

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