Downer EDI Limited
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13 May 2024

The Manager, Listing
Australian Securities Exchange
ASX Market Announcements
Level 14, Exchange Centre
20 Bridge Street
Sydney NSW 2000

Dear Sir/Madam

Fitch Revises Outlook on Downer to Stable; Affirms at 'BBB'

Fitch Ratings have revised its outlook on Downer EDI Limited (ASX: DOW) to Stable from Negative and affirms their issuer rating at 'BBB'.

We attach a copy of the Fitch Ratings Report.

Yours sincerely
Downer EDI Limited

Robert Regan
Company Secretary

Authorised for release by Downer's Chief Executive Officer.

FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Outlook on Downer to Stable; Affirms at 'BBB'

Fri 10 May, 2024 - 3:18 AM ET

Fitch Ratings - Sydney - 10 May 2024: Fitch Ratings has revised the Outlook on Australia-based Downer EDI Limited's Long-Term Issuer Default Rating (IDR) to Stable from Negative. At the same time, Fitch has affirmed Downer's IDR and senior unsecured rating at 'BBB'. The affirmation also applies to all senior unsecured debt issued or guaranteed by Downer, including debt issued by its subsidiary, Downer Group Finance Pty Limited.

The revision of the Outlook reflects Fitch's view that Downer's ability to deliver AUD175 million in identified cost savings over the next two years will enable it to return its EBITDA margin to above 5% by the financial year ending June 2025 (FY25).

The revision also reflects our belief that contagion risks relating to Downer's governance have eased. This follows the release of the final report from an inquiry by the New South Wales' Independent Commission Against Corruption (ICAC), which covered several former Downer employees, and actions taken by the company to address control weaknesses identified following announced accounting irregularities in 2022 and the inquiry.

KEY RATING DRIVERS

Cost Savings Boost Margin Recovery: Fitch believes that the AUD175 million in cost savings identified by Downer's management as part of its strategic reset will enable the company to return its EBITDA margin to above 5% by FY25. The company has already made good progress in delivering around AUD100 million in annualised EBITDA benefits by FY25, with a further AUD75 million announced at 1HFY24, which it expects to deliver in annualised benefits in FY26.

Downer's Fitch-adjusted EBITDA margin stabilised at just under 4% in 1HFY24, with underperforming contracts in its utilities business, difficult weather conditions, staff shortages and supply-chain issues weighing on profitability since FY22. We expect

Downer's margin will improve in 2HFY24 as the underperforming contracts begin to complete, initial cost-reduction measures take effect, volumes recover and labour costs continue to stabilise.

Governance Contagion Risk Eases: Fitch believes that the contagion risks associated with Downer's governance issues have eased, following the release of the ICAC's final report and recommendations concluding its inquiry. ICAC made corrupt conduct findings against several former Downer employees, citing broad project oversight weaknesses and collusion that Downer's systems did not prevent. However, ICAC did not recommend further action by government agencies that may negatively affect the company. No findings were made against Downer as it falls outside ICAC's jurisdiction.

Downer continues to demonstrate its ability to win major contracts with Australian regional governments, with over AUD5.5 billion in new contracts announced over the past year. This follows the company's success in strengthening its governance over the past year, including changes to senior management and board personnel, improvements to the company's risk management framework with the creation of a chief risk officer role, and the completion of an external review of policies. As a result, Fitch has revised ESG Relevance Score for Governance Structure to '3' from '4'.

Weak Free Cash Flow Generation: Fitch views Downer's free cash flow (FCF) generation as weak compared with that of similarly rated peers. The company has reported negative FCF after capex and dividends for three of the last four years, and we expect free cash flow generation to be neutral until FY27. The improvement in profitability, together with the company's approach to balancing shareholder returns, should lead to an improvement in Downer's FCF margin.

Resilient Core Business: We expect Downer to continue to benefit from government prioritisation of infrastructure development, which will remain a source of major opportunities in the medium term. Downer is the largest diversified-services group in Australia and New Zealand for transport, utility and facility-management services. Its strong revenue visibility is supported by work-in-hand of AUD37.5 billion at end-1HFY24, with around 90% from governments or government-related entities, and most on long-term contracts (FYE23: AUD38.1 billion, restated).

