Downer

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Productivity Commission on EFIC

Submission by:

Downer EDI Limited (ABN 97 003 872 848)
Level 2, Triniti III Building
39 Delhi Road
North Ryde
NSW 2113

Introduction to the Downer Group

The Downer Group is a listed ASX company that provides comprehensive engineering and infrastructure management services to the public and private Minerals & Metals, Oil & Gas, Power, Transport, Infrastructure, Communications, Water and Property sectors across Australia, New Zealand, the Asia Pacific region and the United Kingdom.

The Group has total assets of A$3.9 billion, annualised revenue of A$8 billion, an Investment Grade credit rating of BBB – (Stable) and a current market capitalisation of A$1.6 billion.

The contracting work undertaken by the Downer Group spans a broad range of activities from relatively small scale road maintenance and cable TV installations to significant electrical and instrumentation work on Liquid Natural Gas (LNG) plants, construction of transmission lines, large scale mining operations and passenger / freight train manufacture and maintenance. The majority of the Group's revenue is generated in Australia.

Use of Export Credit Finance by the Downer Group

The Downer Group has made active use of Export Credit Agency (ECA) supported finance over the past four years with four transactions completed to date for a total amount of approximately A$250 million. These transaction have involved both direct lending by ECA's and well as ECA's providing credit guarantees to private sector bank lenders.

The underlying equipment that supports these transactions relates to mining and locomotive equipment manufactured in Europe and North America, which have been imported into Australia. The manufacturers producing the equipment are large global companies and with the availability of ECA finance being one of the considerations the Downer Group took into account in selecting the equipment vendor.

The Downer Group is currently considering additional ECA related finance related to the importation of foreign manufactured capital equipment as well as "untied" transactions where ECA credit is made available supported primarily by resource "off-take" agreements from foreign buyers.

Furthermore, given the significant limitations in accessing sufficient private sector performance bonding capacity to support large scale projects, the Downer Group is currently holding discussions with an offshore ECA as well as with EFIC regarding the provision of performance bonding facilities where the underlying work being undertaken relates to export orientated projects.

Rationale for use of ECA finance

General observations

Commencing from early 2008 with the onset of the Global Financial Crisis (GFC), global credit markets have experienced volatility in terms of the availability of funding, general liquidity and pricing. This volatility eased somewhat in 2010 but has since resumed given European sovereign debt issues and is expected to continue for a reasonable period of time.

Furthermore the market may be experiencing a major structural rather than a purely cyclical change in the banking sector, with the capacity of banks to continue lending similar volumes of funds as in the past no longer applies, due to reduced bank risk appetite, capital constraints and a significantly stricter regulatory environment. In this context we expect a particularly material contraction in lending by European banks as they reduce their asset bases by up to EUR1 trillion reflecting reduced risk appetite and the need to comply with tighter capital ratios.

Evidence of this trend has impacted the Australian domestic market with some offshore banks either exiting or selling-off part of their existing loan asset portfolios or not participating in certain transactions.

Given this situation we believe that Export Credit Agencies have an important role to play in filling the "market gap" and thus ensuring there is sufficient debt finance and bonding capacity available to ensure Australia's manufacturing base, infrastructure and resource industries continue to expand and remain globally competitive.

In this context it is worth noting that a number of major resource projects such as LNG projects in Australia and oil projects in PNG (which utilise the skills / resources of numerous Australian companies) would not have been capable of being financed without the significant contributions of global ECA's.

Downer Group perspective

From the Downer Group perspective, ECA finance provides the following benefits:

- Diversification by accessing funding from the non-bank sector;
- Capacity to facilitate large scale equipment / project specific relatively large scale finance with the transactions closed by Downer ranging between amounts of approximately A$30 million to A$110 million;
- Providing long term tenors given that ECA finance is typically available for periods of five to nine years compared to the private sector bank market where tenors are generally limited to three to five years. The lengthening of tenors is an important issue for companies as they seek to reduce refinancing risk by avoiding having multiple loans maturing at similar times;
- Filling "market gaps" which have arisen given private sector funding constraints experienced by many banks (as outlined above);
- Providing direct funding or facilitating funding via their guarantees structures at pricing which is generally in line with the private sector market; and
- A competitive advantage when Downer is bidding on tenders in the knowledge it has access to the prerequisite funding.

Role of EFIC

Given the competitive challenges faced by manufacturers in developed countries, EFIC has an important role to play in providing financing support in respect of Australian manufactured exports.

This will also ensure EFIC's financing activities remain in line with the support given by developed country offshore ECA's to their local manufacturers by agencies such as Compagnie Francaise d'Assurance pour le Commerce Exterieur (COFACE), Export Development Canada (EDC), Euler Hermes Kreditversicherungs – AG (Hermes), Export – Import Bank of China, Export – Import Bank of Japan and Export – Import Bank of the United States.

Furthermore EFIC has a material role to play in facilitating the funding and performance bonding requirements for major export orientated infrastructure and resource projects in Australia.

From the Downer Group's perspective we consider EFIC as an important financier with regard to both debt capital and bonding (the former facilitated via EFIC providing a guarantee to a private sector bank lender and the latter on a direct basis), with EFIC meeting a material "market gap" given constraints in the private sector banking market.

Downer has developed a financing opportunity with EFIC related to the export of iron ore from Australia to Asia and we are currently considering a potential performance bonding facility to support contract work to be undertaken by the Downer Group in respect of LNG and coal export orientated projects. This facility will ensure that the Group has sufficient bonding capacity to meet the increasing demand for its services.

We believe that other companies in our sector also face financing and bonding constraints and therefore the involvement of ECA's in filling these "market gaps" will support these companies in winning major project work in a sector that collectively employs over 100,000 people.

In conclusion the Downer Group considers Export Credit Agencies, including EFIC, as important financing partners and we look forward to continuing to develop these relationships over time.

Yours Sincerely,

Kevin Fletcher
Chief Financial Officer
Downer EDI Limited