Commitment to Balance-Sheet Strength: Downer's EBITDA net leverage increased to 1.7x by FYE23 from 1.4x at FYE22, reflecting delays to cash inflows in 1HFY23. The company has since returned its cash conversion to above 85%, and Fitch expects leverage will fall below 1.5x from FY24. Downer continues to prioritise the strength of its balance sheet as it delivers its strategic reset, evident from its use of sales proceeds to reduce debt, the reduction of dividends declared in FY23 and its focus on delivering strong cash-backed earnings.

DERIVATION SUMMARY

Fitch rates Downer using our service navigator framework. Downer's strong domestic market position and long-term recurring revenue contracts support the rating. However, the company's international diversification remains limited, with revenue largely generated in Australia and New Zealand. This constrains the rating to the 'BBB' category.

Downer's leverage and interest coverage are comparable with that of Australian peer Lendlease Corporation Limited (BBB-/Stable). Lendlease benefits from greater geographical diversification, but Downer's lower exposure to cyclical cash flow and higher share of recurring maintenance-style projects result in a one notch rating differential.

KEY ASSUMPTIONS

Fitch's Key Assumptions within Our Rating Case for the Issuer:

- Revenue falling by around 5% in FY24 following the sale of the Australian Transport Projects business before rising by 2% a year from FY25 to FY27.

- EBITDA margin, adjusted for lease expenses, rising to 4.5% in FY24, with the improvement towards 5% accelerating in 2HFY24. EBITDA margin returning to between 5% and 6% from FY25 as the company delivers on cost cuts and exits underperforming contracts.

- Capex of around 2.5% of revenue a year.

- Dividend payout ratios of between 50% and 70% of consolidated underlying net profit after tax before acquired intangible amortisation.

- Potential returns to shareholders through capital management initiatives of up to AUD200 million spread over FY24 to FY27

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Fitch does not expect to take positive rating action over the medium term due to Downer's geographical concentration, scale, and low profit margins.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- EBITDA margin falling below 5% on a sustained basis (1HFY24: 3.7%; FY23: 3.4%).

- EBITDA net leverage rising to above 2.2x for a sustained period (FY23: 1.7x).

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Downer had AUD553 million in cash and AUD1,337 million in undrawn committed facilities at 1HFY24, with a weighted-average debt duration of 3.3 years (FYE23: 3.0 years). The next bond maturity is in FY26. Downer has also protected itself from current interest rate rises by its recent refinancing activity and hedging, while also benefitting from existing fixed-rate debt. It refinanced a AUD500 million tranche of its Syndicated Sustainability Linked Loan Facility in 1HFY24 to improve its debt maturity profile and reduce medium-term refinancing risk.

Downer has demonstrated access to a wide range of funding sources, including syndicated loans, and local and international capital-market debt and equity.

ISSUER PROFILE

Downer is a leading provider of services in Australia, with operations across transport, utility services and facilities management.

SUMMARY OF FINANCIAL ADJUSTMENTS

Under Fitch's hybrid methodology, we have applied 100% equity credit to Downer's redeemable optionally adjustable distributing securities (ROADs) preference shares. This reflects their subordination, as they are only senior to equity, and permanent status as part of Downer's capital structure.

In accordance with our methodology, we have included all coupons on the ROADs as interest in both the profit and loss and cash flow statements. This has resulted in Fitch's calculated net profit after tax being lower than Downer's reported figure by the amount of the ROADs coupon.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Fitch has revised the ESG Relevance Score for Governance Structure to '3' from '4' following the completion of ICAC's inquiry, the actions taken to date to improve Downer's governance and control structure, and the company's continued ability to win major contracts from Australian regional governments. In our view, this indicates that governances concerns and contagion risks have eased, and that governance issues are credit-neutral or have only a minimal credit impact on the entity, due to the way in which they are being managed by the entity.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Downer EDI Limited	LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Negative
senior unsecured	LT	BBB	Affirmed	BBB
Downer Group Finance Pty Limited				
senior unsecured	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 13 Nov 2020)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 04 Mar 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 14 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 04 Nov 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 04 Nov 2023)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Downer EDI Limited	EU Endorsed, UK Endorsed
Downer Group Finance Pty Limited	EU Endorsed, UK Endorsed

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